CONSOLIDATED BANK OF KENYA LIMITED

We're Better Together

ANNUAL REPORT

& FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31ST DECEMBER 2018

Consolidated Bank
Growing with you

ABOUT US

Consolidated Bank of Kenya Limited was incorporated on 7th December, 1989 .

This was in an effort to stabilise the financial sector through the acquisition of nine insolvent institutions and thereafter restructuring them into a viable, professionally run commercial bank.

The Bank enjoys an independent, dynamic, result oriented culture and a flexible and innovative approach.

We understand the markets in which our clients operate and offer a service built on personalised and specialised banking solutions.

We offer one of the widest range of banking products and services in the market today. We realize that a growing business demands a lot of time and energy.

We understand these challenges and continously develop flexible, innovative and convinient financial solutions to help our customers achieve personal and business success.

With years of banking experience and special focus on SMEs, we are in a strong position to help growing businesses unlock their potential and sail through the complexities they may face.

The bank is fully owned by the Government with the majority ordinary shareholding in the hands of the National Treasury at 85.8%. The remaining shareholding is spread over twenty-five (25) parastatals and other quasi government organizations.

OUR VISION

To be the Bank of choice offering pleasant and convenient services.

OUR MISSION

To provide flexible financial solutions that support our customers achieve success.

OUR CORE VALUES

We are guided by the following core values in our day to day activities:

Customer focus: - The customer is at the centre of our service delivery.

Integrity: - We undertake to operate with the highest degree of honesty and integrity.

Professionalism: - We adhere to high professional and personal standards in the conduct of ourbusiness.

Team work: - We work as a team and nurture a performance driven culture.

Innovation: - We continuously make product improvements to serve the evolving needs of our customers.

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Donation of a water tank and water point to Muchakai Primary School in Gatundu North Constituency by HEAD OFFICE STAFF led by the Chief Commercial Officer,-**Mr. Japheth Kisilu.**

Japheth Kisilu-Chief Commercial Officer leading customers and staff in cake cutting to mark inauguration of the Customer Service Week 2018

Donation of a water tank, 2 double decker beds, mattresses and food stuff to Place of Grace Children's Home in Donholm, Embakasi Constituency by UMOJA BRANCH STAFF led by the Branch Manager-**Isaack Mwabili**.

"I started my banking relationship with Consolidated Bank in the year 1995. I have enjoyed excellent customer service from the Staff. I have grown with the Bank through its loan products. Consolidated Bank has been a pillar of growth."

Margaret Waithera Mwaura
Director of Mwagu Anifeeds Ltd in Thika.

"We have banked with Consolidated Bank for the last 7 years. The Staff offer personalized and prompt service. The products we have enjoyed include Overdraft facilities and Asset Financing which have enabled us to grow our client base and expand to various towns in the country. I am happy to grow with Consolidated Bank."

Hamilton Mwandawiro Samboja
Director of Elegant Investments Ltd in Mombasa.

Tree planting at Malaene Primary School in Igembe Central Constituency by MAUA and LAARE BRANCH STAFF.

Head of Corporate- **Erastus Gachoya** visiting with a customer at their work premises during the Customer Service Week 2018

Mombasa branch team led by the Branch Manager- **Geoofrey Kisaka** in support of a local football team to mark the culmination on the Customer Service Week 2018

BOARD OF DIRECTORS

DIRECTORS:

Dr. Iyaya Wanjala	Chairman (Appointed on 6th June 2018)
Thomas Kiyai	Chief Executive Officer
Cabinet Secretary	National Treasury
Managing Trustee	NSSF
Hon. Yusuf Chanzu	(Appointed on 20th September 2018)
Dr. Kennedy Otiso	(Appointed on 20th September 2018)
Miriam Cherogony	(Appointed on 20th September 2018)
Dr. Nathan Psiwa	(Appointed on 20th September 2018)
Dr. Raymond Omollo	(Term ended on 2nd October 2018)
Joseph Koskey	(Term ended on 2nd October 2018)

DR. WANJALA IYAYA
CHAIRMAN OF THE BOARD OF DIRECTORS

Dr. Iyaya Wanjala was appointed as Chairman of the Consolidated Bank Board of Directors on 6th June, 2018. He has a Doctorate in Applied Mathematics from Kenyatta University where his Thesis was 'Investigation of Some Singular Cauchy Problems'. He also has a Master of Science degree in Applied Mathematics from the University of Nairobi. Dr. Wanjala Iyaya has done several scholarly publications in Kenya.

He is currently a Senior Lecturer at Multimedia University of Kenya. He has also served as a Lecturer at Kenyatta University and an Assistant Lecturer at Maseno University College. He has served in his own capacity as Chairman of Benevolent fund of Multimedia university of Kenya and as a Chairman Mathematics department. He has supervised several Masters and PHD students in various Universities.

THOMAS KIPKEMEI KIYAI
CHIEF EXECUTIVE OFFICER

Thomas Kipkemei Kiyai joined Consolidated Bank in April 2015. He has over 20 years of banking and finance experience having joined Consolidated Bank of Kenya from Kenya Commercial Bank, where he served as Director, Financial planning and Control.

He holds a Bachelors of Commerce Degree in Accounting and a Masters of Business Administration Degree in Corporate Finance from the University of Nairobi. In addition to this, he is also an alumni of the Oxford University Management & Leadership Development Programme. Thomas Kiyai is a member of the Institute of Certified Public Accountants of Kenya (ICPAK).

WAKONYO IGERIA
COMPANY SECRETARY

Wakonyo Igeria was appointed as the Head of Legal Services and Company Secretary in June 2004. She holds a Bachelor of Laws Degree and a Diploma in Law from the Kenya School of Law.

She is an Advocate of the High Court of Kenya of 28 years experience, a Commissioner for Oaths and Notary Public and a Certified Public Secretary (Kenya). Wakonyo Igeria is a member of the Law Society of Kenya and the Institute of Certified Public Secretaries of Kenya.

HENRY K. ROTICH
EGH - CABINET SECRETARY, THE NATIONAL TREASURY - INSTITUTIONAL DIRECTOR

Mr. Henry K. Rotich is currently the Cabinet Secretary for the National Treasury in Kenya. He assumed the position in May 2013 following the successful general election under the new Constitutional dispensation.

DR. ANTHONY OMERIKWA
Ag. MANAGING TRUSTEE, NSSF - INSTITUTIONAL DIRECTOR

Dr. Anthony Omerikwa is the Acting CEO/Managing Trustee of the National Social Security Fund. Prior to his current position, he served as the Acting General Manager Operations in the same institution overseeing Information Technology, Human Resource, Administration and Procurement functions.

He holds a Doctoral degree from the University of Georgia, a specialist advanced degree in labour, workforce development and education and a Master of Science degree in Human Resource Development both from Pittsburgh State University, a Bachelor of Arts degree in Economics from Kenyatta University and a Diploma in data processing and management from Strathmore College. Dr. Omerikwa is an associate member of the Institute of Human Resource Management and Institute of Directors.

DR. KENNEDY NTABO OTISO
PHD. - MEMBER OF THE BOARD

Dr. Kennedy Ntabo Otiso, PhD, was appointed to the board of Consolidated Bank on the 20th of September, 2018. He holds a Doctor of Philosophy in Business Management (Marketing Option), a Master of Business Management (Marketing Option) all from Moi University. He has a bachelor's degree in Business Administration (Marketing Option-Cum Laude) graduated from the University of Eastern Africa, Baraton.

He has over 10 years of experience serving in different capacities in various institutions of higher learning in Kenya. Notably he has served at Kibabii University as lecturer as well as a founding chairman of the Department of Business administration and Management. In addition he served as an assistant Lecturer at the University of Eastern Africa, Baraton. He has also served as Chief Principal at Elgonview College.

Dr. Otiso currently serves as a lecturer in the School of Business and Management Sciences in the University of Eldoret. He has published widely scholarly works; he has reviewed peer academic journals and actively attended several international conferences. He has supervised and examined many postgraduate students from various Universities in Kenya. He is the current Chairman, Board of Management, Ntana High School in Nyamira County. Dr. Otiso is a trained professional marketer as well as a member of the Marketing Society of Kenya and Kenya Institute of Management respectively.

MIRIAM CHEROGONY
MEMBER OF THE BOARD

Miriam Jerotich Cherogony was appointed to the board of Consolidated Bank on 20^{th} of September, 2018. She has over 20 years' experience in research, design& formulation, monitoring& evaluating, development plans and policies as well as a wide knowledge of office work and managing people. Ms. Cherogony has acquired a wide knowledge in strategy development, project and procurement management.

She has also worked in various capactities Internationally in the following countries namely: Canada, Ethiopia, Eritrea, Ghana, Kenya, Lesotho, Mozambique, Nigeria, Rwanda, Sierra Leone, Somaliland, South Africa, Swaziland, Tanzania, Uganda,andZambia.Ms.Cherogonyhas worked as the Africa Regional Manager -Global Development Incubator, Team Leader & Development Finance Specialist-Rural Finance Knowledge Management Partnership (KMP), Team Leader & Knowledge Management Specialist –IFAD Africa Grant, Programme Coordinator at African Rural and Agricultural Association (AFRACA), Nairobi Kenya. She has also served as a Senior Research Officer at K-Rep Development Agency Nairobi, Kenya , Senior Manager-Rural Financial Services Department and Manager-Rural Financial Services Department among other notable institutions.

She has a Master of Science and a Bachelor of Science degree in Agricultural Economics both from the University of Manitoba, Canada.

HON. YUSUF KIFUMA CHANZU CBS, OGW, HSC - MEMBER OF THE BOARD

Hon. Yusuf Kifuma Chanzu, CBS, OGW, HSC was appointed to the Board of Consolidated Bank on 20^{th} of September, 2018. He has over 30 years of public service. He has been a Member of Parliament, Vihiga Constituency from December 2007 to August 2017 where he was Involved in all legislative work of Parliament, performed the oversight role, and representation. He has served in various capacities in the government as Commissioner with Communications Commission of Kenya, Assistant Minister for Labour & Human Resource Development where he was Involved in the management and running of the Ministry, Assistant Minister for Energy where he was Involved in the management and running of the Ministry, Assistant Minister for Water Resources where he was Involved in the management and running of the Ministry. He has also been an Advisor Quipcons Associates, Consulting Quantity Surveyors & Project Managers. He was also a Chief Quantity Surveyor, Ministry of Public Works/ Local Government.

He has been honored by the Head of state with The First Class Order of the Chief of Burning Spear (CBS), The Order of Grand Warrior (OGW) and The Head of State Commendation (HSC) for his work in public service. He holds a Master of Science in Construction Management (Corporate Strategy) from Heriot -Watt University, Edinburgh. He also has an undergraduate Undergraduate Course, B.A Building Economics (Honours),University of Nairobi.

DR. NATHAN KITIO PSIWA
MEMBER OF THE BOARD

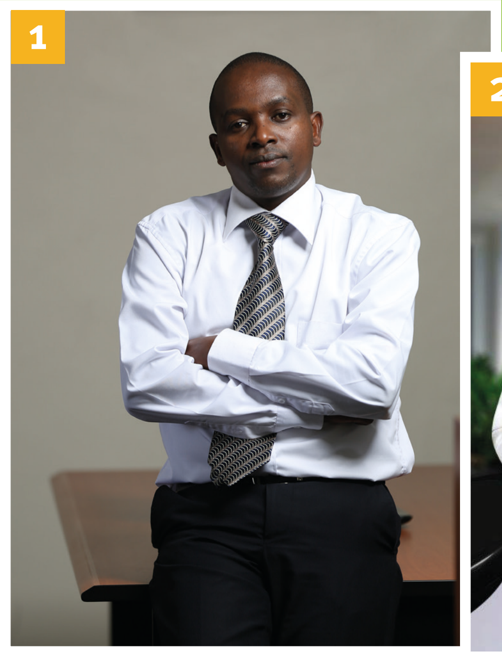
Dr. Nathan Kitio Psiwa was appointed to the Board of Consolidated Bank on 20^{th} of September, 2018. He has over 15 Years' experience in Orthodontics. He has served in three boards, two as a member and one as a Chairperson. He has been a Chairperson and a Member of Council at Rongo University and a Chairperson at Kenya Industrial Research and Development Institute (KIRDI). He is currently a lecturer at University of Nairobi, Department Of Paediatric Dentistry And Orthodontics.

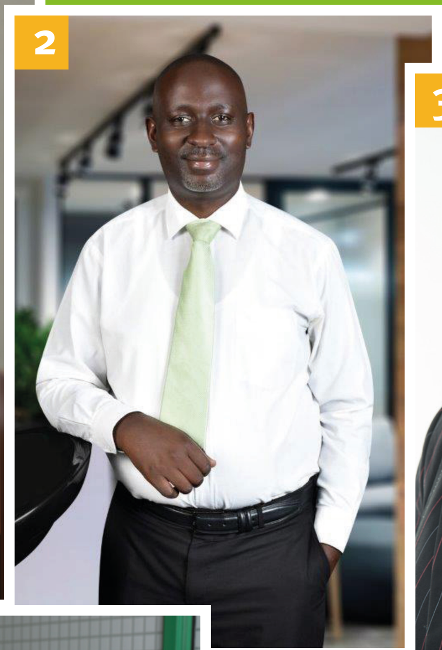
Dr. Nathan Psiwa holds a Certificate in Audit and Risk Management from Association of Internal Auditors Kenya (AIK) and a Certificate in Governance from Kenya School of Governance (KSG).

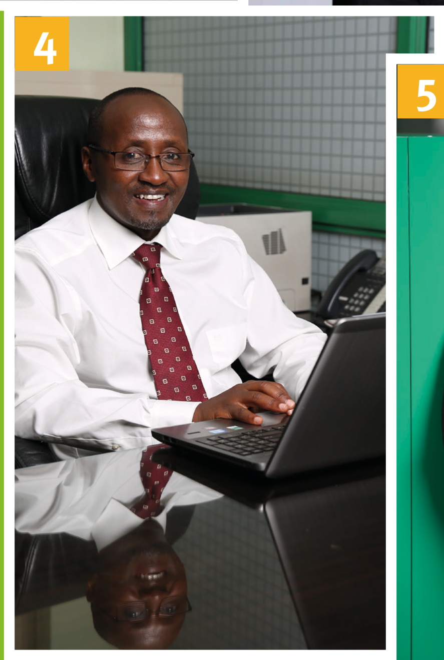
He holds a Master of Science in Dental Surgery (Ortho) from University of the Western Cape in South Africa and a Bachelor of Dental Surgery from the University of Nairobi.

He is currently a member of the following bodies: the Kenya Dental Association, the Kenya Medical Association, the Orthodontic Society of Kenya and Institute of Directors (IOD- K).He is an Associate member of South African Association of Orthodontists (SASO) and Tanzania Medical Association.

SENIOR MANAGEMENT







1. Harrison Muthoka
Manager Risk and Compliance

2. Martin Omido
Head of ICT

3. Jullie Odadi
Ag. Head of Credit

4. Japheth Kisilu
Chief Commercial Officer

5. Josephine Kioko
Head of Retail & SME

6. Edward Nthuli
Head of Operations
and Central Processing

7. Erastus Gachoya
Head of Corporate Banking

8. Joseph Njuguna
Head of Finance

9. Wakonyo Igeria
Company secretary & Head of Legal Services

10. George Rutto
Head of Internal Audit

11. Jacinta Lwanga
Head of Human Resources

12. Joshua Kagia
Head of Treasury

DR. IYAYA WANJALA
Chairman

I am pleased to present to you the Annual Report and Financial Statements for the year ended December 31, 2018. The year was particularly difficult for the bank due challenging operating environment and the capital constraints it continues to face.

Macroeconomic overview

The real Gross Domestic Product - GDP is estimated to have grown by 6.3% compared to 4.9% the previous year. The growth was attributable to increased agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities. The growth was anchored on a relatively stable macroeconomic environment in 2018. Inflation remained low at 4.7% in 2018 compared to 8.0 % in 2017 majorly as a result of considerable declines in prices of food after the shortage experienced in 2017 tax. The current account deficit narrowed to stand at Kshs 441.8 billion in 2018 compared to Kshs 503.4 billion in 2017 mainly due to a faster growth of imports of goods and services.

Banks performance

Apart from the unfavourable operating environment, the bank's performance was significantly impacted by lack of adequate capital to meet regulatory requirements and support business growth.

Total assets declined by 4% to Kshs 12.9 billion from Kshs 13.5 billion in 2017. Net advances and customer deposits remained steady at Kshs 8.4 billion and Kshs 8.6 billion respectively. The bank recorded an after tax loss of Kshs 540 million compared a loss of Kshs 335 million in 2017. This is attributable to the inability to implement the bank's business strategy due to lack of capital.

The board has been actively engaging the National Treasury (the majority shareholder with 85.8% ordinary shareholding) with a view to resolving the capital challenges facing the bank. The National Treasury injected Kshs 500 million in May 2018. This was however not adequate to meet regulatory minimum capital and implement restructuring programmes required to turn around the bank.

The Board's attempt to secure capital from a strategic investor through the issuance of additional 175 million preference shares of Kshs 3.5 billion did not succeed. Hence the Board and management have gone back to the drawing board and are consulting with the National Treasury on how to secure capital in the short term pending the privatization of the bank.

Corporate Social Responsibility

The bank recognizes its corporate responsibility commitments and is determined to sustain high standards of corporate citizenship by preserving and promoting human values as well as conserving the environment for sustainability. The CSR theme for 2018 was "sustainability and growth through CSR". As directed by the President through circular No. DENR/EMC/33(31), the bank in partnership with Kenya Forest Service and other stakeholders planted over 5,000 trees in various forests across the country. The bank also assisted various primary schools and institutions with water tanks and other infrastructure to support water harvesting.

Board Changes

The following board changes were effected during the year:

1. Dr. Iyaya Wanjala was appointed as chairman on 6th June 2018
2 Hon. Yusuf Chanzu was appointed as director on 20th September 2018
3. Dr. Kennedy Otiso was appointed as director on 20th September 2018
4. Miriam Cherogony was appointed as director on 20th September 2018
5. Dr. Nathan Psiwa was appointed as director on 20th September 2018
6. Dr. Raymond Omollo's term as director came to an end on 2nd October 2018
7. Joseph Koskey's term as director came to an end on 2nd October 2018

As I welcome the new board members, I wish to take this opportunity to thank those retiring and wish them the very best in their future eneavours.

Conclusion

I wish to commend our shareholders for their continued support for the bank. Your support in unlocking the capital issues facing the bank will definitely help unlock the full potential of the bank, place it on a growth path and return it to a profit trajectory. I also take this opportunity to thank our customers, the Government, management, staff, suppliers and fellow board members for their dedicated contribution and support towards the growth of the Bank.

Dr. Iyaya Wanjala-Chairman

28 March 2019

THOMAS KIPKEMEI KIYAI

Chief Executive Officer

Macroeconomic Overview

The macroeconomic environment improved significantly in 2018 compared to 2017. The real Gross Domestic Product - GDP is estimated to have grown by 6.3% compared to 4.9% the previous year. The growth was attributable to increased agricultural production, accelerated manufacturing activities, sustained growth in transportation and vibrant service sector activities.

The growth realized was anchored on a relatively stable macroeconomic environment in 2018. Inflation remained low at 4.7% in 2018 compared to 8.0 % in 2017 majorly as a result of considerable declines in prices of food after the shortage experienced in 2017. The current account deficit narrowed to stand at Kshs 441.8 billion in 2018 compared to Kshs 503.4 billion in 2017 mainly due to a faster growth of imports of goods and services.

Bank's Performance

Total assets declined by 4% to Kshs 12.9 billion from Kshs 13.5 billion in 2017. Net advances and customer deposits remained steady at Kshs 8.4 billion and Kshs 8.6 billion respectively. The bank's pre-tax loss declined by 20% to Kshs 351 million from Kshs 438 million in 2017. The loss after tax however increased to Kshs 540 million from Kshs 335 million in 2017 due to derecognition of deferred tax asset of Kshs 173 million due to uncertainty on when the bank is likely to generate sufficient taxable profit.

Net interest income increased by 29% to Kshs 643 million from Kshs 498 million while total income increased by 10% increase to Kshs 1.40 billion from Kshs 1.28 billion in 2017. Total operating expenses increased marginally by 2.4% to Kshs 1.76 billion from Kshs 1.71 billion in 2017. Impairment provisions however declined by 7% to Kshs 368 million from Kshs 395 million the previous year.

Recapitalisation and Privatization

Capitalisation remains a key pillar for the implementation of the business strategy and successful turnaround of the bank. The National Treasury injected bridging capital of Kshs 500 million in May 2018 increasing its stake in the bank to 85.8% from 77.9% in 2017. The bank's attempt to adequately address the perennial capitalization challenge, through the issuance of 175 million new preference shares of Kshs 3.5 billion to a strategic investor was however unsuccessful. The National Treasury has therefore initiated the necessary measures to secure Cabinet approval for the privatisation of the bank.

In the meantime the National Treasury is exploring various options to support the bank pending the implementation of the privatization process.

Recovery of Non-performing Loans (NPLs)

The bank continues to make considerable progress in recovery of non-performing debts and management of the portfolio to bring the assets quality within the industry standards. Over the last three years, the bank has managed to recover about Kshs 2 billion and write backs to income of close to Kshs 800 million. In 2018 the bank managed to recover Kshs 428 million and write back to income of Kshs 212million.

Strategic Focus and Turnaround

The turnaround strategy of the bank hinges on successful recapitalisation as outlined above. Apart from recapitalisation, balance sheet growth, debt recovery, growth of non-funded income form a key focus of our strategy. To grow non-funded income the bank has rolled out an enhanced digital banking platform and expects to operationalise a fully-fledged insurance agency soon.

Corporate Social Responsibility (CSR)

Our corporate social responsibility is firmly anchored on the following values of our corporate brand;

- Customer-primacy: the customer is at the center of our service delivery.
- Social responsibility: as a Bank, we are sensitive to our responsibility to the environment and the community in which we operate.

The CSR theme for 2018 was: 'Sustainability and Growth through CSR'. The bank's CSR activities mainly focused on tree planting as directed by the President through circular No. DENR/EMC/33(31). In partnership with Kenya Forest Service and other stakeholders the bank planted over 5,000 trees in various forests across the country. To improve water harvesting and conservation, the bank also supported various schools across the country with water tanks and water harvesting infrastructure.

Conclusion and appreciation

With the unwavering support and commitment of our Board of Directors, staff, customers, shareholders and partners, we remain confident the bank will overcome and surmount the current challenges and successfully turnaround its performance.

I wish to express my deepest gratitude to firstly, our customers, for believing in us and continuing to retain us as their preferred banking partners. To our shareholders, we thank you for your support. To our regulator, as well as the communities we exist in, thank you for creating an enabling environment for our operations. Lastly, I remain indebted to all employees and the Board of Directors for their commitment and dedication to the Bank throughout the year. We remain resolute to continue serving our customers and providing value to our stakeholders going into the future.

Thomas Kipkemei Kiyai
Chief Executive officer
28 March 2019

CORPORATE INFORMATION

AUDIT COMMITTEE:
J. Koskey - Chaiman
Cabinet Secretary, National Treasury
Managing Trustee - NSSF
R. Omollo

STAFF COMMITTEE:
J. Koskey - Chairman
Cabinet Secretary, National Treasury
Managing Trustee - NSSF
T. Kiyai

RISK COMMITTEE:
R. Omollo - Chairman
J. Koskey
Managing Trustee - NSSF
T. Kiyai

FINANCE AND CREDIT COMMITTEE:
R. Omollo - Chairman
Managing Trustee - NSSF
Cabinet Secretary - Treasury
T. Kiyai

COMPANY SECRETARY:
Wakonyo Igeria
Certified Public Secretary (Kenya)
P. O. Box 51133 – 00200, Nairobi

AUDITORS:
Principal Auditor:
The Auditor General
Anniversary Towers
P. O. Box 30084 – 00100, Nairobi

DELEGATED AUDITOR:
Ernst & Young LLP
Certified Public Accountants
Kenya-Re Towers, Upper Hill,
Off Ragati Road
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REGISTERED OFFICE:
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P. O. Box 51133 - 00200, Nairobi

CORRESPONDENT BANKS:
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Madrid
Italy

ODDO BHF AktiengesellShaft
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Germany

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Kenya

Hamilton Harrison & Mathews
Delta Suites, Waiyaki Way
P.O. Box 30333 - 00100 Nairobi, Kenya

Corporate governance defines the process and structure used to direct and manage the business affairs of Consolidated Bank of Kenya Limited ("the Bank") with the aim of enhancing corporate accounting and shareholders' long term value while taking into account the interests of other stakeholders.

The Board of Directors is responsible for the governance of the Bank and is committed to ensuring that its business operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices of corporate governance and business ethics. To this end the Bank has put in place processes, systems, practices and procedures which are frequently reviewed and updated embracing the changing corporate environment and world trends.

Business Ethics

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

Board of Directors

The names of the Directors as at the date of this report are set out on page 7.

The Board fulfils its fiduciary responsibility to the shareholders by maintaining control over the strategic, financial, operational and compliance issues of the Bank. Whilst the Board provides direction and guidance on strategic and general policy matters and remains responsible for establishing and maintaining overall internal controls over financial, operational and compliance issues, it has delegated authority to the Chief Executive Officer to conduct the day-to-day business of the Bank.

The Memorandum and Articles of association of the Bank provide for ten Directors including the Chairman and Chief Executive Officer. The Board members possess extensive experience in a variety of disciplines in banking, business and financial management, all of which are applied in the overall management of the Bank. The Board meets at least once every two months, and has a formal schedule of matters reserved for it. The Directors are given appropriate and timely information so that they can perform their fiduciary responsibilities effectively.

a)Directors' Emoluments and Loans

The remuneration of all Directors is subject to the guidelines issued by the Office of the President on terms and conditions of service for State Corporations. The Directors are not eligible for membership of the pension scheme and do not participate in any of the Bank's bonus schemes. Information on the compensation received and the dealings of the Directors with the Bank are included in notes 12 and 39 to the financial statements.

b)Related Party Transactions

There have been no materially significant related party transactions, pecuniary transactions or relationships between the Bank and its Directors or Management except those disclosed in Note 39 to the financial statements.

The Board has set up working committees to assist in discharging its duties and responsibilities as follows:

Audit Committee

The Committee reviews the integrity of the financial statements of the bank and recommends the statements for approval to the Board. The Committee considers management's recommendations in respect of impairment on loans and advances as well as other disclosure requirements. The Committee is also mandated to raise the standards of corporate governance by reviewing the quality and effectiveness of the internal control systems, the internal and external audit functions and the quality of financial reporting. In addition to advising the Board on best practice, the committee also monitors management's compliance with relevant legislation, regulations and guidelines as well as the Bank's laid down policies and procedures. The committee has direct contact with the Internal Audit function, the Company Secretary and the external auditors. During the year, the committee received and reviewed the findings of the internal and external audit reports and management's action to address them.

Risk Committee

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

Finance and Credit Committee

The committee is mandated to review and make recommendations on the Bank's credit, financial and accounting policies, and review and make recommendations on the Bank's Annual Budget, oversight of the overall lending policy of the Bank and deliberate and consider loan applications beyond the credit discretion limits set for management. The committee also reviews and considers all issues that may materially impact the present and future quality of the Bank's credit risk management function as well as the quality of the loan portfolio and ensure adequate bad debt provisions are maintained in line with the Central Bank of Kenya prudential guidelines and IFRS. The committee also reviews, approves and monitors the management's compliance with applicable statutory provisions, Bank policies and guidelines relating to the monitoring of price, liquidity, exchange rate and interest rate risks.

Staff Committee

The committee is mandated to formulate staff policies and procedures and ensure an adequately staffed and professionally managed human resource. The committee assists the Board in discharging its corporate governance role by reviewing staffing needs of the Bank, appoints senior management staff, reviews training needs and undertake disciplinary measures as per the staff policies.

Board meeting attendance

During the year under review, the Board held main board and working committee meetings. The Board members attendance for 2018 is as follows:

Name	Board Meeting			Audit Committee			Risk & Compliance Committee			Credit & Finance Committee			Staff Committee		
	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%	Meetings required to attend	Meetings attended	%
Thomas Kiyai - (Chief Executive Officer)	11	11	100%	3	3	100%	3	3	100%	5	5	100%	3	3	100%
George Omino – Representing Cabinet Secretary National Treasury	11	11	100%	3	3	100%	-	-	-	5	4	80%	3	3	100%
Moses Cheseto- Alternate to Managing Trustee - NSSF	11	10	91%	3	3	100%	3	3	100%	5	5	100%	3	3	100%
Dr. Raymond Omollo	9	8	89%	2	2	100%	3	3	100%	5	5	100%	2	2	100%
Joseph Koskey	9	8	89%	3	3	100%	3	3	100%	-	-	-	3	3	100%
Dr. Iyaya Wanjala - (Chairman)	2	2	100%	-	-	-	-	-	-	-	-	-	-	-	-
Hon. Yusuf Chanzu	2	2	100%	-	-	-	-	-	-	-	-	-	-	-	-
Miriam Cherogony	2	2	100%	-	-	-	-	-	-	-	-	-	-	-	-
Dr. Kennedy Otiso	2	2	100%	-	-	-	-	-	-	-	-	-	-	-	-
Dr. Nathan Psiwa	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Board performance evaluation

The Chairman conducts evaluations of the performance of the Board, individual Directors and Board Committees annually. In addition, the Board and its Committees undertake an annual evaluation of their performance and report their findings and any resulting recommendations to the Board. The Board also undertakes an evaluation of the performance of the Chairman. The Board discusses the results of its evaluations and uses the process to constructively improve the effectiveness of the Board.

Shareholders

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

	No. of Ordinary Shares	%	No. of Preference shares	2018 %	2017 %
Cabinet Secretary/The National Treasury	60,000,000	85.80%	-	-	-
National Social Security Fund	2,225,000	3.20%	8,050,000	22.30%	22.30%
Kenya National Assurance (2001)	1,094,487	1.60%	3,958,300	11.00%	11.00%
Kenya National Assurance Company Limited	835,513	1.20%	3,021,700	8.40%	8.40%
Kenya Pipeline Company Limited	720,000	1.00%	2,631,500	7.30%	7.30%
Kenya National Examination Council	695,000	1.00%	2,520,000	7.00%	7.00%
Public Trustees	660,000	0.90%	2,420,000	6.70%	6.70%
Telkom Kenya Limited	620,000	0.90%	2,250,000	6.20%	6.20%
National Hospital Insurance Fund	590,000	0.80%	2,120,000	5.90%	5.90%
LAPTRUST Retirement Services Limited	486,000	0.70%	1,756,000	4.90%	4.90%
Total of 10 above	67,923,000	97.10%	28,727,500	79.70%	79.70%
Other shareholders	1,997,000	2.90%	7,329,000	20.30%	20.30%
TOTAL SHAREHOLDING	**69,920,000**	**100%**	**36,056,500**	**100%**	**100%**

Compliance

The Board provides oversight to ensure that management adheres to all applicable laws, regulations, governance codes, policies, procedures and systems to monitor and control compliance across the bank. Additionally, the Bank prepares its financial statements in accordance with International Financial Reporting Standards (IFRS)

Chairman
Dr. Iyaya Wanjala
28 March 2019

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 16.

DIRECTORATE

The Directors who held office during the year and to the date of this report are set out on page 7. The following changes took place in the directorship during the year.

- Dr. Iyaya Wanjala was appointed as chairman on 6th June 2018
- Hon. Yusuf Chanzu was appointed as director on 20th September 2018
- Dr. Kennedy Otiso was appointed as director on 20th September 2018
- Miriam Cherogony was appointed as director on 20th September 2018
- Dr. Nathan Psiwa was appointed as director on 20th September 2018
- Dr. Raymond Omollo term as director came to an end 2nd October 2018.
- Joseph Koskey term as director came to an end on 2nd October 2018.

PRINCIPAL ACTIVITIES

The principal activities of the Bank, which is governed by the Banking Act, are the provision of banking, financial and related services.

RESULTS	2018 Kshs'000	2017 Kshs'000
Loss before taxation	(351,567)	(438,570)
Taxation (Charge)/credit	(188,467)	102,889
Loss for the year transferred to accumulated deficit	**(540,034)**	**(335,681)**

The Directors do not recommend the payment of a dividend for the year (2017: nil).

DIVIDEND

The Directors do not recommend the payment of a dividend for the year (2017: nil).

STATEMENT AS TO DISCLOSURE TO THE BANK'S AUDITOR

With respect to each of the persons who is a Director at the date of approval of this report confirms that:

- there is, so far as the Director is aware, no relevant audit information of which the Bank's auditor is unaware; and
- the Director has taken all the steps that he/she 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.

BUSINESS REVIEW

The Kenyan economy is estimated to have grown by 5.9% in 2018 compared with 4.7% the previous year supported by good weather, eased political uncertainties and improved business confidence. The banking sector remained resilient in the face of increased regulation focusing in the areas such as; Anti Money Laundering, implementation of the new IFRS 9 and the law on interest rate capping. Credit to the private sector especially the SMEs remained constrained due to the law on capping which makes it difficult for banks to price risk inherent in this sector.

The Bank received the expected bridging capital injection of Kshs. 500 million from the National Treasury in May 2018. This was however not adequate to cure the capital challenges as the bank required a minimum of Kshs. 1.6 billion to meet the minimum prudential requirements. The Bank's performance continued to deteriorate with the balance Sheet declining further to Kshs. 12.9 billion from Kshs. 13.5 billion in 2017. Loss before tax recorded in the year was Kshs. 351.6 Million further eroding the capital position.

The Board has requested the National Treasury, the majority shareholders with 85.8% to support the Bank with a shareholder loan of Kshs 1 billion and capital injection of Kshs 500 million pending the implementation of the privatisation process. The request is still under consideration. The Bank has also requested NSSF one of the other major shareholders to inject an additional Kshs 395 million through conversion of the Medium Term Note holding into equity and the matter is currently under consideration.

The Bank is therefore keen on addressing the capital challenges to comply with regulatory requirements and support balance Sheet and revenue growth. The Bank expects to leverage on the Digital Banking to grow customer numbers and increase non-funded income through enhanced products offering and increased transaction volumes.

The Bank's medium term note of Kshs 1.6 billion disclosed on note 29 matures on 22 July 2019. The bank is making appropriate arrangements to ensure availability of adequate funds to settle the maturing obligation. These include deposits mobilization, capital injection of Kshs 500 million and shareholder loan of Kshs 1 billion from the National Treasury the majority shareholder. Furthermore, the request for conversion of Kshs 395 million of the medium term into equity is under consideration by NSSF one of the major shareholding.

AUDITOR

The Auditor General is responsible for the statutory audit of the Bank's books of account in accordance with section 14 and section 39(i) of the Public Audit Act, 2004 which empowers the Auditor General to nominate other auditors to carry out the audit on his behalf and subject to the approval by the Central Bank of Kenya in accordance with the requirements of Section 24(1) of the Banking Act of Kenya.

Ernst & Young LLP, who were nominated by the Auditor General, carried out the audit of the financial statements for the year ended 31 December 2018. The financial statements of the Bank for the year ended 31 December 2017, were audited by another firm.

BY ORDER OF THE BOARD

Company Secretary
Wakonyo Igeria

Nairobi
28 March 2019

The Kenyan Companies Act, 2015, requires the Directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the company as at the end of the financial year and of its profit or loss for that year. It also requires the Directors to ensure that the company maintains proper accounting records that are sufficient to show and explain the transactions of the company and disclose, with reasonable accuracy, the financial position of the company. The Directors are also responsible for safeguarding the assets of the company, and for taking reasonable steps for the prevention and detection of fraud and error.

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

The Directors have considered the Bank's non-compliance with the minimum capital requirements of the Central Bank of Kenya's (CBK's) Prudential Guidelines as discussed in note 3 to the financial statements, which indicates that, as at 31 December 2018, the Bank's total regulatory capital to risk weighted assets ratio is 1.05% (2017: 5.1%), which is significantly below the CBK minimum prudential ratio of 14.5%. The Directors, in consultation with National Treasury, are taking the necessary measures to recapitalise the Bank and ensure compliance with the regulatory and prudential requirements. National Treasury, the majority Shareholder, with 88.6% stake, requested the Privatization Commission to support the bank structure and implement the transaction to recapitalize the bank pending privatization. The Privatization Commission appointed a transaction advisor who carried out due diligence and recommended the implementation of a balance sheet reorganization mainly involving creation and sale of preference shares pending privatisation. The Bank has commenced a process for the issuance of 175 million convertible preference shares of Kshs. 3.5 billion to a strategic investor who will eventually take up a majority stake in the Bank upon conversion of the shares through the privatisation process. Based on the foregoing the Directors believe that the Bank will remain a going concern in the foreseeable future.

Nothing else has come to the attention of the Directors to indicate that the Bank will not remain a going concern for at least the next twelve months from the date of this statement.

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 28 March 2019 and signed on its behalf by:

Dr. Iyaya Wanjala
Chairman

Hon. Yusuf Chanzu
Director

The Board establishes and approves formal and transparent remuneration polices to attract and retain both Executive and Non-Executive Directors. The remuneration of all Directors is subject to the guidelines issued by the State Corporations Advisory Committee (SCAC) on terms and conditions of service for State Corporations.

In accordance with the guidelines provided by the State Corporations Advisory Committee (SCAC), Salaries and Remuneration Commission (SRC) as well as the National Treasury and other shareholders' approval during the Annual General Meetings, the Directors are paid a sitting allowance of Kshs. 20,000 for every meeting attended. The Directors and the Chairman are also paid a monthly retainer of Kshs. 50,000 and Kshs. 150,000, respectively. The Directors are not eligible for membership of the pension scheme and do not participate in any of the Bank's bonus schemes.

Contract of Service

In accordance with the Kenyan Companies Act, 2015 and the Capital Market Regulations of Kenya on Non-Executive Directors, a third of the Board is elected at every Annual General Meeting by shareholders for a term of three years, on rotational basis.

The Chief Executive Officer has a three-year renewable contract of service with Consolidated Bank of Kenya Limited starting 10th April 2015. The contract was renewed for a further term of three years with effect from 10th April 2018.

Changes to Directors' Remuneration

During the period, there were no changes in Directors' remuneration which is set as per the guidelines provided by the State Corporation Advisory Committee and the Salaries and Remuneration Commission.

Statement on approval of Directors' Remuneration during the Annual General Meeting

During the Annual General Meeting held on 27th July 2018, the shareholders approved the payment of Directors' fees for the year ended 31st December 2018 in accordance with the guidelines provided by the State Corporations Advisory Committee and the Salaries and Remuneration Commission.

The following tables shows a single figure remuneration for the CEO and Non-Executive Directors in respect of qualifying services for the year ended 31st December 2018 together with the comparative figures for 2017. The aggregate Directors emoluments are shown in note 12.

For the year ended 31st December 2018	Category	Gross payments	Honorarium	Allowances	Total
		Kshs' 000	Kshs' 000	Kshs' 000	Kshs' 000
Dr. Iyaya Wanjala - (Appointed on 6th June 2018)	Chairman Non-Executive	-	408	81	489
Thomas Kiyai	Chief Executive Officer	21,980	-	-	21,980
George Omino – Representing Cabinet Secretary National Treasury	Non-Executive	-	600	470	1,070
Moses Cheseto- Alternate to Managing Trustee - NSSF	Non-Executive	-	600	552	1,152
Dr. Raymond Omollo-(Term ended on 2nd October 2018)	Non-Executive	-	451	455	906
Joseph Koskey-(Term ended on 2nd October 2018)	Non-Executive	-	451	426	877
Dr. Kennedy Otiso-(Appointed on 20th September 2018)	Non-Executive	-	80	192	272
Miriam Cherogony (Appointed on 20th September 2018)	Non-Executive	-	80	62	142
Hon. Yusuf Chanzu (Appointed on 20th September 2018)	Non-Executive	-	78	62	140
Dr. Nathan Psiwa (Appointed on 20th September 2018)	Non-Executive	-	-	-	-
Total		**21,980**	**2,748**	**2,300**	**27,028**

For the year ended 31st December 2017	Category	Gross payments Kshs' 000	Honorarium Kshs' 000	Allowances Kshs' 000	Total Kshs' 000
Dr. Benson Ateng - (Term ended on 9th January 2017)	Chairman Non-Executive	-	44	24	68
Thomas Kiyai	Chief Executive Officer	21,580	-	-	21,580
George Omino – Representing Cabinet Secretary National Treasury	Non-Executive	-	600	420	1,020
Moses Cheseto- Alternate to Managing Trustee - NSSF	Non-Executive	-	300	524	824
Dr. Raymond Omollo	Non-Executive	-	600	509	1,109
Joseph Koskey	Non-Executive	-	600	458	1,058
Amb. Charles Amira (Term ended on 4th February 2017)	Non-Executive	-	55	69	124
Miriam Cherogony (Term ended on 4th February 2017)	Non-Executive	-	55	23	78
Papius Muhindi (Term ended on 4th February 2017)	Non-Executive	-	55	22	77
Evans Vitisia (Term ended on 4th February 2017)	Non-Executive	-	55	68	123
Dr. Anthony Omerikwa-Ag. Managing Trustee -NSSF	Non-Executive		300	-	300
Pius Metto- Alternate to Managing Trustee - NSSF	Non-Executive	-	-	44	44
Total		**21,580**	**2,664**	**2,160**	**26,404**

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statement of Consolidated Bank of Kenya Limited, set out on page 30 to 96, which comprise the statement of financial position as at 31 December 2018, and the statement of profit and loss and other comprehensive income, statement of change in equity and statement of cash flow for the year then ended, and summary of significant accounting policies and other explanatory information, have been audited on my behalf by Ernst & Young LLP auditors appointed under section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on basis of their report, I'm satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit have been obtained.

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

Basis for Opinion

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

Material Uncertainty Related to Going Concern

I draw attention to Note 3 of the financial statements, which indicates that the Bank incurred a net loss of Kshs. 540 million during the year ended 31 December 2018 (2017-Kshs.335.7 million), resulting into a reported accumulated deficit of Kshs. 2.12 billion (2017-Kshs. 1.26 billion) and, as of that date, the Bank had a total regulatory capital to risk weighted assets ratio of 1.05% (2017: 5.09%) against a regulatory minimum required ratio of 14.5%. Further, as disclosed in note 6 to the financial statements, the Bank failed to meet the minimum core capital requirement of Kshs. 1 billion. In addition, the bank's Medium term note of Kshs.1.6 billion, disclosed on note 29(b), matures on 22 July 2019. These conditions, along with other matters as set forth in note 3, indicate that a material uncertainty exists that may cast significant doubt on the Bank's ability to continue as a going concern. My opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of the Bank's financial statements of the current year. These matters were addressed in the context of my audit of the financial statements, and in forming the opinion thereon, and therefore I do not provide a separate opinion on these matters. For each matter below, a description of how the audit addressed the matter is provided in that context.

Key Audit Matters (continued)

Key Audit Matter	How Our Audit Addressed the Key Audit Matter
Impairment of financial assets As disclosed in the Financial Statements under Note 2.1 on Impairment of Financial assets and note 5(a) on Credit Risk, the impairment losses on financial assets as at 31 December 2018 are determined under application of IFRS 9-Financial instruments based on the Expected Credit Losses model. The Bank's financial assets comprise loans and advances to customers, debt instruments at amortized cost, other financial instruments at amortized cost, balances due from banking institutions, and balances with the Central Bank of Kenya. The Bank opted for the modified retrospective approach resulting into an opening balance adjustment as at 1 January 2018 of Kshs 102.63 million. The transition disclosures relating to this adjustment are included in Note 4. I considered this to be a key audit matter because significant judgement involved in determining the credit losses on financial instruments. The key areas of judgement included: • The interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Bank's expected credit loss model; • The identification of exposures with a significant deterioration in credit quality; • Assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward looking macroeconomic factors(e.g inflation rate and lending rate); and, • The need to apply additional overlays to reflect current or future external factors that are not appropriately captured by the expected credit loss model. Note 2.2 to the financial statements and key sources of estimation uncertainty while Note 16 to 22 of the financial statements deals with impairment disclosures.	Audit procedures included the following: • Undertaking an assessment of the Bank's new provisioning methodology and compared it with the requirements of IFRS 9 • Assessment of: i. data used to determine the impairment losses for completeness and accuracy ii. expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy • Assessment and testing the material modelling assumptions as well as overlays with a focus on the: i. key modelling assumptions adopted by the Bank; ii. basis for and data used to determine overlays; and iii. sensitivity of the collective provisions to changes in modelling assumptions. • In addition, assessment of the adequacy of the disclosures in the financial statements.

Report on Lawfulness and Effectiveness in use of Public Resources

Conclusion

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

Basis for Conclusion

1. Non- Compliance

1.1 Single Borrower Rule

Contrary to the Central Bank of Kenya (CBK) Prudential Guidelines of January 2013 on Single Borrower Limits Section 3.1 and the Banking Act Section 10"…not grant to any person or permit to be outstanding any advance , credit facility or give any financial guarantee or incur any other liability on behalf of any person, so that the total value of the advances, credit facilities, financial guarantees and other liabilities in respect of that person at any time exceeds 25% of its core capital", the Bank was in breach of the provision as at 31 December 2018.

1.2 In Duplum Rule

Section 44A(1)(b)of the Banking Act sets the limit for which interest should not exceed the principal owing when the loan becomes non-performing. The Bank continues to use non automated systems to monitor compliance with rule. Consequently, the provisions of the rule have not been integrated into its core banking system which makes it impossible to operationalize the rule. In addition, interest accrued on the non-performing loans over and above the outstanding principals as at the time of migration into the new core banking system is yet to be reversed.

2. Late Submission of Financial statement for Audit

Section 47 of the Public Audit Act 2015 and the Public Finance Management Act, No. 18 of 2012 requires Public entities to the Auditor- General submit financial statements within 3 months of its close of financial year. For the year under review, the Bank submitted the financial statements on 2nd May 2019 which was 32 days after the statutory deadline of 31 March 2019.

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

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

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

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and governance were operating effectively, in all material respects.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Responsibilities of Management and those charged with Governance

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

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

Management is also responsible for the submission of the financial statements to the Auditor – General in accordance with the provisions of Section 47 of the Public Audit Act, 2015 . Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor- General's Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of section 48 of the Public of Audit act, 2015 and submit the audit report in compliance with Article 229(7) of the constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when 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. Those charged with governance are responsible for overseeing the Bank's financial reporting process.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

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

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

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

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

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

- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Bank to express an opinion on the financial statements.

- Perform such other procedures as I consider necessary in the circumstances.

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

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

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

1) I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purposes of the audit;
2) In my opinion, adequate accounting record have been kept by the Bank, so far as appears from the examination of those books of account ;and
3) The Bank's financial statements are in agreement with the accounting records

FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi
10 June 2019

CONSOLIDATED BANK OF KENYA LIMITED
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018

	Notes	2018 Kshs'000	2017 Kshs'000
INTEREST INCOME	7	1,401,466	1,344,653
INTEREST EXPENSE	8	(758,458)	(846,213)
NET INTEREST INCOME		643,008	498,440
Fee and commission income	9	298,292	323,650
Foreign exchange trading income	10	21,436	28,433
Other operating income	11	442,044	425,737
OPERATING INCOME		1,404,780	1,276,260
Operating expenses	12	(1,388,179)	(1,319,803)
Credit loss expense on loans and advances	20	(368,162)	(395,027)
Credit loss expense on balances due from banking institutions	17(a)	(6)	-
LOSS BEFORE TAXATION		(351,567)	(438,570)
INCOME TAX (CHARGE)/ CREDIT	14(a)	(188,467)	102,889
LOSS FOR THE YEAR		(540,034)	(335,681)
OTHER COMPREHENSIVE INCOME/(LOSS)			
Items that may be reclassified subsequently to profit or loss:			
Net change in fair value of debt instruments at fair value through other comprehensive income	22	(412)	-
Net gains on available-for-sale financial assets	22	-	1,042
Total other comprehensive income for the year, net tax		(412)	1,042
TOTAL COMPREHENSIVE LOSS FOR THE YEAR, NET TAX		**(540,446)**	**(334,639)**
LOSS PER SHARE		Kshs	Kshs
Basic and diluted	15	**(7.72)**	**(7.38)**

CONSOLIDATED BANK OF KENYA LIMITED
STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

ASSETS	Notes	31 December 2018 Kshs'000	31 December 2017 Kshs'000
Cash and balances with Central Bank of Kenya	16	918,709	857,738
Balances due from banking institutions	17(a)	119,420	107,453
Financial assets at amortised cost	18	2,190,093	2,605,899
Loans and advances to customers	19	8,429,659	8,421,072
Other assets	21	306,950	284,438
Equity instruments at fair value through other comprehensive income			
comprehensive income	22	6,727	–
Financial investments – available-for-sale	22	-	7,139
Taxation recoverable	14(c)	2,809	6,022
Deferred tax asset	28	-	173,299
Property and equipment	23	720,115	746,346
Intangible assets	24	186,211	239,528
Prepaid operating lease rentals	25	6,639	6,810
TOTAL ASSETS		**12,887,332**	**13,455,744**
LIABILITIES AND SHAREHOLDERS' FUNDS			
LIABILITIES			
Deposits and balances due to banking institutions	17(b)	235,751	208,561
Balances due to Central Bank of Kenya	17(c)	1,120,000	1,484,201
Customer deposits	26	8,588,544	8,646,305
Other liabilities	27	285,362	241,241
Borrowings	29	1,732,320	1,807,002
TOTAL LIABILITIES		**11,961,977**	**12,387,310**
SHAREHOLDERS' FUNDS			
Share capital	30(b)	2,119,530	1,619,530
Revaluation surplus	31	370,509	379,130
Accumulated deficit	32	(2,061,222)	(1,265,665)
Statutory reserve	33	490,679	329,168
Fair value reserve	34	5,859	6,271
TOTAL SHAREHOLDERS' FUNDS		**925,355**	**1,068,434**
TOTAL LIABILITIES AND SHAREHOLDERS' FUNDS		**12,887,332**	**13,455,744**

The financial statements on pages 30 to 96 were approved and authorised for issue by the Board of Directors On 28 March 2019 and were signed on its behalf by:

Director - Dr. Iyaya Wanjala **Director – Hon. Yusuf Chanzu**

Chief Executive Officer - Thomas Kiyai **Company Secretary - Wakonyo Igeria**

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

	Note	Share capital Kshs'000	Revaluation surplus Kshs'000	Accumulated deficit Kshs'000	Statutory reserve Kshs'000	Fair value reserve Kshs'000	Total Kshs'000
At 1 January 2017		1,619,530	387,751	(873,623)	264,186	5,229	1,403,073
Loss for the year		-		(335,681)		-	(335,681)
Other comprehensive loss		-				1,042	1,042
Transfer of excess depreciation	31	-	(12,316)	12,316	-	-	-
Deferred tax on excess depreciation	31	-	3,695	(3,695)	-	-	-
Transfer to statutory reserve	33	-	-	(64,982)	64,982	-	-
At 31 December 2017		**1,619,530**	**379,130**	**(1,265,665)**	**329,168**	**6,271**	**1,068,434**
Impact of adopting IFRS 9	4	-	-	(102,631)		-	(102,631)
Restated opening balance under IFRS 9 as at 1 January 2018		1,619,530	379,130	(1,304,792)	265,662	6,271	965,803
Capital injection		500,000	-	-	-	-	500,000
Loss for the year		-		(540,034)	-	-	(540,034)
Other comprehensive income		-	-	-	-	(412)	(412)
Transfer of excess depreciation	31	-	(12,316)	12,316	-	-	-
Deferred tax on excess depreciation	31	-	3,695	(3,695)	-	-	-
Transfer to statutory reserve	33	-	-	(225,017)	225,017	-	-
At 31 December 2018		**2,119,530**	**370,509**	**(2,061,222)**	**490,679**	**5,859**	**925,355**

	Notes	2018 Kshs'000	2017 Kshs'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cashflows generated from/ (used in operations)	35(a)	238,380	(291,316)
Tax paid	14(c)	(11,955)	(21,827)
Net cashflows from/ (used in) operating activities		226,425	(313,143)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	23	(24,190)	(25,092)
Proceeds on sale of property and equipment		112	86
Purchase of intangible assets	24	(36,619)	(45,517)
Net cash used in investing activities		(60,697)	(70,523)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of shares		500,000	-
Repayment of principal and interest on borrowings	29	(294,233)	(307,369)
Net cash from/(used in) financing activities		205,767	(307,369)
NET DECREASE IN CASH AND CASH EQUIVALENTS DURING THE YEAR		371,495	(691,035)
CASH AND CASH EQUIVALENTS AT 1 JANUARY		(1,224,714)	(533,679)
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**35(b)**	**(853,219)**	**(1,224,714)**

1. Reporting entity

Consolidated Bank of Kenya Limited (The "Bank") provides commercial banking services.

The address of its registered office is as follows:
Consolidated Bank House, Koinange Street
P O Box 51133
Nairobi- 00200.

2. Significant accounting policies, critical judgements and key sources of estimation uncertainty

2.1 summary of significant accounting policies

2.1.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), the Kenyan Companies Act and the Banking Act.

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

2.1.2 Changes in accounting policies and disclosures

New and amended Standards Interpretation

IFRS 9 Financial Instruments
In these financial statements, the Bank has applied IFRS 9, effective for annual periods beginning 1 January 2018, for the first time. IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Bank elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39. The Bank has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in Note 4
Changes to classification and measurements
To determine their classification and measurement category, IFRS 9 requires all financial instruments, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.
The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

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

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to the income statement. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 4.

Changes to impairment calculation

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts.
The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset. Details of the Bank's impairment method are disclosed in Note 5.1. The quantitative impact of applying IFRS 9 as at 1 January 2018 is disclosed in Note 4.

2.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 supersedes the previous revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related Interpretations.

The core principle of IFRS 15 is that the bank recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduced a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, the bank recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the performance obligation is transferred to the customer. This standard did not impact how the Bank accounts for transactions affected by its implementation in its operations.

Relevant new and amended standards in issue but not yet effective in the year ended 31 December 2018.

New and Amendments to standards	*Effective for annual periods beginning on or after*
IFRS 16 Leases	January 2019, with earlier application permitted

The company is still in the process of assessing the full impact of the application of IFRS 16 on the company's financial statements and it is not practicable to provide a reasonable financial estimate of the effect until the directors complete the detailed review.

Early adoption of standards

The Bank did not early-adopt any new or amended standards in 2018.

The principal accounting policies applied in the preparation of the financial statements are set out below. These policies have been applied consistently, except the adoption of the new standards (IFRS 9).

Basis of preparation
The financial statements have been prepared on the historical cost basis of accounting except for certain properties that are measured at revalued amounts and certain financial instruments, measured at fair value:

Consolidation
The Bank prepares a separate set of consolidated financial statements which is available at its headquarters.The subsidiaries are at nil value, and therefore consolidated and the bank's financial statements reflect the same numbers.

Investments in subsidiary companies
Investments in subsidiary companies are stated at cost less impairment loss where applicable. The dormant subsidiaries listed in note 36 have no assets and liabilities and are at nil value. Details of the subsidiaries and how they are related to the bank are separately disclosed in note 36.

Interest income and expense
Interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost. Interest income on interest bearing financial assets measured at amortised cost under IFRS 9. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

2.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interest income and expense (continued)

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

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

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

The average effective interest on financial assets held at amortised cost and loans and advances to customers are disclosed under notes 18 and 19 respectively.

Fees and commissions income and other fees and commissions expense

In the normal course of business, the Bank earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.
Other fees and commission income, including account servicing fees, investment management fees, placement fees and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period.

Other fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Credit cards and other revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products, is five years for corporate and seven years for retail products. The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade, greater emphasis is also given to qualitative factors such as changes in usage.

Property and equipment

Property and equipment are stated at cost or as professionally re-valued from time to time less accumulated depreciation and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The Bank's policy is to professionally revalue freehold land and buildings regularly.

Any increase arising on the revaluation is recognised in other comprehensive income and accumulated in the revaluation surplus. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and charged against the revaluation surplus; all other decreases are charged to profit or loss.

2.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Addition and disposal
The addition and disposal or decommissioning of property and equipment and intangible assets is done on the date of the acquisition and the date of the disposal respectively.

Depreciation
Depreciation is calculated on a straight-line basis at annual rates estimated to write off the cost of each asset or the revalued amounts, to its residual values over its estimated useful life as follows:

Fixtures, fittings, equipment & ATMs	5 years
Leasehold improvements	8 years or lease period if shorter
Computers	3 years
Motor vehicles	4 years
Buildings	40 years or land lease period if shorter

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

The depreciation charge to profit and loss is based on the carrying amounts of the property and equipment. The excess of this charge over that based on the historical cost of the property and equipment is released each year from the revaluation surplus to retained earnings.

Intangible assets - computer software costs

Costs incurred on computer software are initially accounted for at cost and subsequently at cost less any accumulated amortisation and accumulated impairment losses. Amortisation is calculated on a straight-line basis over the estimated useful lives not exceeding a period of 5 years.

Leases
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the Bank as a lessee. All other leases are classified as operating leases.

When a lease includes land and buildings elements, the Bank assesses the classification of each element as either a finance lease or an operating lease. In determining classification of the land element, an important consideration is that land normally has an indefinite economic life. See note 2.2 to these financial statements.

The Bank as lessor
Assets held under finance leases are recognised as assets of the Bank at their fair value at the date of acquisition. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the statement of profit or loss and other comprehensive income over the term of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

The Bank as lessee
Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Impairment of non-financial assets
At the reporting date, the Bank reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that these assets have suffered an impairment loss.

If objective evidence on impairment losses exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss. In cases where the asset is carried at revalued amount, the impairment loss is treated as a revaluation decrease. In determining the recoverable amount, the Bank considers the higher of the fair value of the asset less costs to sell, and value in use. In estimating value in use, the Bank is cognisant of the estimated future cash flows discounted to the present value using a pre-tax discount rate that is reflective of the current market assessment of time value of money and the risks specific to the asset itself.

Intangible assets with indefinite useful life are tested for impairment annually, and when there is indication that the asset may be impaired.

Where impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised, unless such asset is carried at revalued amount, in which case the reversal of the impairment loss is treated as revaluation income.

Foreign currencies

i) Functional and presentation currency

The financial statements of the Bank are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). The financial statements are presented in Kenya shillings, which is the Bank's functional and presentation currency. Except as indicated, financial information presented in Kenya shillings has been rounded to the nearest thousand (Kshs'000).

ii) Transactions and balances

Foreign currency transactions that are transactions denominated, or that requires settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. At the reporting date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised through profit or loss.

Taxation

Current tax

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

Deferred income tax

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

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

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

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

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

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

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

Deferred income tax (Continued)

Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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

Value Added Tax

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

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

Financial instruments

A financial asset or liability is recognised when the Bank becomes party to the contractual provisions of the instrument.

Financial instruments

Initial recognition

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

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments. Financial instruments are initially measured at their fair value except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount.

Classification and measurement

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms. The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

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

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

2.1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Instruments (continued)

Classification and measurement (continued)

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 January 2018 is set out in the transitional disclosures note 4 (a)

Business model assessment

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

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

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

SPPI Test

As a second step of its classification process the Bank assesses the contractual terms of financial assets to identify whether they meet the SPPI test. Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount). The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

Financial Assets and Liabilities

Due from banks, loans and advances to customers, financial investments at amortised cost

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

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

An analysis of the gross carrying amount, maximum exposure to credit risk based on the bank's internal credit grading system and year end classification and the corresponding ECLs for the loans and advances to customers and balances due from other banking institutions is shown in note 5(a).

Financial investments at amortised cost

Investment in Treasury bonds previously classified as held to maturity under IAS 39 have been reclassified to debt instruments at amortised cost. The instruments meet the business model criteria of hold to collect contractual cash flows rather than to sell the instrument prior to maturity and the SPPI test.

The gross carrying amount of financial investments at amortised cost, the credit quality and maximum exposure to credit risk based on the bank's internal rating system and year end classification and the corresponding ECL are disclosed in note 5(a).

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Instruments (continued)

Equity instruments at FVOCI
The bank holds quoted equity shares and has elected to classify this as equity instruments at FVOCI. Gains and losses on these equity instruments are recognised through other comprehensive income. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established. Equity instruments at FVOCI are not subject to an impairment assessment.

Debt issued and other borrowed funds
After initial measurement, debt issued and other borrowed funds are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue funds, and costs that are an integral part of the EIR. A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

The bank issued a medium term note of seven years in July 2012. The medium-term notes issued by the bank do not have a conversion, write down or call option. The details of the of the medium-term notes are disclosed in note 29

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

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

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recognised to the profit or loss.

Impairment of Financial assets
Over view of the expected credit loss – ECL principle
The adoption of IFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing IAS 39's incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee and letters of credit contracts, in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.
The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the
allowance is based on the 12 months' expected credit loss (12mECL). The Bank's policies for determining if there has been a significant increase in credit risk are set out in note 5(a).

ECLs
The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

Based on the above process, the Bank groups its loans into Stage 1, Stage 2, Stage 3 as described below:

ECLs (continued)

Staging	Internal Rating Description	12 Months Basel III PD range	External Rating Equivalent
Stage 1	Performing	0.00% - 0.50%	Very Good

Stage 2	Significant increase in credit risk	0.50% - 11.7%	Good
Stage 3	Non-performing	11.7% - 100.00%	Bad

Stage 1: These are financial instruments that are performing in accordance with contractual terms and are expected to continue to do so since there are no signs or deterioration in credit risk or circumstances of the borrower from initial recognition. The bank recognises impairment allowance based on 12 months ECL.

Stage 2: These are financial instruments that have exhibited potential weaknesses which may if not corrected weaken the asset. The financial instruments have shown significant increase in credit risk and hence the bank recognises impairment allowance on the life time ECL

Stage 3: These financial instruments that are credit impaired. The bank considers financial instruments credit impaired when the borrower becomes 90 days past due on its contractual payments. Other qualitative considerations include existence of events and circumstances that indicates that the borrower is unlikely to pay.

Calculation of ECL
The key components and the mechanics behind the computation of the ECL are outlined below

PD: The probability of default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. The bank models its PDs at sector level using survival analysis over a defined period.

EAD: Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

LGD: The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The PD and LGD investment in government securities and bonds are considered to be 0%

Undrawn Loan commitments guarantees and letters of credit
When estimating LTECLs for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. Details of the gross carrying exposure and the corresponding ECL are disclosed in note 5(a).

Forward looking information
The bank has included a forward looking macro-economic overlay in its ECL model. The bank relies on the following economic indicators to develop. The bank adopts the following data sets for analysis of macroeconomic over lay;

Historical industry and Bank's non-performing loans
Historical macroeconomic statistics. The adopted macroeconomic factors include;
• Gross Domestic Product – GDP
• Inflation – consumer price index
• Exports
• Lending rates
• Exchange rates – effective

Forecast macroeconomic data
This is then regressed against Banks Non-performing loans in order to determine a relationship with the Macro economic variables.

To eliminate biasness and ensure there is probability weighting, the bank adopts base, worst and best-case forecasts adjustment factors to obtain a probability weighted PD. The weights are determined based on R2. R2 provides the Base while an even split of 1-R2 provides the weights for best and worst-case scenarios.

ECLs (continued)

Collateral valuation
To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such

as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The Bank's accounting policy for collateral assigned to it through its lending arrangements under IFRS 9 is the same is it was under IAS 39. The fair value of collateral affects the calculation of ECLs. The fair value of collateral values are disclosed in note 5(a).

Write off
The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the Bank has stopped pursuing the recovery i.e. after exhausting all recovery efforts. If the amount to be written off is greater than the accumulated loss allowance, the difference is charged to the profit and loss account. Any subsequent recoveries are recognised as income through the profit and loss account.

Financial liabilities and equity instruments issued by the Bank

a) Classification and measurement
Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

i) Equity instruments
An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

ii) Other financial liabilities
Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

b) Derecognition of financial liabilities
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. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss. The Bank derecognises financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

Offsetting
Financial assets and liabilities are offset and stated at net amount in the statement of financial position when there is a legally enforceable right to set off, and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

Provisions
A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Statutory reserve
IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVTL together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. However, Central Bank of Kenya prudential

guidelines require the Bank to set aside amounts for impairment losses on loans and advances in addition to those losses that have been recognised under IFRS 9. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. These amounts are dealt with in the statutory reserve.

Cash and cash equivalents
Cash and cash equivalents include cash in hand, unrestricted balances held with the Central Bank of Kenya and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Contingent liabilities
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-balance sheet transactions and disclosed as contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets or liabilities affected in future periods.

Employee benefit costs
The Bank operates a defined contribution retirement benefit scheme for all its employees. The scheme is administered by an independent investment management company and is funded by contributions from both the Bank and employees.

The Bank also contributes to the statutory National Social Security Fund. This is a defined contribution scheme registered under the National Social Security Fund Act. The obligations under the scheme are limited to specific contributions legislated from time to time.

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

Employee entitlement to leave not taken is charged to profit or loss as it accrues.

Foreign exchange contracts

Foreign exchange contracts include open spot contracts and foreign exchange forward contracts. These instruments are valued by either observable foreign exchange rates and observable or calculated forward points. These forwards and spot contracts are in foreign exchange deals carried out in the interbank markets. These are held for risk management purposes and therefore include hedges that are economic hedges, but do not meet the hedge accounting requirements. Most of the trading portfolio is within the Bank's investment banking division (Treasury Department) and is treated as trading risk for risk management purposes.

2.2 CRITICAL JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Bank's accounting policies, which are described in note 2.1, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities 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 including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

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

(i) Critical judgements in applying the Bank's accounting policies

The following are the critical judgements, apart from those involving estimations (see (ii) overleaf), that management have made in the process of applying the Bank's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Impairment losses on financial instruments

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition. The Bank considers an exposure to have significantly increased in credit risk when the IFRS 9 lifetime PD has doubled since initial recognition and has increased by more than 20 bps a year.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list stage 2. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

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

Consolidation of subsidiaries

The subsidiaries have not been consolidated because the parent Company has determined that the investments are not material and have no impact to the reported profit or loss and its statement of financial position. The shareholders through their trustees (Board of directors) made a resolution not to consolidate the entities in line with the vested orders issued by the government in 2002.

(ii) Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Property, equipment and intangible assets

Critical estimates are made by management in determining depreciation rates and residual values for property, equipment and intangible assets.

Fair value of trade receivables and payables

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows a the current market interest rate that is available to the Bank for similar financial instruments.

Contingent Liabilities

The preparation of the Bank's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets or liabilities affected in future periods. However, provisions are only made in the financial statements where based on the directors' evaluation, a present obligation has been established.

Taxation

The Bank is subjected to numerous taxes and levies by various government and quasi- government regulatory bodies. As a rule of thumb, the Bank recognises liabilities for the anticipated tax /levies payable with utmost care and diligence. However, significant judgement is usually required in the interpretation and applicability of those taxes /levies. Should it come to the attention of management, in one way or the other, that the initially recorded liability was erroneous, such differences will impact on the income and liabilities in the period in which such differences are determined.

3. GOING CONCERN

As at 31 December 2018, the Bank had a total regulatory capital/risk weighted assets ratio of 1.05% (2017: 5.09%) against a regulatory minimum ratio of 14.5%. As further disclosed in note 6, the Bank has not met the minimum capital requirement of Kshs. 1 billion. The Bank therefore had not met the minimum regulatory capital requirements. Further, the bank reported a net loss of Kshs 540 million (2017: Kshs 335.7 million). In addition, the Bank's medium term note of Kshs. 1.6 billion disclosed on note 29 matures on 22 July 2019. These conditions indicate that a material uncertainty exists which may cast significant doubt about the Banks's ability to continue as a going concern and, therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

The bank is exploring appropriate arrangements to ensure availability of adequate funds to settle the maturing obligation. Although the repayment involves significant liquidity outflow it is expected to have a positive impact on earnings because the bank expects to replace the same with a much cheaper finance from a combination of shareholder funds and customer deposits.

Further the Board has requested the National Treasury, the majority shareholders with 85.8% to support the Bank with a shareholder loan of Kshs 1 billion and capital injection of Kshs 500 million pending the implementation of the privatisation process. The request is still under consideration. The Bank has also requested NSSF one of the other major shareholders to inject an additional Kshs 395 million through conversion of the medium term note holding into equity and the matter is currently under consideration.

Based on the foregoing, the financial statements have been prepared on the basis of accounting policies applicable to a going concern. This basis of preparation presumes that the Bank will realize its assets and discharge its liabilities in the ordinary course of business.

4. TRANSITION DISCLOSURES

The following notes set out the impact of adopting IFRS 9 on the statement of financial position, and retained earnings including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs.

(a) A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 January 2018 is, as follows:

Financial Assets	IAS 39 measurement		Re-Classification	Re-measurement-ECL	IFRS 9	
	Category	Kshs'000	Kshs'000	Kshs'000	Kshs'000	Category
Cash and balances with Central Bank of Kenya	L&R	857,738	-	-	857,738	AC
	L&R	857,738	-	-	857,738	AC
Balances due from banking institutions	L&R	107,453	-	(54)	107,399	AC
Loans and advances to customers	L&R	8,421,072	-	(102,579)	8,318,493	AC
		9,386,263	-	(102,633)	9,283,630	
Financial instruments at amortised cost						
Debt instruments at amortised cost	HTM	2,605,899	-	-	2,605,899	
Total		**11,992,162**	**-**	**(102,633)**	**11,889,529**	

(b) The impact of transition to IFRS 9 on reserves and retained earnings is, as follows:

Retained earnings	Kshs'000
Closing Balance under IAS 39 (31 December 2017)	(1,265,665)
Recognition of IFRS 9 ECLs –Loans and advances	(102,579)
Recognition of IFRS 9 ECLs -Balances due from banking institutions	(54)
Opening balance under IFRS 9 (1 January 2018)	(1,368,298)

(c) The following table reconciles the aggregate opening loan loss provision allowances under IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37 Provisions Contingent Liabilities and Contingent Assets to the ECL allowances under IFRS 9.

	Loan loss provision under IAS 39 as at 31 December 2017	Re-measurement	ECLs under IFRS 9 at 1 January 2018
Impairment allowance for Loans and receivables per IAS 39/under IFRS 9	458,152	94,777	552,929
			-
Guarantees	-	371	371
LCS	-	2,865	2,865
Other commitments		4,566	4,566
Total	**458,152**	**102,579**	**560,731**

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

The Bank defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors. The Bank aims to achieve an appropriate balance between risk and return and minimise the potential adverse effects of the Bank's financial performance.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The board has established a risk management committee comprising of three non-Executives Directors to assist in the discharge of this responsibility. The board has also established the Bank Asset and Liability (ALCO), Credit and Operational Risk committees, which are responsible for developing and monitoring risk management policies in their specified areas. These committees comprise of executive members and report regularly to the board of Directors on their activities.

The Board provides written principles for overall risk management as well as written policies covering specific risk areas. 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 best market practices. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Board Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. This committee is assisted in these functions by the Internal Audit Function. The Internal Audit Function undertakes reviews of risk management controls and procedures, the results of which are reported to the committee.
The most important type of risks to which the Bank is exposed to are financial risks which include:

a) Credit risk
b) Liquidity risk
c) Market risks

(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. Credit risk arises principally from the Bank's loans and advances to customers and other Banks and investment securities but can also arise from credit enhancement provided such as financial guarantees, letters of credit and acceptances. The Bank is also exposed to other credit risks arising from its trading activities including derivatives.

The Bank enters into derivative transactions in forwards and spot contingents in the foreign exchange deals carried out in the interbank markets. The derivatives are recorded at fair value. Derivatives held for risk management purposes include hedges that are economic hedges, but do not meet the hedge accounting requirements. Most of the trading portfolio is within the Bank's investment banking division (treasury) and is treated as trading risk for risk management purposes.

Credit risk is the single largest risk for the Bank's business and management carefully manages its exposure to credit risk. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure.

For risk management purposes, credit risk arising on trading securities is managed independently, but reported as a component of market risk exposure.

Management of credit risk
The Board of Directors has delegated responsibility for the oversight of credit risk to its Credit and Finance Committee comprising of four non-executive directors. The implementation of the credit risk policies and monitoring of the

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

credit portfolio to ensure that risks are managed within acceptable standards is the responsibility of the credit committee comprising of executive management.

The committee assisted by the credit department is responsible for the management of the Bank's credit risk including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are delegated to the head of credit and the credit committee while larger facilities require approval by the Board of Directors.
- Limiting concentrations of exposure to counterparties, geographies and industries for loans and advances.
- Developing and maintaining the Bank's risk grading in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks.
  The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of eight grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Risk grades are subject to regular reviews by credit department.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to Bank credit committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to branches to promote best practice throughout the Bank in the management of credit risk.

Credit risk measurement
In measuring credit risk of loans and advances to customers, the Bank takes into account the following factors:
- The probability of default: this is the possibility of the customer failure to pay over the stipulated period in the contract.
- Exposure at default: current exposure on the borrower and the likely future development from which the Bank derives the expo sure at default
- Estimated recovery ratio should default occur; this is the amount that can be recovered through sale of collateral

The Bank assesses the probability of default of individual borrowers using internal rating methods tailored to the various categories of the borrower. In assessing the credit quality of the customer the Bank takes into account the customers financial position, past experience and other industry specific factors. The credit risk measurements are embedded in the Bank's daily operational management and closely aligned to the Central Bank of Kenya loan classifications.

Risk limit control and mitigation policies

The Bank structures the level of credit risk it undertakes by placing limits on amounts of risk accepted in relation to one borrower or a group of borrowers. Such risks are monitored on a revolving basis and are subject to annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing limits where appropriate.

The Bank takes security for funds advances and implements guidelines on the acceptability of specific classes of collateral. To minimise credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are identified for the relevant individual loans and advances. Collateral held for other financial assets other than loans and advances depends on the nature of the instrument.

The primary purpose of acceptances, letters of credit and guarantees is to ensure funds are available to a customer as required. Guarantees and standby letters of credit carry the same risk as loans. Documentary and commercial letters of credit which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions are collateralised by the underlying

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

goods to which they relate and therefore carry less risk than a direct loan.

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

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values.

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

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

- The borrower is deceased
- A material decrease in the borrower's turnover, the loss of a major customer or cessation of significant part of operation
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection

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

Treasury Trading and Interbank Relationships
The Bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank's credit risk department analyses publicly available information such as financial information and other external data, e.g., the rating of Good Rating Agency, and assigns the internal rating, as shown in the table below.

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

Maximum exposure to credit risk before collateral held

	2018 Kshs'000	%	2017 Kshs'000	%
Credit Exposures On – balance sheet items				
Cash and balances with the CBK	918,709	7	857,738	6
Government securities	2,190,093	16	2,605,899	19
Balances due from banking institutions	119,420	1	107,453	1
Loans and advances to customers	8,429,659	64	8,421,072	61
	11,657,881	88	11,992,162	87
Off-balance sheet items				
Acceptances and letters of credit	62,292	1	57,601	-
Guarantees	984,621	7	1,079,860	8
Undrawn formal stand-by facilities, credit lines and other commitments to lend	531,333	4	721,000	5
	1,578,247	12	1,858,461	13
At 31 December	**13,245,128**	**100**	**13,850,623**	**100**

The above represents the worst-case scenario of credit exposure for 31 December 2018 and 2017, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures, set out above are based on net carrying amount as reported on the statement of financial position.

Loans and advances to customers comprise of 64% (2017 - 61%) of the total maximum exposure. The fair value of collateral held in respect of assets subject to credit risk as at 31 Decembers 2018 was Kshs. 21,818,102,126 (2017- Kshs 27,948,191,208).

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

(a) Credit risk (Continued)

While collateral is an important mitigant to credit risk, the Bank's policy is to establish that loans are within the capacity of the customer to repay, as the primary way out. The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to Banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

The Bank is confident that its policies and procedures provide sufficient safeguards against exposure on credit risk as shown on the table overleaf.

The table below shows the ECL charges on financial instruments for the year recorded in the income statement:

Credit loss expense	Stage 1		Stage 2		Stage 3	Total
	collective	individual	collective	individual		
Cash and balances with Central Bank of Kenya	-	-	-	-	-	-
Financial investments at amortised cost	-	-	-	-	-	-
Balances due from banking institutions	-	-	-	-	-	-
Loans and advances to customers	3,379	-	-	2,415	362,367	368,162
Total Impairment loss	3,379	-	-	2,415	362,367	368,162

Apart from the loans and receivables to customers all other credit exposures are neither past due nor impaired.

Loans and Advances to customers

Loans and receivables neither past due nor impaired
The Bank classifies loans and advances under this category for those exposures that are up to date and in line with contractual agreements. These exposures will normally be maintained within approved product programs and with no signs of impairment or distress. These exposures are categorised internally as grade 1, that is, normal accounts in line with CBK prudential guidelines and a provision of 1 % is made and appropriated from revenue reserves to statutory reserves.

Loans where the contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank are classified as past due but not impaired. These exposures are graded internally as category 2 that is watch accounts in the Bank's internal credit risk grading system, in line with CBK guidelines

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Loans whose terms have been renegotiated are no longer treated as past due but are reclassified as performing loans. In subsequent years, the renegotiated terms apply in determining whether the asset is considered past due.

Allowances for impairment
The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy
When a loan is uncollectible it is written off against the related provisions for loan impairment. Such loans are written off after all the necessary recovery procedures have been completed and the amount of loan has been determined.

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to Banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

The Bank adopted the rebuttable presumption approach by bucketing performing loans as follows; 0-30 Days - Stage 1, 30-90 Days past due - stage 2, >90 days past due - stage 3 loans. All financial assets are rated as normal on origination. PDs are modelled by segment based on a survival analysis by tracking points of defaults since origination to reporting date.

The table below shows the credit quality and the maximum exposure to credit risk based on the bank's internal credit rating system and year end stage classification. The amounts presented are gross of impairment allowances. Details of the banks internal grading system are disclosed in note 2.1.

	Stage 1 **Kshs '000**	**Stage 2** **Kshs '000**	**Stage 3** **Kshs '000**	**Total 2017** **Kshs '000**
Performing	6,350,665	-	-	6,350,665
Significant increase in credit risk (Standard Grade)	-	808,388	-	808,388
Non-Performing (Credit impaired)	-	-	1,720,171	1,7201,171
	6,350,665	**808,388**	**1,720,171**	**8,8879,224**

An analysis of the changes in the gross carrying amount and the corresponding ECL allowance in relation to loans and advances to customers is as follows

	Stage 1 **Kshs '000**	**Stage 2** **Kshs '000**	**Stage 3** **Kshs '000**	**Total 2017** **Kshs '000**
Gross carrying amount as at 1 January 2018	6,350,665	808,388	1,720,171	9,640,546
New assets originated or purchased (excluding write off)	988,745	111,146	-	1,099,891
Assets derecognised or repaid	(538,836)	(11,967)	(441,451)	(992,254)
Stage 1	376,422	(321,759)	(54,663)	-
Stage 2	(442,323)	647,012	(204,689)	-
Stage 3	(368,923)	(332,443)	701,366	-
Changes to contractual due to modifications not resulting in derecognition	-	-	-	-
Amounts written off	(86)	(28)	(28,086)	(28,200)
Foreign exchange adjustment	-	-	-	-
As at 31 December 2018	**6,365,664**	**900,349**	**1,692,648**	**8,958,661**

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

(a) Credit risk (Continued)

Write-off policy (continued)

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Off-Balance Sheet Kshs '000	Total 2017 Kshs '000
ECL allowance as at 1 January 2018 as per IFRS 9	100,004	18,810	433,901	8,017	560,732
New assets originated or purchased	21,124	1,023	-	13,135	35,282
Assets derecognised or repaid (excluding write off)	(35,210)	-	(18,388)	-	(53,598)
Transfer to stage 1	17,605	(15,781)	(1,824)	-	-
Transfer to stage 2	(9,522)	12,311	(2,789)	-	-
Transfer to stage 3	-	-	-	-	-
impact of year end ECL of exposures transferred between stages during the year	8,083	(3,470)	(4,613)	-	-
Unwind of discount	-	-	-	-	-
Changes to contractual cash flows due to modifications not resulting to derecognition	-	-	-	-	-
Recoveries	-	-	-	-	-
Amounts written off	-	-	(13,414)	-	(13,414)
Foreign exchange adjustment	-	-	-	-	-
As at 31 December 2018	**94,001**	**16,363**	**397,486**	**21,152**	**529,002**

The table below shows the gross balances under IAS 39 as at 31 December 2017 based on the bank's internal credit rating system which is outlined in note 18

Neither past due nor impaired

	High grade	Standard Grade	Sub	Past due but not impaired	Individually impaired	Total
Financial investments Held to maturity	-	-	-	-	-	-
Kenya Government treasury bonds	2,605,899	-	-	-	-	2,605,899
Corporate bonds	-	-	-	-	-	-
Total	**2,605,899**	**-**	**-**	**-**	**-**	**2,605,899**

5. RISK MANAGEMENT OBJECTIVES AND POLICIES RISK

RISK (Continued)

(a) Credit risk (Continued)

Classification of loans and receivables

An analysis of the allowance for impairment losses under IAS 39 for loans and advances by class for the year to 31 December 2017 is as follows

The table below classifies the loans and advances by sector and the overall allowance on impairment

	2018 Kshs'000	2017 Kshs'000
Agriculture	105,327	98,453
Building and Construction	894,211	860,470
Energy and water	27,415	16,858
Financial services	134,031	141,732
Manufacturing	105,614	183,926
Mining and Quarrying	76,365	59,324
Personal house hold	939,306	951,669
Real Estate	1,667,227	1,709,827
Tourism Restaurant and Hotel	282,013	309,362
Trade	3,869,135	3,460,396
Transport and communication	858,017	1,087,207
	8,958,661	8,879,224
Less: Allowance for ECL/impairment	(529,002)	(458,152)
Total	**8,429,659**	**8,421,072**
Loan and commitments		
Guarantees	984,621	1,079,860
Letters of Credits (Imports/Outward)	97,743	104,800
	1,082,364	1,184,660
Less: Allowance for ECL/impairment	(22,079)	-
Total	**1,060,285**	**1,184,660**

Financial investments at amortized cost

The table below summarizes the credit quality, the maximum exposures to credit risk based on the bank's internal credit risk rating system and year end stage classification. The amounts presented are gross of impairment allowance. Details of the bank internal grading system and policies on whether ECL allowances are calculated on an individual or collective basis are explained in note 2.1.

Internal rating grade	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Total Kshs '000
Performing				
High Grade	2,190,093	-	-	2,190,093
Standard Grade	-	-	-	-
Sub-standard grade	-	-	-	-
Past due but not impaired	-	-	-	-
Non-performing				-
Individually impaired	-	-	-	-
Total	**2,190,093**	**-**	**-**	**2,190,093**

An analysis of the changes in the gross carrying amount and the corresponding ECL is as follows

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Total Kshs '000
Gross carrying amount as at 1 January 2018	2,605,899	-	-	2,605,899
New assets purchased	-	-	-	
Assets derecognised or matured	(415,806)	-	-	(415,806)
Stage 1	-	-	-	-
Stage 2	-	-	-	-
Stage 3	-	-	-	-
Changes due to modifications not derecognised	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustment	-	-	-	-
At 31 December 2018	**2,190,093**	**-**	**-**	**2,190,093**

ECL Financial investment at amortized cost

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs'000	Total
ECL as at 1 January 2018	-	-	-	-
New assets purchased	-	-	-	-
Assets derecognised matured (excluding write offs)	-	-	-	-
Transfer to stage 1	-	-	-	-
Transfer to stage 2	-	-	-	-
Transfer to stage 3	-	-	-	-
Impact on year end ECL of exposures transferred between stage	-	-	-	-
Impact of net remeasurement of year end ECL	-			-
Changes due to modifications not resulting in derecognition	-	-	-	-
Changes to models and input used for ECL calculation note	-	-	-	-
Recoveries	-	-	-	-
Foreign exchange adjustment	-	-	-	-
As at 31 December 2018	**-**	**-**	**-**	**-**

NB. The ECL relating to government securities rounds to zero

Dues from other banking institutions

The table below shows the credit quality and the maximum exposure to credit risk based on the bank's internal credit rating system and year end classification. The amounts are gross of impairment allowances. Details of the bank's internal credit grading system are explained in note 21.

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 2 Kshs '000	Total 2017 Kshs '000
Internal Rating	107,453	-	-	107,453
Performing high grade	-	-	-	-
Standard grade	-	-	-	-
Substandard grade	-	-	-	-
Past due but not impaired	-	-	-	-
Non-performing	-	-	-	-
Total	**107,453**	**-**	**-**	**107,453**

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

	Stage 1 Kshs	Stage 2 Kshs	Stage 3 Kshs	Total Kshs
Gross Carrying amount 1 January 2018	107,453	-	-	107,453
New assets originated	17,931	-	-	17,931
Assets derecognised or repaid (Excluding write offs)	(5,904)	-	-	(5,904)
Transfer stage 1		-	-	-
Transfer stage 2	-	-	-	-
Transfer stage 3	-	-	-	-
Changes to contractual cashflows due to modification not resulting to derecognition	-	-	-	-
Amount written off	-	-	-	-
Foreign currency adjustment	-	-	-	-
As at 31 December 2018	**119,480**	**-**	**-**	**119,480**

Corresponding ECL for dues from banking institutions

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '002	Total Kshs '000
ECL allowance as at 1 January 2018	54	-	-	54
Assets derecognised or repaid (Excluding write offs)	(48)	-	-	(48)
Transfer stage 1	-	-	-	-
Transfer stage 2	-	-	-	-
Transfer stage 3	-	-	-	-
Impact on year end ECL of exposures transferred between stages during the year	-	-	-	-
Changes to contractual cash flows due to modification not resulting to derecognition	-	-	-	-
Recoveries	-	-	-	-
Amount written off	-	-	-	-
Foreign currency adjustment	-	-	-	-
As at 31 December 2018	**6**	**-**	**-**	**6**

Letters of credit and guarantees

Letters of credit and guarantees (including standby letters of credit commit the bank to make payments in the event of a specific act generally to the import or export of goods. Guarantees and standby letters of credit carry a similar credit risk to loans. The nominal values of such commitments are listed below;

	2018 Kshs	2017 Kshs
Financial guarantees	984,621	1,079,860
Letters of credit	62,292	57,601
Other undrawn commitments	65,824	55,884
Total	**1,112,737**	**1,193,345**

The table below shows the credit quality and the maximum exposures to credit risk based on the bank's internal credit risk internal credit rating system and year end classification. Details of the bank internal grading system and policies on whether ECL are calculated in an individual or collective basis are explained in note 2.1.

Performing	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Total Kshs '000
Standard Grade	172,782	-	-	172,782
Past due but not impaired (Significant increase in credit risk)	-	592,472	-	592,472
Non-performing	-	-	-	-
Individually impaired	-	-	347,483	347,483
Total	**172,782**	**592,472**	**347,483**	**1,112,737**

An analysis of the outstanding exposures and the corresponding ECLs are as follows

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Total Kshs '000
Outstanding exposure as at 1 January 2018	1,412	165,422	42,203	207,872
New exposures	197,509	427,049	305,279	758,468
Exposures derecognised or matured/ lapsed (excluding write off)	(26,139)	(784,230)	(200,076)	(1,010,445)
Transfers to stage 1	-	-	-	-
Transfers to stage 2	-	-	-	-
Transfers to stage 3	-	-	-	-
Changes due to modifications not resulting in derecognition	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
As at 31 December 2018	**172,782**	**592,471**	**347,484**	**1,112,737**

The corresponding ECL

	Stage 1 Kshs '000	Stage 2 Kshs '000	Stage 3 Kshs '000	Total Kshs '000
ECL as at 1 January 2018	-	4,070	3,947	8,017
New exposures	1	3,069	10,065	13,135
Exposures derecognised or matured (excluding write offs)	-	-	-	-
Transfers to stage 1	-	-	-	-
Transfers to stage 2	-	-	-	-
Transfers to stage 3	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
As at 31 December 2018	**1**	**7,139**	**14,012**	**21,152**

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

	Loans and advances to customers	
	2018 Kshs'000	2017 Kshs'000
Against individually impaired financial assets	3,778,736	3,919,728
Against collectively impaired financial assets	2,196,826	1,784,219
Total	**5,975,562**	**5,703,947**

Settlement risk

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

Settlement limits form part of the credit approval/limit monitoring process described earlier. Acceptance of settlement risk on free settlement trade requires transaction specific or counterparty specific approvals from the Bank's Credit Committee.

Concentration of risk

Details of significant concentrations of the Bank's assets, liabilities and off-balance sheet items by industry groups are as detailed below:

	2018		2017	
	Kshs'000	%	Kshs'000	%
(i) Advances to customers- gross				
Manufacturing	179,173	2	177,584	2
Wholesale and retail	4,120,984	46	4,084,443	46
Transport and communication	806,279	9	799,130	9
Agricultural	89,587	1	88,792	1
Business services	268,760	3	266,377	3
Real estate	2,239,665	25	2,219,806	25
Other	1,254,213	14	1,243,091	14
	8,958,661	**100**	**9,640,567**	**100**
(ii) Customer deposits				
Central and local Government	508,903	6	304,735	3
Non-financial public enterprises	17,568	-	81,238	1
Co-operative societies	578,191	7	302,800	4
Insurance companies	7,073	-	9,845	-
Private enterprises and individuals	7,476,523	87	7,944,758	92
Non-profit institutions	286	-	2,929	-
	8,588,544	**100**	**8,646,305**	**100**
(iii) Off balance sheet items				
(Letters of credit and guarantees)				
Manufacturing	3,378	0.33	15,267	1
Wholesale and retail	755,605	66	772,619	62
Transport and communication	4,579	0.4	4,060	-
Business services	374,024	32.7	435,020	35
Other	6,869	0.6	15,295	1
	1,144,856	**100**	**1,242,261**	**100**

(b) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments or other cash outflows.

Management of liquidity risk

The Bank's liquidity risk management is carried out within the Bank and monitored by the Asset Liability committee (ALCO).

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

Liquidity risk is addressed through the following measures:

- The treasury department monitors liquidity ratios on a daily basis against internal and regulatory requirements
- Day to day funding is managed by monitoring future cash flows to ensure that requirements can be met. These include replenishment of funds as they mature or are borrowed by customers.
- The Bank invests in short term liquid instruments which can easily be sold in the market when the need arises.
- The Bank enters into lending contracts subject to availability of funds.
- The Bank has an aggressive strategy aimed at increasing the customer deposit base.
- The Bank borrows from the market through interbank transactions with other Banks and the Central Bank of Kenya for short term liquidity requirements.
- Investments in property and equipment are properly budgeted for and done when the Bank has sufficient cash flows.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the board. Daily reports covering the liquidity position of the Bank are regularly submitted to Asset and Liability Committee.

Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from Banks, debt securities issued, other borrowings and commitments maturing within the next month. The Central Bank of Kenya minimum liquidity ratio is 20%. Details of the reported Bank ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

	2018	2017
At 31 December	22%	22%
Average for the period	23%	27%
Maximum for the period	28%	30%
Minimum for the period	20%	22%

Liquidity risk based on discounted cash flows

The table below analyses the cash flows payable by the Bank under non-derivative financial liabilities by remaining contractual maturities and non-derivative financial assets by expected maturity dates as at the date of the statement of financial position.

AT 31 DECEMBER 2018	Up to 1 month Kshs'000	1 – 3 months Kshs'000	4 - 12 months Kshs'000	1 - 5 Years Kshs'000	Total Kshs'000
FINANCIAL ASSETS					
Cash and balances with the CBK	650,077	234,734	33,898	-	918,709
Balances due from banking institutions	119,420	-	-	-	119,420
Equity instruments at fair value through other comprehensive income	-	-	-	6,727	6,727
Government securities	-	129,195	80,126	2,155,948	2,365,269
Loans and advances to customers	2,327,780	175,491	361,533	7,572,334	10,437,138
Total financial assets	**3,097,277**	**539,420**	**475,557**	**9,735,009**	**13,847,263**
FINANCIAL LIABILITIES					
Balance due to Central Bank of Kenya	1,120,000	-	-	-	1,120,000
Deposits and balances due to banking institutions	235,751	-	-	-	235,751
Customer deposits	4,648,473	3,827,419	483,625	-	8,959,517
Borrowed funds	84,006	-	1,639,197	118,323	1,841,526
Total financial liabilities	**6,088,230**	**3,827,419**	**2,122,822**	**118,323**	**12,156,794**
Net liquidity gap	(2,990,953)	(3,287,999)	(1,647,265)	9,616,686	1,690,469
AT 31 DECEMBER 2017					
Total financial assets	**3,176,767**	**485,576**	**463,447**	**9,068,967**	**13,194,757**
Total financial liabilities	**7,579,341**	**3,054,646**	**293,096**	**1,918,566**	**12,845,649**
Net liquidity gap	**(4,402,574)**	**(2,569,070)**	**170,351**	**7,150,401**	**349,109**

The above table shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately. The table below shows maturity analysis for the loans and commitments (off-balance sheet commitments).

AT 31 DECEMBER 2018	Up to 1 month Kshs'000	1-3 months Kshs'000	4-12 months Kshs'000	1-5 Years Kshs'000	Total Kshs'000
Guarantees	128,048	280,190	516,664	59,719	984,621
Acceptances and letters of credit	15,299	36,252	10,741	-	62,292
Undrawn formal stand-by facilities, credit lines and other commitments to lend	597,157	-	-	-	597,157
Total	**740,504**	**316,442**	**527,405**	**59,719**	**1,644,070**

(c) Market risks

Market risk is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk arise from open positions in interest rates, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, equity prices, foreign exchange rates and credit spreads. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

The Bank separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with clients or with the market. Non-trading portfolios mainly arise from the interest rate management of the entity's retail and commercial Banking assets and liabilities.

Management of market risks

Overall responsibility of managing market risk rests with the Asset and Liability Committee (ALCO). The Treasury department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken which is monitored daily.

Exposure to interest rate risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The ALCO is the monitoring body for compliance with these limits and is assisted by Treasury Department in its day-to-day monitoring activities. Other assets are settled no more than 12 months after the reporting date. All the balances are interest bearing.

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

AS AT 31 December 2018	Up to 1 month Kshs'000	1 – 3 months Kshs'000	4 - 12 months Kshs'000	1 - 5 Years Kshs'000	Non-interest bearing Kshs'000	Total Kshs'000
FINANCIAL ASSETS						
Cash and balances with the CBK	-	-	-	-	918,709	918,709
Balances due from other banking institutions	119,420	-	-	-	-	119,420
Government securities	-	129,195	77,849	1,983,049	-	2,190,093
Loans and advances to customers	8,429,659	-	-	-	-	8,429,659
Total financial assets	**8,549,079**	**129,195**	**77,849**	**1,983,049**	**918,709**	**11,657,881**

	Up to 1 month Kshs'000	1 – 3 months Kshs'000	4 - 12 months Kshs'000	1 - 5 Years Kshs'000	Non-interest bearing Kshs'000	Total Kshs'000
FINANCIAL LIABILITIES						
Balance due to Central Bank of Kenya	1,120,000	-	-	-	-	1,120,000
Deposits and balances due to banking institutions	235,751	-	-	-	-	235,751
Customer deposits	1,610,214	3,612,134	449,466	-	2,916,730	8,588,544
Borrowed funds	84,006	22,696	1,625,618	-	-	1,732,320
Total financial liabilities	**3,049,971**	**3,634,830**	**2,075,084**	**-**	**2,916,730**	**11,676,615**
Interest rate sensitivity gap	**5,499,108**	**(3,505,635)**	**(1,997,235)**	**1,983,049**	**(1,998,021)**	**(18,734)**

Management of market risks

Interest rate/equity price volatility

Volatility measures the expected future variability of a market price. It is generally quoted as a percentage; a higher number represents a more volatile instrument, for which larger swings in price (or interest rate) are expected. Volatility is a key input in option-based models and is used to estimate the future prices for the underlying instrument (e.g., equity or interest rate). Volatility varies per instrument and in time and therefore, it is not viable to make reliable and meaningful general statements about volatility levels.

Certain volatilities, generally those relating to longer-term maturities are unobservable and are estimated by the Bank.

Sensitivity analysis on interest rates

An increase of 1 percentage point in interest rates for the period would have increased/ (decreased) profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. This analysis is performed on the same basis for 2017.

	Profit or loss		Equity	
	2018	2017	2018	2017
	KShs'000	KShs'000	KShs'000	KShs'000
Interest income	83,991	87,967	58,794	61,577
Interest expense	(73,784)	(75,595)	(51,649)	(52,916)
Net change in interest	**10,207**	**12,373**	**7,145**	**8,661**

A decrease of 1 percentage point in interest rates for the period would have had an equal but opposite effect on the profit or loss and equity, on the basis that all other variables remain constant.

Recovery rates
Recovery rates reflect the estimated loss that the Bank will suffer given expected defaults. The recovery rate is given as a percentage and reflects the opposite of loss severity (i.e., 100% recovery reflects 0% loss severity).

In line with general market convention, loss severity is applied to asset-backed securities while recovery rate is more often used as pricing input for corporate or government instruments. Higher loss severity levels / lower recovery rates indicate lower expected cash flows upon the default of the instruments. Recovery rates for complex, less liquid instruments are usually unobservable and are estimated based on historical data. Currently, the Bank has no such investments.

Currency risk

The bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cashflows. The board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions which are monitored daily.

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

AS AT 31 DECEMBER 2018	KSHS Kshs'000	USD Kshs'000	GBP Kshs'000	EURO Kshs'000	OTHERS Kshs'000	TOTAL Kshs'000
FINANCIAL ASSETS						
Cash and balances with Central Bank of Kenya	873,018	31,949	8,164	4,544	1,034	918,709
Balances due from Banking institutions	-	100,027	1,893	16,146	1,354	119,420
Government securities	2,190,093	-	-	-	-	2,190,093
Loans and advances to customers	8,321,564	108,095	-	-	-	8,429,659
Total financial assets	**11,384,675**	**240,071**	**10,057**	**20,688**	**2,389**	**11,657,881**
FINANCIAL LIABILITIES						
Balance due to Central Bank of Kenya	1,120,000	-	-	-	-	1,120,000
Deposits and balances due to banking institutions	235,340	-	-	-	-	235,340
Customer deposits	8,459,180	106,882	7,678	14,804	-	8,588,544
Borrowed funds	1,605,007	-	-	127,313	-	1,732,320
Total financial liabilities	**11,419,527**	**106,882**	**7,678**	**142,117**	**-**	**11,676,204**
NET ON BALANCE SHEET POSITION	(34,852)	133,189	2,379	(121,428)	2,389	(18,323)
NET OFF BALANCE SHEET POSITION	947,536	137,679	-	13,303	46,138	1,144,656
AT 31 DECEMBER 2017						
Total financial assets	**11,722,740**	**246,264**	**4,178**	**15,138**	**3,842**	**11,992,162**
Total financial liabilities	**11,824,135**	**142,567**	**6,404**	**172,964**	**-**	**12,146,070**
NET ON BALANCE SHEET POSITION	(101,395)	103,697	(2,226)	(157,806)	3,842	(153,888)
NET OFF BALANCE SHEET POSITION	1,055,182	78,308	-	3,250	720	1,137,460

Market risks - sensitivity analysis

A principal part of the Bank's management of market risk is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling) and the sensitivity of future earnings and capital to varying foreign exchange rates. Stress tests provide an indication of the potential size of losses that could arise in extreme conditions. Consolidated Bank aims, through its management of market risk, to mitigate the impact of prospective interest rate movements and foreign exchange fluctuations which could reduce future earnings and capital.

For simulation modelling, the Bank uses a combination of scenarios relevant to local businesses and local markets. These scenarios are used to illustrate the effect on the Bank's earnings and capital.

Interest rate risks – increase/decrease of 10% in net interest margin

The Interest rate risks sensitivity analysis is based on the following assumptions.

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

The analysis below sets out the impact on future net interest income of an incremental 10% parallel fall or rise in all yield curves as at 31 December 2018.

Assuming no management actions, a series of such appreciation would increase net interest income for 2018 by Kshs 64,301,000 (2017 - Kshs 49,400,000), while a series of such falls would decrease net interest income for 2018 by Kshs 64,301,000 (2017 -Kshs 49,400,000). Also a series of such rises would increase the adjusted core capital to RWA and Adjusted total capital to RWA by 0.7% (2017: 0.4%) and 0.7% (2017: 0.4%) respectively, while a series of such falls would decrease the adjusted core capital to RWA and Adjusted total capital to RWA by 0.4% (2017: 0.4%) and 0.4% (2017: 0.4%) respectively.

Foreign exchange risks – appreciation/depreciation of Kshs against other currencies by 10%

The Foreign Exchange Risks sensitivity analysis is based on the following assumptions:

- Foreign exchange exposures represent net currency positions of all currencies other than Kenya shillings.
- The Currency Risk sensitivity analysis is based on the assumption that all currency positions are highly effective.
- The Base currency in which the Bank's business is transacted is Kenya shillings.

The table below sets out the impact on future earnings of an incremental 10% parallel fall or rise in all foreign currencies as at 31 December 2018.

Assuming no management actions, a series of such rise and fall would impact the future earnings and capital as illustrated in the table overleaf:

Market risk- sensitivity analysis(Continued)

	Amount 31 December 2018 Kshs'000	Scenario 1 10% appreciation Kshs'000	Scenario 2 10% Depreciation Kshs'000
Loss before taxation	(351,567)	(349,423)	(353,711)
Adjusted Core Capital	80,336	82,480	78,192
Adjusted Total Capital	312,064	314,208	309,921
Risk Weighted Assets (RWA)	11,128,071	11,128,071	11,128,071
Adjusted Core Capital to RWA	0.9%	0.9%	0.9%
Adjusted total Capital to RWA	2.8%	2.8%	2.8%

Assuming no management actions, a series of such appreciation would increase earnings for 2018 by Kshs. 2,144,000 (2017 - Kshs 2,843,000), while a series of such falls would decrease earning for 2018 by Kshs. 2,144,000 (2017 – Kshs 2,843,000).

Also, a series of such rises would increase the adjusted core capital to RWA and Adjusted total capital to RWA by,0.0 % (2017 - 0.0%) and 0.0% (2017 - 0.1 %) respectively, while a series of such falls would decrease the adjusted core capital to RWA and Adjusted total capital to RWA byo.0% (2017 - 0.1%) and 0.0% (2017 - 0%) respectively.

The impact of the increase or decrease is not significant.

Non-financial risk management disclosures:

a) Strategic risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of organization's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation.

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

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

The Board of Directors is ultimately responsible for the overall generation and implementation of the Bank's strategy for purposes of enhancing shareholders' value. It has however delegated the implementation aspects to the Chief Executive Officer and the Senior Management team. The Board of Directors, with support of the Chief Executive Officer Senior Management, develops and implements a new strategic cycle every 5 years to cater for the next growth phase of the Bank.

The Chief Executive Officer supported by the (Executive Committee) EXCOM is responsible for the execution of the approved strategic objectives on a day to day basis and actively monitors business performance against these objectives through periodic reviews. The business carries out business performance reviews periodically but at a minimum on a monthly basis against pre-determined milestones and key performance indicators. The reviews are reported to the Board of Directors for information and advice, or action where significant deviations occur. These reports include identifying the key risks faced by the Bank and how they are being managed.

(a) Strategic risk(Continued)

Each business head is responsible for ensuring that strategic initiatives are aligned to the overall strategy of the Bank and supported by the relevant and appropriate operating policies and programs that direct behaviour. They are also responsible for monitoring, managing and reporting on the effectiveness and risks of their business' strategic objectives, and the progress they have made towards achieving these. They oversee the direction and trends of significant current and emerging risks related to their business units and that mitigating actions are taken where appropriate.

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

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

Non-financial risk management disclosures:

b) Operational risk

Operational Risk is "the risk that the Bank will incur direct or indirect loss due to an event or action causing the failure of technology, processes, infrastructure, personnel, and other risks having an operational impact". The impact of these risks can result in significant financial loss, reputational harm or regulatory censure and penalties.

The major operational risks faced by the Bank include:

- People and related issues such as staff retention, frauds, amongst others.
- Systems and processes changes related to the drive to meet our clients' needs.

The Board of Directors takes the lead in establishing the "tone at the top" which promotes a strong risk management culture. The Bank has also put in place a corporate culture that is guided by strong risk management and that supports and provides appropriate standards and incentives for professional and responsible behaviour.

All members of staff are responsible for the management and mitigation of Operational risks. This is reflected in the continuous control environment, risk awareness and management style. Specific roles or responsibilities are assigned for leading and managing the internal control environment through the following people:

- Board and CEO;
- Audit Committee;
- Internal Audit Department;
- Board Risk Management Committee;
- Risk Management Committee;
- Risk & Compliance Department;
- Business Operational Risk functions in corporate, Retail and SME ;
- Information Technology (IT) Steering Committee; and
- Business Heads and Operations Head.

Internal Audit is responsible for assessing compliance with operational risk policy and for reporting significant issues to the Board Audit Committee and the Board of Directors.

The Bank seeks to minimize actual or potential losses arising from Operational Risk failures. These include inadequately defined procedures or policies, systems failure, internal control flaws or breaches, insufficiently skilled staff, unmanageable events or customer actions. To achieve this, the Bank ensures:

- Robust operational risk policy and procedures that reflects industry practice are put in place and operationalized. These include toolkits to help identify, assess, control, manage and report on key Operational Risks. Toolkits in the Operational Risk Procedures manual include inter alia:

    i) Framework for the Bank, businesses, and support functions to identify their major operational risks and mitigation plans;
    ii) Key control standards;

Non-Financial Risk Management disclosures:

b) Operational risk (Continued)

iii) Indicators to identify Operational Risk; and

iv) Incident and issues tracking mechanisms to identify causal factors and operational losses:

- All staff in business and support functions, are aware of their responsibilities for Operational Risk Management.
- Potential Operational Risk impact of Bank activities and products are considered at their outset with a view to minimizing these as far as possible.
- There are structured processes to report control failures to designated individuals and escalate material issues to Risk Management Committee, Executive Committee (EXCOM) and Board Risk Management Committee as appropriate.
- Employees are given Operational Risk training appropriate to their roles.
- Employee and Bank assets are adequately protected.
- Workable Business Continuity Plans are established (including Disaster Recovery and Crisis Management procedures) to minimize the impact of unplanned events on business operations and customer service.
- The financial impact of operational losses is mitigated through the utilization of insurance or other risk transfer mechanisms where appropriate.

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

Compliance risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility of incorrect interpretation of effective laws or regulations.

The Bank is committed to ensuring that its business activities are conducted in accordance with applicable laws and regulations, internal rules, policies and procedures, and ethical standards ("compliance laws, rules and standards"). The Bank has established appropriate policies, procedures and controls that will ensure effective compliance with laws, regulations and codes relevant to its businesses, customers and staff.

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

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

d) Reputational risk

Reputational risk is the potential that negative stakeholder impressions or perceptions, whether true or not, regarding the Bank's business practices, actions or inactions, will or may cause a decline in customer base, liquidity, and overall brand value. It is a resultant effect of all other risks highlighted in this report and therefore cannot be managed in isolation. Therefore, when all the other risks are managed well, this risk is substantially minimised.

The Bank's reputation is an invaluable and fragile asset that is broad and far reaching and includes image, goodwill and brand equity. Reputational risk management supports value creation and seeks to deal effectively with potential future events that create uncertainty.

(d) Reputational Risk(Continued)

Ultimate responsibility for this risk rests with the Board of Directors and Senior Management who examine the Bank's reputational risk as part of their regular mandate. They are assisted in this aspect by the Corporate Communications Department. Their purpose is to ensure that all products, services, and activities meet the Bank's reputational risk objectives in line with the Board of Director's approved appetite. The Bank's reputational risk strategy however cascades into the other Bank's policies procedures each level of management is responsible for the appropriateness of policies, processes and controls within its purview.

Senior Management and the Board of Directors receive periodic reports on the assessment of the Bank's reputational risk exposures that arise from its business activities so as to form a view on associated risks and implement corrective actions.

FINANCIAL ASSETS AT THROUGH OTHER COMPREHENSIVE INCOME

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1: fair value through OCI measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Financial assets held for trading:

		Level 1	Level 2	Level 3	Total
31 December 2018					
	Note	Kshs'000	Kshs'000	Kshs'000	Kshs'000
Quoted investments		6,727	-	-	6,727
31 December 2017					
Quoted investments		7,139	-	-	7,139

FINANCIAL ASSETS AT THROUGH OTHER COMPREHENSIVE INCOME (Continued)

The above were valued at quoted bid prices in an active market (Nairobi Securities Exchange).

Except as detailed above, the Directors consider that the carrying amounts of financial assets and financial liabilities recognised in the statement of financial position approximate their fair values.

This note provides information about how the Bank determines fair values of various financial assets and financial liabilities.

Fair value of the Bank's financial assets and liabilities that are measured at fair value on a recurrent basis.

Some of the Bank's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used):

Financial assets	Fair value as at		Fair value hierarchy	Valuation technique(s) and key inputs	Significant unobservable inputs	Relationship of unobservable inputs to fair value
	31/12/18 Kshs '000	31/12/17 Kshs'000				
Quoted investments	6,727	7,139	Level 1	Quoted bid prices in an active market	N/A	N/A

There were no transfers between levels 1, 2 and 3 in the period (2017: none).

6. CAPITAL MANAGEMENT

Regulatory capital

The Banks objectives when managing capital are:

- To safeguard the Banks' ability to continue as a going concern so that it can continue to provide returns for the shareholders and benefits for the other stakeholders.
- To maintain a strong capital base to support the current and future development needs of the business.
- To comply with the capital requirements set by the Central Bank of Kenya.

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

The Central Bank of Kenya requires each Bank to:

a) Hold the minimum level of regulatory capital of Kshs 1 billion.
b) Maintain a ratio of total regulatory capital; to risk weighted assets plus risk weighted off balance assets at above the required minimum of 10.5%;
c) Maintain a core capital of not less than 10.5% of total deposit liabilities; and
d) Maintain total capital of not less than 14.5% of risk weighted assets plus risk weighted off balance sheet items.

The Bank had not complied with the above requirement as at 31 December 2018 and 31 December 2017

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

- Tier 1 capital, which includes ordinary share capital, non-cumulative irredeemable non-convertible preference shares, disclosed reserves such as share premiums, retained earnings, and 50% un-audited after tax profit less investment in subsidiaries conducting banking business, investments in equity of other institutions, intangible assets (excluding computer software) and goodwill.

- Tier 2 capital, which includes 25% revaluation surplus which have received prior CBK approval, subordinated debt, hybrid capital instruments or any other capital instruments approved by CBK.

The Bank's regulatory capital position at 31 December 2018 and 31 December 2017 was as follows:

	2018 Kshs'000	2017 Kshs'000
Tier 1 capital		
Ordinary share capital	1,398,400	898,400
Non-cumulative irredeemable shares	721,130	721,130
Share capital	2,119,530	1,619,530
Accumulated deficit	(2,061,222)	(1,265,665)
Total	58,308	353,865
Tier 2 capital		
Revaluation reserves (25%)	58,308	94,783
General loan loss provision-statutory reserve	-	146,112
(Maximum of 1.25% of RWA)	-	-
Total	**58,308**	**240,895**
Total regulatory capital	**116,616**	**594,760**
Risk-weighted assets	11,107,327	11,685,595
Capital ratios:		
Total regulatory capital expressed as a percentage of		
Total risk-weighted assets (CBK minimum 14.5%)	1.05%	5.09%
Total tier 1 capital expressed as a percentage of		
risk-weighted assets (CBK minimum 10.5%)	0.52%	3.03%

	2018 Kshs'000	2017 Kshs'000
7. INTEREST INCOME		
Interest on loans and advances	1,223,220	1,115,343
Interest on Bank placements	1,654	10,036
Interest on government securities - Held to maturity	176,592	219,274
	1,401,466	**1,344,653**
8. INTEREST EXPENSE		
Interest on customer deposits	430,192	513,196
Interest on inter-bank borrowings	2,849	3,040
Interest on Central Bank of Kenya Repos	105,866	101,553
Interest on borrowed funds	219,551	228,424
	758,458	**846,213**
9. FEE AND COMMISSION INCOME		
Ledger related fees and commissions	41,234	42,472
Credit related fees and commissions	162,909	163,370
Transaction related fees	94,149	117,808
	298,292	**323,650**
10. FOREIGN EXCHANGE TRADING INCOME		
Foreign exchange net income includes gains and losses from spot and forward contracts and translated foreign currency assets and liabilities.		
Gains on foreign exchange trading	25,278	31,627
Losses on foreign exchange trading	(3,842)	(3,194)
	21,436	**28,433**

	2018 Kshs'000	2017 Kshs'000
11. OTHER OPERATING INCOME		
Recoveries on loans and advances	372,335	350,302
Gain on disposal of property and equipment	40	17
Sundry income*	122	1,440
	442,044	**425,737**

** relate to income on sale of tenders.*

	2018 Kshs'000	2017 Kshs'000
12. OPERATING EXPENSES		
Staff costs (note 13),	740,346	719,588
Directors' emoluments - Fees	5,048	4,824
- Other	21,980	21,580
Depreciation - Current year (note 23)	50,348	80,569
Amortisation of intangible assets (note 24)	89,935	77,553
Amortisation of operating lease (note 25)	170	170
Contribution to Kenya Deposit Insurance Corporation	13,612	14,214
Auditors' remuneration-Current year	5,577	4,834
-Prior year under provision	-	3,147
Other operating expenses	461,163	393,324
	1,388,179	**1,319,803**
13. STAFF COSTS		
Salaries and wages	621,496	598,311
Training, recruitment and staff welfare costs	23,752	26,919
Pension contributions	39,739	39,968
Medical expenses	43,929	44,021
Leave pay provision	356	(695)
Staff insurance	5,090	6,186
Gratuity provision	5,326	4,200
NSSF contributions	658	678
	740,346	**719,588**
14. INCOME TAX		
a) Taxation charge/(credit)		
Current tax based on the taxable profit for the year at 30%	15,892	15,202
Deferred tax credit (note 28)	-	(116,728)
Prior year over provision- current taxation	(724)	(1,426)

	2018 Kshs'000	2017 Kshs'000
	-	63
Prior year overprovision - deferred taxation		
Derecognition of prior year deferred tax	173,299	-
	188,467	**(102,889)**
Reconciliation of expected tax based on accounting loss		
to tax charge		
b) Loss before taxation	(351,567)	377,682
Tax calculated at a tax rate of 30%	(105,470)	(113,305)
Tax effect of expenses not deductible for tax purposes	22,063	13,579
Non-taxable income	(11,699)	(1,800)
Prior year over provision- current taxation	(724)	(1,426)
Prior year under provision- deferred taxation	-	63
Current year's deferred tax not recognised	110,998	-
Prior year deferred tax derecognition	173,299	-
	188,467	**(102,889)**

	2018 Kshs'000	2017 Kshs'000
c) Taxation recoverable/(payable)		
At 1 January	6,022	(2,029)
Charge for the year	(15,892)	(15,202)
Prior year under provision	724	1,426
Tax paid during the year	11,955	21,827
At 31 December	**2,809**	**6,022**

15. LOSS PER SHARE

Loss per share is calculated by dividing the net loss attributable to shareholders by the number of ordinary shares in issue during the year.

	2018 Kshs'000	2017 Kshs'000
Loss for the year (Kshs'000)	(540,034)	(335,681)
Number of ordinary shares (number in thousands)	69,920	44,920
Loss per share		
Basic and diluted (Kshs)	(7.72)	(7.38)

There were no potentially dilutive shares outstanding as at 31 December 2018 and 31 December 2017, respectively. Diluted earnings per share are therefore the same as basic earnings per share.

16. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

Cash in hand	372,065	276,107
Balances with Central Bank of Kenya:		
- Cash ratio reserve	535,597	497,143
- Other balances (available for use by the Bank)	11,047	84,488
	918,709	**857,738**

Cash in hand and balances with Central Bank of Kenya are non-interest bearing. The cash ratio reserve is based on the value of customer deposits as adjusted by the Central Bank of Kenya requirements. As at 31 December 2018 the cash ratio reserve requirement was 5.25% (2017 – 5.25%) of all customer deposits held by the Bank. These funds are not available to finance the Bank's day to day operations.

17. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2018 Kshs'000	2017 Kshs'000
a) Balances due from banking institutions maturing within 90 days:		
Balances with correspondent banks	79,570	39,599
Balances with local banks	39,910	67,854
	119,480	**107,453**
Impact of adopting IFRS 9	54	-
Increase in allowance for impairment	6	-
Allowance for impairment as at 31 December	60	
Net carrying value	119,420	107,453
	-	
b) Balances due to banking institutions maturing within 90 days:	235,751	208,561
c) Balances due to Central Bank of Kenya maturing within 90 days:		
Borrowing from Central Bank of Kenya	1,120,000	1,484,201

Deposits with/from local banks as at 31 December 2018 represent overnight lending. The effective interest rate on deposits due from and due to local banking institutions at 31 December 2018 was 7% (2017 – 10.17%) and nil (2017–nil) for balances with correspondent banks.

The borrowings from Central Bank of Kenya was a REPO:

- Tenure: The period of the borrowings was 1 month from 13 December 2018 to 10 January 2019-560,000,000, 14 December 2018 to 11 January 2019-320,000,000 and 20 December 2017 to 10 January 2018-240,000,000.
- Interest rate: the borrowing attracted an interest rate of 9%.
- Security: pledge of the Banks only a portion of the Treasury Bonds whose fair value was Kshs 1,400,000,000.

18.	FINANCIAL ASSETS AT AMORTISED COST	2018 Kshs'000	2017 Kshs'000
	GOVERNMENT SECURITIES		
	Kenya Government Treasury bonds – at amortised cost	2,190,093	-
	Kenya Government Treasury bonds – Held to Maturity	-	2,605,899
		2,190,093	**2,605,899**

	2018 Kshs'000	2017 Kshs'000
The maturity profile of government securities is as follows:		
Less than 1 year	203,044	144,996
3 years to 5 years	579,694	747,831
Over 5 years	1,407,355	1,713,072
	2,190,093	**2,605,899**

The weighted average effective interest rate on treasury bonds was 8.5% (2017 –8.9%). As at 31 December 2018 treasury bonds with a fair value of Kshs 1,400,000,000 (201–1,725,000,000) had been pledged to secure borrowings from Central Bank of Kenya.

19.	LOANS AND ADVANCES TO CUSTOMERS	2018 Kshs'000	2017 Kshs'000
	a) Commercial loans	4,407,379	4,150,001
	Asset finance loans	1,083,094	1,314,017
	Staff loans	441,074	538,092
	Gross loans and receivables	8,958,661	8,879,224
	Less:		
	Impairment losses on loans and receivables (note 20)	(529,002)	(458,152)
	Net loans and receivables	**8,429,659**	**8,421,072**

The weighted average effective interest rate on loans and receivables as at 31 December 2018 was 13% (2017 – 14%).

Included in gross loans and receivables of Kshs 8,959,661,000 (2017 – Kshs 8,879,224,000) are non-performing loans amounting to Kshs 1,830,300,000 (2017 – Kshs 1,720,170,000). These are included in the statement of financial position net of specific provisions of Kshs 397,487,000 (2017 – Kshs 433,900,000).

	2018 Kshs'000	2017 Kshs'000
a) Analysis of gross loans and receivables by maturity		
Maturing:		
Within 1 year	2,861,146	2,835,776
Between 1 and 3 years	2,486,298	2,464,252
After 3 years	3,611,217	3,579,196
Loans and receivables to customers	8,958,661	8,879,224

The related party transactions and balances are covered under note 39 and concentration of advances to customers is covered under note 5.

20.

IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES	2018 Kshs'000	2017 Kshs'000
At 1 January	458,152	438,582
IFRS 9Adjustment	102,579	-
Increase in impairment allowances	368,162	395,027
Write offs	(38,678)	(36,278)
Reversals in impairment allowances	(361,213)	(339,179)
At 31 December	**529,002**	**458,152**
Collectively assessed impairment	131,515	24,252
Individually assessed impairment	397,487	433,900
	529,002	**458,152**

21. OTHER ASSETS

	2018 Kshs'000	2017 Kshs'000
Un-cleared items in the course of collection	36,409	27,032
Prepayments	42,372	51,139
Rent receivable	15,199	15,059
Deposits for services	13,570	13,449
Others*	199,400	177,759
	306,950	**284,438**

* *mainly relate to M-Pesa and Kenswitch balances.*

22. EQUITY INSTRUMENTS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

At beginning of the year	7,139	6,097
Gain/(loss) in market value of investment	(412)	1,042
At end of the year	**6,727**	**7,139**

The investment consists of 21,699 shares of Kakuzi Limited which are in the name of Jimba Credit Corporation Limited but beneficially vested in the Bank. In accordance with IFRS 13, the fair value ranking of the investment is at level 1.

23. PROPERTY AND EQUIPMENT

	Land and buildings	Leasehold improvements	Motor vehicles	Fixtures, fittings, equipment & ATMs	Computers	Work in progress	Total
	Kshs'000	Kshs'000	Kshs'000	Kshs'000	Kshs'000		Kshs'000
COST/VALUATION							
At 1 January 2017	719,000	411,817	20,476	319,168	140,923	1,834	1,613,218
Additions	-	7,819	-	10,659	5,429	1,185	25,092
Transfer from WIP	-	-	-	6,440	-	-	6,440
Disposal	-	-	-	-	(157)	-	(157)
At 31 December 2017	**719,000**	**419,636**	**20,476**	**336,267**	**146,195**	**3,019**	**1,644,593**
At 1 January 2018	719,000	419,636	20,476	336,267	146,195	3,019	1,644,593
Additions	-	3,203	-	2,132	16,684	2,171	24,190
Transfer from WIP	-	-	-	1,185	1,834	(3,019)	-
Disposal	-	-	-	(14,015)	(16,709)	-	(30,724)
At 31 December 2018	**719,000**	**422,839**	**20,476**	**325,569**	**148,004**	**2,171**	**1,638,059**
Comprising							
At cost	-	422,839	20,476	325,569	148,004	2,171	919,059
At valuation 2018	719,000	-	-	-	-	-	719,000
	719,000	**419,636**	**20,476**	**336,267**	**146,195**	**3,019**	**1,638,059**

23. PROPERTY AND EQUIPMENT (Continued)

	Land and buildings Kshs'000	Leasehold improvements Kshs'000	Motor vehicles Kshs'000	Fixtures, fittings, equipment& ATMs Kshs'000	Computers Kshs'000	Work in progress	Total Kshs'000
ACCUMULATED DEPRECIATION							
At 1 January 2017	32,650	366,517	12,270	271,745	134,584	-	817,766
Charge for the year	17,525	29,837	2,718	25,595	4,894	-	80,569
Elimination on disposal	-	-	-	-	(88)	-	(88)
At 31 December 2017	**50,175**	**396,354**	**14,988**	**297,340**	**139,390**	**-**	**898,247**
At 1 January 2018	50,175	396,354	14,988	297,340	139,390	-	898,247
Charge for the year	16,725	8,755	2,472	16,926	5,470	-	50,348
Elimination on disposal	-	-	-	(14,014)	(16,637)	-	(30,651)
At 31 December 2018	66,900	405,109	17,460	300,252	128,223	-	917,944
NET BOOK VALUE							
At 31 December 2018	**652,100**	**17,730**	**3,016**	**25,317**	**19,781**	**2,171**	**720,115**
At 31 December 2017	**668,825**	**23,282**	**5,488**	**38,927**	**6,805**	**3,019**	**746,346**

Land and buildings were last revalued as at 31 December 2015, by Vidmerck Limited, independent valuers. Valuations were made on the basis of the open market value using the highest and best use valuation model resulting in a total valuation surplus of Kshs 151,293,000. The book values of the properties were adjusted to the revalued amounts and the resultant surplus was credited to the revaluation surplus.

Motor vehicles, fixtures fittings and equipment with a cost of Kshs. 767,740,948 (2018- Kshs 740,998,018) were fully depreciated as at 31 December 2017. The notional depreciation charge on these assets would have been Kshs 141,229,418 (2017- Kshs 140,091,437).

In accordance with IFRS 13, the fair value ranking of the land and buildings is at Level 2 as the fair value measurement is derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly as prices or indirectly as derived from prices.

Work in progress relates to the Euro Mastercard Visa switch migration which is at various stages of completion.

If the land and buildings were stated on the historical cost basis, their carrying amounts would be as follows:

	2018 Kshs'000	2017 Kshs'000
At 1 January	126,597	131,118
Depreciation charge	(4,521)	(4,521)
At 31 December	**122,076**	**126,597**

24. INTANGIBLE ASSETS

	Computer Software Kshs'000	Work in Progress Kshs'000	Total
COST/VALUATION			
At 1 January 2017	390,883	74,020	464,903
Additions	35,826	9,691	45,517
Transfer from WIP	34,551	(40,991)	(6,440)
At 31 December 2017	461,260	42,720	503,980
At 1 January 2018	461,260	42,720	503,980
Additions	24,347	12,272	36,619
Transfer from WIP	42,720	(42,720)	-
At 31 December 2018	528,327	12,272	540,599
ACCUMULATED AMORTISATION			
At 1 January 2017	186,899	-	186,899
Charge for the year	77,553	-	77,553
At 31 December 2017	264,452	-	264,452
At 1 January 2018	264,452	-	264,452
Charge for the year	89,935	-	89,935
At 31 December 2018	354,387	-	3564,387
NET BOOK VALUE			
AT 31 DECEMBER 2018	**173,939**	**12,272**	**186,211**
AT 31 DECEMBER 2017	**196,808**	**42,720**	**239,528**

Work in progress relates to the EMV project and insurance agency project which was at various stages of completion.

25. PREPAID OPERATING LEASE RENTALS (LEASEHOLD LAND)

	2018 Kshs'000	2017 Kshs'000
COST		
At 1 January and 31 December	45,298	45,298
ACCUMULATED AMORTISATION		
At 1 January	38,489	38,319
Charge for the year	170	170
At 31 December	38,659	38,489
NET BOOK VALUE		
At 31 December	**6,639**	**6,889**

26. CUSTOMER DEPOSITS

Current and demand accounts	3,113,010	3,154,517
Savings accounts	965,599	995,543
Fixed deposit accounts	4,419,174	4,406,202
Margins	90,761	90,043
	8,588,544	**8,646,305**

Maturity analysis of customer deposits:		
Repayable:		
On demand	4,169,370	4,240,103
Within one year	4,419,174	4,406,202
	8,588,544	**8,646,305**

The weighted average effective interest rate on interest bearing customer deposits at 31 December 2018 was 5.1% (2017 – 7.2%). The related party transactions and balances are covered under note 37 and concentration of customers' deposits is covered under note 5.

27. OTHER LIABILITIES

	2018 Kshs'000	2017 Kshs'000
Accrued expenses	9,244	6,846
Gratuity (note 27(a))	4,168	11,442
Leave pay provision (note 27(b))	7,683	7,327
Tenants deposits	16,804	18,341
Cheques for collection	73	1,089
Deferred fees income	60,402	63,484
Sundry payables	186,988	132,712
	285,362	**241,241**

a) Gratuity

Balance as at 1 January	11,442	7,242
Paid	(12,600)	-
Charge for the year	5,326	4,200
Balance as at 31 December	**4,168**	**11,442**

b) Leave pay provision

Balance as at 1 January	7,327	8,022
charge /(Credit) for the year	356	(695)
Balance as at 31 December	**7,683**	**7,327**

28. DEFERRED TAX ASSET

The deferred tax asset computed at the enacted rate of 30% is attributed to the following items:

	2018 Kshs'000	2017 Kshs'000
Revaluation surplus	156,088	161,168
Impairment losses	(17,792)	(16,385)
Provision for leave pay	(2,305)	(2,198)
Provision for gratuity	(1,250)	(3,433)
Accelerated depreciation allowances	(17,236)	(11,773)
	117,505	127,379
Tax losses	(117,505)	(300,678)
Net deferred tax asset	-	(173,299)
Movement in deferred tax asset is as follows:		
At 1 January	(173,299)	(56,634)
Credit to profit or loss (note 14)	-	(116,728)
Prior year over/(under) provision (note 14)	-	63
Charge to profit and loss account (note 14)	173,299	-
At 31 December	**-**	**(173,299)**

The Bank has unused tax loss in current year for which no deferred tax asset was derecognised due to uncertainty regarding the probability of future taxable profits.

However, the bank will be reassessing the deferred tax asset at each reporting date so as to determine whether it has become probable that future taxable profit will be available to utilise against the tax losses. Under Kenyan legislation, tax losses can only be carried forward to a maximum of ten years.

29. BORROWINGS

	2018 Kshs'000	2017 Kshs'000
As at 1 January	1,807,002	1,885,948
Interest expense	219,551	228,423
Repayments during the year	(294,233)	(307,369)
At the end of the year	**1,732,320**	**1,807,002**
Analysis by currency:		
Borrowings in Euros	127,315	160,485
Borrowings in Kenya shillings (Kshs)	1,605,005	1,646,517
	1,732,320	1,807,002
Analysis by lender:		
European Investment Bank (EIB)	127,315	160,485
Corporate bond – medium term notes	1,605,005	1,646,517

Facility terms:

a) EIB Loan facility: The facility from European investment Bank was a credit line of Eur 6,500,000 received by the Bank as part of its participation in the global loan facility extended by EIB to a group of financial institutions in Kenya under the Cotonou Agreement. The facility terms are as follows:

- Tenure: The period of the financing which shall be between 4 to 10 years save in respect of sub-loans for small projects where the sub loan is less than the equivalent of EUR 50,000 and finance leases, which shall have a minimum tenor of 3 years.
- Interest rate: For a tranche denominated in EUR or USD as margin of 2.88% per annum and for tranches denominated in Kenya Shillings will attract additional currency risk premium depending on the tenor of the loan
- Security: a negative pledge on present and future business undertakings together with all the assets or revenues of the Bank.

b) Medium term notes: this refers to a series of senior and subordinated notes issued by the Bank and traded on the Nairobi Securities Exchange. The issued and currently traded notes have a face value Kshs 1,678,200,000.

- Tenor: the notes mature on 22 July 2019
- Interest rate: the notes attract a fixed interest rate of 13.5 % for the senior notes and 13.25% for the subordinated notes.

30. SHARE CAPITAL

	2018 Kshs'000	2017 Kshs'000
a) Authorised:		
80,000,000 ordinary shares of Kshs 20 each	1,600,000	1,100,000
80,000,000, 4% non-cumulative irredeemable non-convertible preference shares of Kshs 20 each	1,600,000	1,600,000
	3,200,000	**2,700,000**
b) Issued and fully paid:		
69,920,000 ordinary shares of Kshs 20 each (2017 – 44,920,000)	1,398,400	898,400
36,056,500, 4% non-cumulative irredeemable Non-convertible preference Shares of Kshs 20 each	721,130	721,130
	2,119,530	**1,619,530**

Non-convertible non-participating preference shares are entitled to receive a discretionary dividend before any dividend is declared to the ordinary shareholders. The preference shares have no right to share in any surplus assets or profits and no voting rights.

31. REVALUATION SURPLUS

	2018 Kshs'000	2017 Kshs'000
At 1 January	379,130	387,751
Transfer of excess depreciation	(12,316)	(12,316)
Deferred tax on transfer of excess depreciation- Buildings	3,695	3,695
At 31 December	**370,509**	**379,130**

The revaluation surplus arises on the revaluation of freehold land and buildings. Where revalued land or buildings are sold, the portion of the revaluation surplus that relates to that asset, and is effectively realised over the period in which this is transferred, is transferred directly to revenue reserves. The revaluation surpluses are non-distributable.

32. ACCUMULATED DEFICIT

	2018 Kshs'000	2017 Kshs'000
At 1 January	(1,265,665)	(873,623)
IFRS 9 opening balance adjustment	(102,633)	-
Loss for the year	(540,034)	(335,681)
Transfer of excess depreciation	12,316	12,316
Deferred tax on transfer of excess depreciation	(3,695)	(3,695)
Transfer to statutory reserve	(225,017)	(64,982)
At 31 December	**(2,124,728)**	**(1,265,665)**

33. STATUTORY RESERVE

	2018 Kshs'000	2017 Kshs'000
At 1 January	329,168	264,186
Transfer from accumulated deficit	225,017	64,982
Transfer to IFRS stage 1 provision	(63,506)	-
At 31 December	**490,679**	**329,168**

34. FAIR VALUE RESERVE

At 1 January	6,271	5,229
Gain/(loss) in market value of quoted equity shares	(412)	1,042
At 31 December	**5,859**	**6,271**

The fair value deficit shows the effects from the fair value measurement of equity instruments at fair value through other comprehensive income. Any gains and losses are not recognised in the profit or loss until the asset has been sold or impaired. Refer to note 4 (c) for additional fair value disclosures.

35. NOTES TO THE STATEMENT OF CASH FLOWS

	2018 Kshs'000	2017 Kshs'000
(a) Reconciliation of loss before taxation to cash used in operations		
Loss before taxation	(351,567)	(438,570)
Adjustments for:		
Depreciation of property and equipment (note 23)	50,348	80,569
Amortisation of intangible assets (note 24)	89,935	77,553
Amortisation of leasehold land (note 25)	170	170
(Gain)/loss on disposal of property and equipment	(40)	(17)
Interest expense on borrowings (note 29)	219,551	228,423
Impairment (credit)/charge on loans and advances (note 19)	6,955	55,848
Profit before working capital changes	**15,352**	**3,976**
Increase in cash ratio balance	(38,454)	(168,068)
Increase in other assets	(22,512)	(41,339)
(increase)/decrease in gross loans and receivables	(118,174)	684,564
Decrease in customer deposits	(57,761)	(845,498)
Increase in other liabilities	44,123	17,457
Decrease in treasury bonds	415,806	57,592
Cash from/(used in) operations	**238,380**	**(291,316)**

35. NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

	2018 Kshs'000	2017 Kshs'000
(b) Analysis of the balances of cash and cash equivalents as shown in the statement of financial position and notes		
Cash on hand (Note 16)	372,065	276,107
Balances with Central Bank of Kenya –other (Note 16)	11,047	84,488
Balances with other banking institutions	119,420	107,453
Balance from Central Bank (Note 16 (c))	(1,120,000)	(1,484,201)
Deposits and balances from other banking institutions (note 16 (b))	(235,751)	(208,561)
	(853,219)	**(1,224,714)**

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short term highly liquid investments with original maturities of three months or below, less advances from banks repayable within three months from the dates of the advances.

36. INVESTMENTS IN SUBSIDIARIES

i) The operations of the companies below were vested in the Bank in July 2002 and are all incorporated in Kenya.
Jimba Credit Corporation Limited
ii) Kenya Savings & Mortgages Limited
iii) Citizen Building Society
iv) Estate Building Society
v) Estate Finance Company of Kenya Limited
vi) Business Finance Company Limited
vii) Home Savings and Mortgages Limited
viii) Union Bank of Kenya Limited
ix) Nationwide Finance Company Limited
Further to the above, the bank incorporated, Consolidated Bank Insurance Agency Limited, which commenced operations in January 2019.

All the subsidiaries are dormant and are wholly owned by the Bank. The subsidiaries had a nil carrying value as at 31 December 2018 (2017: Nil).

37. OTHER SUPPLEMENTARY INFORMATION

The bank's business comprises the following reportable units:

- Corporate Banking – This include banking services such as business current accounts, fixed deposits, overdrafts, loans, asset finance and other credit facilities in local and foreign currencies
- Retails & SME (Small medium size enterprises) – incorporating banking current accounts, savings accounts, individual fixed deposits, personal loans, retail and SME lending
- Treasury – operates the bank's fund management and investment activities.

Others comprise rental income and other incidental income from the rental space in the Bank's Head Office building at Consolidated Bank House.

37. OTHER SUPPLEMENTARY INFORMATION (Continued)

The table below summarizes the breakdown of other supplementary information l assets, liabilities, income and expenses;

Profit or loss for the year ended 31 December 2018

	Corporate banking Kshs'000	Retail banking Kshs'000	Treasury Kshs'000	Other Kshs'000	Total Kshs'000
Net interest income	151,094	641,932	(150,019)	-	643,007
Net fee and commission	111,537	1,223,053	642	-	1,335,232
Other income	-	-	-	69,547	69,547
Operating income	262,631	1,864,985	(149,377)	69,547	2,047,786
Operating expenses	(389,416)	(1,967,163)	(18,584)	(24,190)	(2,399,353)
Profit/(loss) before tax	**(126,785)**	**(102,178)**	**(167,961)**	**45,357**	**(351,567)**
Profit or loss for the year ended 31 December 2017					
Net interest income	273,751	309,999	(85,310)	-	498,440
Net fee and commission	178,107	497,302	28,433	-	703,842
Other income	-	-	-	73,978	73,978
Operating income	451,858	807,301	(56,877)	73,978	1,276,260
Operating expenses	(425,609)	(1,255,511)	(14,914)	(18,796)	(1,714,830)
Profit/(loss) before tax	**26,249**	**(448,210)**	**(71,791)**	**55,182**	**(438,570)**
Statement of financial position as at 31 December 2018					
Assets					
Short term funds	-	491,465	2,736,737	-	3,228,202
Loans	1,777,226	6,652,433	-	-	8,429,659
Other assets	-	749,619	-	652,100	1,401,719
Total assets	**1,777,226**	**7,893,517**	**2,736,737**	**652,100**	**13,059,580**
Liabilities and equity:					
Customer deposits	2,164,196	6,424,348	-	-	8,588,544
Borrowed funds			3,088,050	-	3,088,050
Other liabilities	-	285,362	-	-	343,044
shareholders' funds	-	1,097,624	-	-	622,978
Total liabilities and equity	**2,164,196**	**7,807,334**	**3,088,050**	**-**	**13,059,580**

37. OTHER SUPPLEMENTARY INFORMATION (Continued)

Statement of financial position as at 31 December 2017

	Corporate banking Kshs'000	Retail banking Kshs'000	Treasury Kshs'000	Other Kshs'000	Total Kshs'000
Assets					
Short term funds	-	368,560	3,202,530	-	3,571,090
Loans	2,243,144	6,177,928	-	-	8,421,072
Other assets	-	794,757	-	668,825	1,463,582
Total assets	**2,243,144**	**7,341,245**	**3,202,530**	**668,825**	**13,455,744**
Liabilities and equity:					
Customer deposits	2,121,466	6,524,839	-	-	8,646,305
Borrowed funds	-	-	3,499,764	-	3,499,764
Other liabilities	-	241,241	-	-	241,241
Shareholders' funds	-	1,068,434	-	-	1,068,434
Total liabilities and equity	**2,121,466**	**7,834,514**	**3,499,764**	**-**	**13,455,744**

38. CONTINGENCIES AND COMMITMENTS INCLUDING OFF BALANCE SHEET ITEMS

a) Contingent liabilities

In common with other financial institutions, the Bank conducts business involving acceptances, letters of credit, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties.

	2018 Kshs'000	2017 Kshs'000
Acceptances and letters of credit	62,292	57,601
Guarantees	984,621	1,079,860
	1,046,913	**1,137,461**
Litigations against the bank	**2,246,847**	**2,285,195**

Nature of contingent liabilities:

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

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

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

Concentrations of contingent liabilities are covered under note 5.

Litigations against the Bank relate to civil suits lodged against the Bank by customers and employees in the normal course of business. The likely outcome of these suits cannot be determined as at the date of signing these financial statements. The Directors, however, do not anticipate that any material liability will accrue from the pending suits.

b) Commitments to extend credit

	2018 Kshs'000	2017 Kshs'000
Other commitments to lend	531,333	721,000
Undrawn formal stand-by facilities, credit lines	65,824	55,884

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

c) Capital commitments

	2018 Kshs'000	2017 Kshs'000
Authorised but not contracted for	97,208	181,846

Capital commitments relate to; investment in ICT cyber security and replacement of computers and equipment for the branches.

d) Operating lease commitments

Rental income earned during the year was Kshs 69,546,580 (2017 – Kshs 73,977,583). At the reporting date, the Bank had contracted with tenants for the following minimum future lease receivables:

The Bank as a lessor:	2018 Kshs'000	2017 Kshs'000
Within one year	44,829	54,678
In the second to fifth year inclusive	117,408	135,780
After five years	-	2,267
	162,237	**192,725**

Operating leases relate to the buildings and are negotiated for an average term of 6 years, with the rentals being reviewed every two years and hence classified as operating leases. The leases are cancellable with a penalty when the tenants do not give three months' notice to vacate the premises.

All operating lease contracts contain market review clauses in the event that the lessor exercises its option to renew. The lessees do not have an option to purchase the property at the expiry of the lease period. The operating lease contracts are cancellable.

The Bank as a lessee

At the reporting date, the Bank had outstanding commitments under operating leases which fall due as follows:

	2018 Kshs'000	2017 Kshs'000
Within one year	57,332	50,957
In the second to fifth year inclusive	133,336	130,387
After five years	36,779	18,847
	227,447	**200,191**

Operating lease payments represent rentals payable by the Bank for its office premises.

e) Foreign exchange contracts

The Bank enters into derivatives for trading and risk management purposes, as explained in Note 2.1 in the Summary of significant accounting policies. The Bank may take positions with the expectation of profiting from favourable movements in prices, rates or indices. The trading portfolio is within the Bank's investment banking division (treasury) and is treated as trading risk for risk management purposes. Derivatives held for risk management purposes include hedges that are economic hedges, but do not meet the hedge accounting requirements. The table below shows the fair values of derivative financial instruments recorded as assets or liabilities together with their notional amounts.

The notional amount, recorded gross, is the quantity of the derivative contracts' underlying instrument (being foreign currency, reference rate or index). The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of either the market or credit risk.

At 31 December 2018	Carrying value assets KShs'000	Carrying value liabilities KShs'000	Notional amount KShs'000
Derivatives in economic hedge relationships:			
Foreign exchange contracts	1,083	3	97,743
At 31 December 2017			
Foreign exchange contracts	1,126	101	104,800

Forwards and spot contingents are the foreign exchange deals carried out in the interbank markets.

39. RELATED PARTY TRANSACTIONS

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

Placings are made in the Bank by Directors, their associates and companies associated to Directors. Advances to customers at 31 December 2018 include advances and loans to companies associated with the directors. Contingent liabilities at 31 December 2018 include guarantees and letters of credit for companies associated with the Directors.

All transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers.

	Directors	
	2018 Kshs'000	2017 Kshs'000
Movement in related party balances was as follows:		
Loans and advances:		
At 1 January	1,062	4,043
Advanced during the year	-	-
Interest earned	28	372
Repaid during the year	(1,090)	(3,353)
At 31 December	**-**	**1,062**

As at 31 December 2018 loans and advances to staff amounted to Kshs 441,073,713 (2017– Kshs 538,092,160).

The loans and advances to related parties are performing and are adequately secured.

	Directors and employees	
	2018	2017
	Kshs'000	Kshs'000
Customer deposits:		
At 1 January	29,182	29,334
Placed during the year	1,106,052	1,108,065
Net interest applied	1,079	699
Withdrawals	(1,099,450)	(1,108,916)
At 31 December	**36,863**	**29,182**

Key management compensation

The remuneration of Directors and other members of key management during the year were as follows:

Short term benefits		
Salaries and other benefits	127,024	125,294
Fees for services as Directors	5,048	4,824
	132,072	**130,118**

Staff number

The total number of staff as at the end of the year was as follows:

	2018	2017
Number of staff	267	266

40. INCORPORATION

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

41. CURRENCY

These financial statements are prepared in Kenya shillings thousands (Kshs'000) which is the Bank's functional and presentation currency.

42. EVENTS AFTER THE REPORTING DATE

No material events or circumstances have arisen between the reporting date and the date of this report that require disclosure.

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