ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2018

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CORPORATE INFORMATION

Directors & Committees

DIRECTORS J P M Ndegwa – Chairman J Gachora - Group Managing Director* D Abwoga–Executive Director, Finance and Strategy* - – Appointed 21st Mar 2018 P R Lopokoiyit – Appointed 21st Mar 2018 G A Maina A S M Ndegwa E N Ngaine P V Shah J Somen – Appointed 21st Mar 2018 *Executive directors	**AUDIT & RISK COMMITTEE** P R Lopokoiyit - Chairman G A Maina E N Ngaine **GOVERNANCE AND NOMINATIONS COMMITTEE** E N Ngaine – Chairman P Lopokoiyit G A Maina A S M Ndegwa J Somen **INFORMATION, COMMUNICATIONS AND TECHNOLOGY (ICT) COMMITTEE** J Somen - Chairman E N Ngaine P R Lopokoiyit
EXECUTIVE / STRATEGY COMMITTEE A S M Ndegwa - Chairman G A Maina P V Shah J Somen J Gachora D Abwoga	**REGISTERED OFFICE** NIC House Masaba Road PO Box 44599-00100 Nairobi
COMPANY SECRETARY L Murage Certified Public Secretary (Kenya) NIC House, Masaba Road PO Box 44599-00100 Nairobi	**REGISTRARS AND TRANSFERS OFFICE** Custody & Registrars Services Limited 6th Floor, Bruce House, Standard Street PO Box 8484-00100 Nairobi
AUDITOR PricewaterhouseCoopers Certified Public Accountants (Kenya) PwC Tower Waiyaki Way/Chiromo Road, Westlands PO Box 43963-00100 Nairobi	

DIRECTORS' REPORT

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

BUSINESS REVIEW

NIC Group PLC (the "Company/Parent") and its subsidiaries (together, the "Group") provide retail, corporate banking, brokerage, bancassurance, property and investment banking services.

The Group performance was mainly impacted by lower yields on loans and advances and high cost of funds that contributed to shrinkage in margins. The Group recorded a profit before tax of Shs 5.82 billion, which represents a 4% growth year on year. Total assets grew 1% year on year to Shs 208.4 billion. Customer deposits grew 4% from Shs 138.9 billion to Shs 144.5 billion, while long term borrowings declined by 13% from Shs 17 billion to Shs 14.9 billion. Investment in Government securities grew 13% year on year to close at Shs 61.7 billion. Gross loan book increased by 2% while the net loan book reduced by 1% due to an increase in provisions.

The Group adopted International Financial Reporting Standard (IFRS) 9, financial instruments effective 1 January 2018. As a result, it recorded a charge to its opening equity on 1 January 2018 of Shs 3,028,293,000 to reflect the impact of the new requirements for provisions and classification and measurement of financial instruments at the adoption date. The Group did not restate comparative periods, as permitted by the standard. Accordingly, the 2018 results are based on IFRS 9, while the prior year's results are based on International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement* and therefore, certain amounts herein and related ratios are not comparable. The main impact under IFRS 9 is related to provisions for expected credit losses on financing arrangements. The provision for impairment on performing financing arrangements is stages 1 and 2 under IFRS 9, while impairment provision for credit losses on impaired financing arrangements is stage 3. For detailed description of the changes, refer to Note 3 in the financial statements.

On 6 December 2018, NIC Group PLC and Commercial Bank of Africa Limited announced that their Board of Directors authorized the commencement of discussions regarding a potential merger of the two entities. The proposed merger will be completed upon fulfilment of a certain set of conditions precedent, customary to transactions of this nature, including but not limited to, the parties obtaining applicable shareholder and regulatory approvals, and the parties entering into and completing various transactional agreements to complete the merger.

DIVIDENDS

The Group profit for the year of Shs 4,228,370,000 (2017: Shs 4,144,418,000) has been added to retained earnings.

No interim dividend (2017: Nil) was paid to shareholders during the year. The Board has resolved to recommend to the shareholders at the forthcoming Annual General Meeting, scheduled for 17 April 2019, the payment of a first and final dividend for the year of Shs 1.25 per share (2017: final dividend of Shs 1 per share). The dividend will be payable to the shareholders registered on the Company's register at the close of business on 11 April 2019 and will be paid on or after 18 April 2019.

The total dividend for the year, therefore is Shs 1.25 (2017: Shs 1.00) for every one ordinary share amounting to Shs 879,925,000 (2017:Shs 639,946,000).

DIRECTORS

The directors who held office during the year and to the date of this report are shown on page 2.

DIRECTORS' REPORT (CONTINUED)

DISCLOSURES TO AUDITOR

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

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

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

TERMS OF APPOINTMENT OF THE AUDITOR

PricewaterhouseCoopers continue in office in accordance with the Company's Articles of Association and Section 721 of the Kenyan Companies Act, 2015.

The directors monitor the effectiveness, objectivity and independence of the auditor. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders.

BY ORDER OF THE BOARD

LIVINGSTONE MURAGE
Group Company Secretary

DIRECTORS REMUNERATION REPORT

INFORMATION NOT SUBJECT TO AUDIT

This report describes the Group's remuneration policy and the remuneration paid to Directors in 2018. The remuneration policy, including all structures and policies related to remuneration is in line with the Companies Act, No. 17 of 2015, the CMA Code of Corporate Governance Practices for issuers of Securities to the Public, 2015 and the Companies General Amendment Regulations No. 2 of 2017.

There were no changes to the structure of the Directors' remuneration in the year ended 31st December 2018. Directors continued to be remunerated at the same rate as in the year ended 31st December 2017 and therefore there were no substantial changes in the year ended 31st December 2018 in relation to the Directors' remuneration.

The first part of this report describes the remuneration policy, while the second part describes the implementation of the policy in 2018.

Chairman, Board Governance and Nominations Committee.

Background:

The members of the Board Governance and Nominations committee are:

E N Ngaine – Chairman
P R Lopokoiyit (Appointed 21st March 2018)
G A Maina
A S M Ndegwa
J Somen (Appointed 21st March 2018)

PART 1

Remuneration Policy

The remuneration policy has the objective of providing remuneration that will attract, retain and engage high calibre directors whilst protecting and promoting the Group's strategy and objectives. The structure supports the Group's short term and long term objectives. The policy seeks to provide market competitive remuneration.

Remuneration of Executive Directors

Performance parameters for Executive Directors are drawn from the Group's Strategy. The Directors' targets and performance indicators are closely linked with the performance targets for the business and are anchored on the short-term (annual) and long-term (5 year) strategic objectives of the Group. The targets are set and measured by the Board on a quarterly, half yearly and annual basis in line with the release of the business performance reports.

The remuneration of the Executive Directors consists of:

- Base Salary
- Performance based Compensation
- Deferred Compensation
- Other Benefits – such as company car, medical and life cover, retirement benefits and loans as determined by the Board

DIRECTORS REMUNERATION REPORT (CONTINUED)

INFORMATION NOT SUBJECT TO AUDIT (CONTINUED)

Remuneration of Non-Executive Directors

The performance of Non-Executive Directors (NEDs) is assessed annually through the Board Evaluation process which considers individual contribution to the activities of the Board and Board Committees. An Evaluation Report is generated with clear recommendations on the performance of the Directors not only as a team but also as individuals. Their remuneration is based on proposals by the Board Governance and Nominations Committee (BGNC) and approved by the Board and the Shareholders. Non-Executive Directors are not entitled to a salary, performance based compensation or other cash or non-cash benefits.

In 2016 the Board approved a compensation structure for NEDs which followed a benchmarking exercise in order to provide market competitive remuneration. The remuneration for NEDs consists of:

- Monthly retainer fee; and
- Sitting allowance for Board and Board Committee meetings

Expenses incurred in respect of travel, accommodation or other incurred expense whilst carrying out duties as a Director are reimbursed at cost.

Share Option Scheme

Currently, the Group does not have a share option scheme for Directors or Employees and therefore Directors were not entitled to take up any shares through an Employee Share Option Scheme (ESOP) or a Directors' Share Option Scheme (DSOP).

Directors' Contracts of Service

The Group Managing Director has been appointed on a five (5) year renewable contract term, with the renewal being approved by the Board of Directors prior to maturity date. The Group's Executive Director has been appointed on an open-ended contract while the Bank's Executive Director has been appointed on a two (2) year renewable contract, such renewal being approved by the Board of Directors prior to maturity date. The Executive Directors' continued service is subject to an annual performance review by the Board.

Non-Executive Directors are appointed in accordance with the procedure laid out in the Articles of Association and the Board Charter. NEDs are appointed for a term of 3 years and retire by rotation but are eligible for reappointment taking into consideration their performance and the shareholders' views. The Board Governance and Nominations Committee makes recommendations to the Board based on professional skills and experience, independence and ethical standards. Appointments by the Board are subject to approval from the Central Bank of Kenya, the Group's Shareholders, and where applicable the Capital Markets Authority.

The Notice period for the Group Managing Director is six (6) months while that of the Executive Directors is three (3) months or payment in lieu of notice in all cases. With regards to NEDs, the notice period will vary depending on the circumstances of the departure.

On termination of contract, an Executive Director will be entitled to be paid any amounts due as per contract terms up to the date of such termination. The maximum amount payable would be the salary and applicable benefits payable in lieu of notice where it is agreed to terminate the contract prior to maturity of the notice period. Non-Executive Directors will be entitled to any outstanding dues on the monthly retainer fees and the sitting allowances up to the date of termination. No additional amounts are payable to Directors unless these are expressly approved under special circumstances by the Board of Directors.

DIRECTORS REMUNERATION REPORT (CONTINUED)

INFORMATION NOT SUBJECT TO AUDIT (CONTINUED)

Statement of the Previous General Meeting

A Resolution to approve the Directors' remuneration report for the year ended 31st December 2017 was unanimously passed through acclamation by shareholders at the Annual General Meeting held on the 25th day of May 2018. There were no objections to the Directors' Remuneration Report.

INFORMATION SUBJECT TO AUDIT

PART 2: IMPLEMENTATION REPORT

The Board is responsible for ensuring that the remuneration policy, and its implementation, are aligned with the Group's strategies and objectives. The policy is designed to avoid instances where the Directors, act in their own interests or take risks that are not in line with the Group's strategy and risk appetite. Where other benefits are granted, the Board ensures that these are in line with market norms.

The following tables show the remuneration for the Chairman, Non-Executive Directors (NEDs) and Executive Directors in respect of qualifying services for the year ended 31st December 2018. The aggregate Directors' emoluments are shown on note 40.

Directors Remuneration for the year ended 31 December 2018	Fees Shs 000	Salary Shs 000	Cash incentive compensation Shs 000	Deferred cash incentive Compensation Shs 000	Retirement Benefits Shs 000	Total Shs 000
J P M Ndegwa – Chairman	2,720					2,720
J Gachora - Group Managing Director*		61,564	23,572	3,198	6,602	94,936
D Abwoga*		22,509	7,848	1,108	2,507	33,972
P R Lopokoiyit	3,760					3,760
G A Maina	3,300					3,300
A S M Ndegwa	7,771					7,771
E N Ngaine	4,100					4,100
P V Shah	2,860					2,860
J Somen	2,486					2,486
	26,997	84,073	31,420	4,306	9,109	155,905

The total Directors fees for J P M Ndegwa was paid to Asset Managers Limited in respect of Director's services in the year ended 31 December 2018.

*** Executive Directors**

DIRECTORS REMUNERATION REPORT (Continued)

INFORMATION SUBJECT TO AUDIT (Continued)

PART 2: IMPLEMENTATION REPORT (Continued)

Included in the NEDs fees for the year ended 2018 are amounts relating to fees earned for services rendered to individual NIC Group Companies as tabulated below.

Directors Remuneration For the year ended 31 December 2018	NIC Group PLC	NIC Bank Kenya PLC	NIC Bank Tanzania Ltd	NC Bank Uganda Ltd	NIC Capital Ltd	NIC Securities Ltd	NIC Leasing LLP	Total
	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000
J P M Ndegwa – Chairman	300	2,420						2,720
P R Lopokoiyit	810	2,455		495				3,760
G A Maina	690	2,610						3,300
A S M Ndegwa	450	3,330	1,668	1,723	240	240	120	7,771
E N Ngaine	750	3,350						4,100
P V Shah	200	2,660						2,860
J Somen	550	1,936						2,486
	3,750	18,762	1,668	2,218	240	240	120	26,997

DIRECTORS REMUNERATION REPORT (Continued)

INFORMATION SUBJECT TO AUDIT (Continued)

PART 2: IMPLEMENTATION REPORT (Continued)

The following tables show the remuneration for the Chairman, Non-Executive Directors (NEDs) and Executive Directors in respect of qualifying services for the year ended 31st December 2017.

Directors Remuneration for the year ended 31 December 2017	Fees	Salary	Cash Incentive Compensation	Deferred cash incentive Compensation	Retirement Benefits	Total
	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000
J P M Ndegwa – Chairman	2,300					2,300
F M Mbiru - Vice Chairman	6,000					6,000
J Gachora - Group Managing Director*		57,698	29,989	4,131	6,236	98,054
A Dodd*		35,087	10,245	1,533	-	46,865
G A Maina	2,540					2,540
F N Mwanzia	2,940					2,940
A S M Ndegwa	7,606					7,606
E N Ngaine	3,320					3,320
I Ochola-Wilson	4,875					4,875
P V Shah	2,760					2,760
K Thuo	2,100					2,100
	34,441	92,785	40,234	5,664	6,236	179,360

The 2017 remuneration includes fees for directors who served prior to the reorganisation.

The total Directors fees for J P M Ndegwa was paid to Asset Managers Limited in respect of Director's services in the year ended 31 December 2017.

*** Executive Directors**

Included in the NEDs fees for the year ended 2017 are amounts relating to fees earned for services rendered in other NIC Group Companies other than NIC Bank Kenya PLC as tabulated below.

Directors Fees For the year ended 31 December 2017	NIC Bank Tanzania Ltd Shs 000	NC Bank Uganda Ltd Shs 000	NIC Capital Shs 000	NIC Securities Shs 000	Total Shs 000
F M Mbiru - Vice Chairman		2,480			2,480
A S M Ndegwa	1,956	1,910	180	180	4,226
I Ochola-Wilson	2,295				2,295
	4,251	4,390	180	180	9,001

DIRECTORS REMUNERATION REPORT (Continued)

INFORMATION SUBJECT TO AUDIT (Continued)

PART 2: IMPLEMENTATION REPORT (Continued)

Share Option Scheme

There was no share option scheme for Directors in the year ended 31st December 2018

Long Term Incentives

There were no Long Term incentives granted to NEDs in the year ended 31st December 2018.

Pension Related Benefits

Pension for Executive Directors is provided under the NIC Group Defined Contribution Pension Scheme, which is registered with the Retirement Benefits Authority and whose members are all employed staff of the Group up to the age of 60 years. The contribution to the scheme is made up of a minimum five percent (5%) contribution of basic salary by the employee and fifteen percent (15%) contribution from the company. This does not include the statutory contribution to the National Social Security Fund (NSSF). As at 31st December 2017, only one Executive Director was a member of the scheme and as at 31st December 2018, two Executive Directors were members of the scheme following the appointment of an Executive Director to the Board of NIC Group PLC.

NEDs are not entitled to a pension benefit.

Compensation for past directors

The Group did not make any payments to Directors for loss of office during the year ended 31st December 2018. (2017: Nil)

There was no change in the Group's policy on payments to former directors in the year ended 31st December 2018.

On behalf of the Board

____________________ (signature)
E N Ngaine
Chair, Governance and Nominations Committee

Date ____________________

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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 Group and Company as at the end of the financial year and of its profit or loss for that year. The directors are responsible for ensuring that the Group and Company keep proper accounting records that are sufficient to show and explain the transactions of the Group and Company; disclose with reasonable accuracy at any time the financial position of the Group and Company; and that enables them to prepare financial statements of the Group and Company that comply with prescribed financial reporting standards and the requirements of the Kenyan Companies Act, 2015. They are also responsible for safeguarding the assets of the Group and Company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

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

(ii) Selecting suitable accounting policies and then applying them consistently; and

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

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

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

Approved by the board of directors on ________________ 2019 and signed on its behalf by:

________________________	________________________
J P M NDEGWA	**J GACHORA**
Chairman	**Group Managing Director**

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NIC GROUP PLC

Report on the financial statements

Our opinion

We have audited the accompanying financial statements of NIC Group PLC (the 'Company') and its subsidiaries (together, the 'Group') set out on pages 17 to 113, which comprise the consolidated statement of financial position at 31 December 2018 and the consolidated statements of profit or loss, comprehensive income, changes in equity and cash flows for the year then ended, together with the separate statement of financial position of the Company at 31 December 2018 and the statements of profit or loss, comprehensive income, changes in equity and cash flows for the year then ended, and the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of NIC Group PLC give a true and fair view of the financial position of the Group and the Company at 31 December 2018 and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015.

Basis for opinion

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

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

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Key audit matter	How our audit addressed the Key audit matter
Credit risk and provision for expected credit losses on financial assets including IFRS 9 transition The Group implemented IFRS 9, Financial Instruments, (IFRS 9) effective 1 January 2018 with the transition adjustment recorded in retained earnings. As explained in note 2.1 (v), the new standard requires the recognition of expected credit losses (ECL) on financial assets. Previously, under IAS 39, impairment losses were recognised on incurred basis only if there was objective evidence of impairment. The inputs in the calculation of expected credit losses, such as, forward looking data, past credit experience, probability of default, discounting of cash flows, computation of exposures at default, cash conversion factors for off-balance sheet exposures and assessment of significant increase in credit risk (SICR), involved significant management judgement, assumptions and estimates. Variations in these assumptions and estimates could result in materially different credit loss outcomes in the financial statements. Note 2 "Significant accounting policies", Note 3 "Financial risk management", Note 6 "Critical accounting estimates and judgments" and Note 22 "Loans and advances to customers" to the financial statements provide detailed information on the estimation of the provision for expected credit losses on loans and advances to customers as at 31 December 2018. Note 2 "Significant Accounting Policies" to the financial statements provides information on the adoption of IFRS 9 by the Group from 1 January 2018, including the estimated impact of the adoption.	Our audit procedures focused on the significant areas of judgement and estimation which could result in material misstatements in the financial statements. These included: ● Review and assessment of the reasonableness of management's accounting policies over key IFRS 9 concepts, including significant increase in credit risk (SICR), default definition and forecasting of forward looking macro-economic factors. ● Testing and reviewing consistency and compliance of asset risk classification in line with IFRS and Group policies. ● For significant facilities, assessment of the reasonableness of management judgement and assumptions over the critical data inputs for ECL calculation. ● For collective expected credit losses computation: - testing of models by validating historical data input used in the derivation of key model parameters; - assessment of the reasonableness of management assumptions on multiple economic scenarios and variables and the forward looking information; and - assessment of the accuracy of the ECL calculation by testing the model logic and reviewing the ECL formulae to validate that the calculations operated as per our expectation. ● Assessment of the consistency of application of the IFRS 9 principles and assumptions on transition (at 1 January 2019) and at the end of the year (at 31 December 2018). ● Review of management's ECL related disclosures in the financial statements especially on transition related disclosures and reconciliations, accounting policies and other IFRS 9 related disclosures.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NIC GROUP PLC (CONTINUED)

Other information

The other information comprises the Corporate information, Directors report, Directors' remuneration report and Statement of directors' responsibilities which we obtained prior to the date of this auditor's report, and the rest of the other information in the Annual Report which are expected to be made available to us after that date, but does not include the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information we have received prior to the date of this auditor's report we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the rest of the other information in the Annual Report and we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of the directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NIC GROUP PLC (CONTINUED)

Auditor's responsibilities for the audit of the financial statements (continued)

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

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

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

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

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group 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 of the entities or business activities within the Group to express an opinion on the Group's financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the Group's financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NIC GROUP PLC (CONTINUED)

Report on other matters prescribed by the Kenyan Companies Act, 2015

Report of the directors

In our opinion the information given in the report of directors' report on pages 3 to 4 is consistent with the financial statements.

Directors' remuneration report

In our opinion the auditable part of the directors' remuneration report on pages 5 to 10 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

Certified Public Accountants
Nairobi

______ **March 2019**

FCPA Richard Njoroge, Practising certificate No. 1244
Signing partner responsible for the independent audit

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

Company				Group	
2018	**2017**			**2018**	**2017**
Shs'000	**Shs'000**		**Note**	**Shs'000**	**Shs'000**
59,124	-	Interest income	8 (a)	20,999,501	19,416,130
-	-	Interest expense	8 (b)	(8,716,105)	(7,641,620)
59,124	**-**	**Net Interest Income**		**12,283,396**	**11,774,510**
-	-	Fee and commission income	9 (a)	1,387,426	1,294,386
-	-	Fee and commission expense	9 (b)	(112,802)	(102,735)
-	**-**	**Net Fee and Commission Income**		**1,274,624**	**1,191,651**
-	-	Net trading income	10	1,288,249	1,186,095
345,811	46,708	Other operating income	11	1,243,456	182,962
404,935	**46,708**	**Operating Income**		**16,089,725**	**14,335,218**
-	-	Credit impairment charges	12(a)	(3,338,598)	(2,479,535)
404,935	**46,708**	**Net operating income**		**12,751,127**	**11,855,683**
(200,632)	(44,707)	Employee benefits	13	(3,834,982)	(3,373,785)
-	-	Depreciation and amortisation	14(a)	(473,917)	(497,238)
(31,297)	(750)	Other operating expenses	14(b)	(2,619,363)	(2,383,710)
(231,929)	**(45,457)**	**Operating Expenses**		**(6,928,262)**	**(6,254,733)**
173,006	**1,251**	**Profit Before Income Tax**		**5,822,865**	**5,600,950**
(31,812)	34,822	Income tax expense	15(a)	(1,594,495)	(1,456,532)
141,194	**36,073**	**Profit for the year**		**4,228,370**	**4,144,418**
		Profit for the year attributable to:			
141,194	36,073	Equity holders of the Group		4,262,634	4,176,755
-	-	Non-controlling interests		(34,264)	(32,337)
141,194	**36,073**			**4,228,370**	**4,144,418**
		Earnings per share (Shs)			
Shs 0.20	**Shs 0.05**	**Basic and diluted**	16	**Shs 6.06**	**Shs 5.93**

The notes on pages 24 to 113 are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2018

Company 2018 Shs'000	Company 2017 Shs'000		Note	Group 2018 Shs'000	Group 2017 Shs'000
141,194	**36,073**	**Profit for the year**		**4,228,370**	**4,144,418**
		Other comprehensive income:			
		Items that may be subsequently reclassified to profit or loss			
-	969,197	Fair value gains on financial assets measured at FVOCI (2017 – AFS)	36(c)	489,349	1,090,176
-	(969,197)	Fair value gains on financial assets measured at FVOCI (2017 – AFS) released on re-organisation	36(c)	-	(969,197)
-	-	Exchange differences on translation of foreign operations	36(d)	(150,283)	(148,994)
		Items that will not be reclassified to profit or loss			
-	-	Revaluation surplus on property and equipment	36(b)	175,750	-
-	**-**	**Other Comprehensive income for the year, net of tax**		**514,816**	**(28,015)**
141,194	**36,073**	**Total Comprehensive income for the year**		**4,743,186**	**4,116,403**
		Attributable to:			
141,194	36,073	Equity holders of the Group		4,807,607	4,171,422
-	-	Non-controlling interests		(64,421)	(55,019)
141,194	**36,073**			**4,743,186**	**4,116,403**

The notes on pages 24 to 113 are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2018

Company				Group	
2018	2017			2018	2017
Shs'000	Shs'000		Note	Shs'000	Shs'000
		Assets			
337,455	1,200,000	Cash and balances with Central Banks	17	11,955,411	9,516,131
-	-	Items in the course of collection	18	400,689	233,004
-	-	Due from banking institutions	19	5,237,549	12,425,067
-	53,955	Due from group companies	24	-	-
-	-	Derivative assets	21	161,554	-
-	-	Government securities	20	61,706,465	54,715,795
-	-	Loans and advances to customers	22	116,853,003	118,446,485
500	-	Other assets	23	1,590,532	2,356,680
29,568,705	29,118,705	Investments	25	1,310,103	1,413,836
-	-	Property and equipment	27	1,369,575	1,148,712
-	-	Intangible assets	28	1,829,118	1,580,311
-	-	Operating lease prepayments	29	522,625	522,750
19,232	34,822	Current income tax	15(c)	1,075,176	395,513
-	-	Deferred income tax	26	4,395,617	3,418,176
29,925,892	**30,407,482**	**Total assets**		**208,407,417**	**206,172,460**
		Liabilities			
-	-	Customer deposits	30	144,501,060	138,916,570
-	-	Due to banking institutions	31	9,906,429	12,138,495
15,850	61,685	Due to group companies	33	-	-
-	-	Derivative liabilities	21	-	16,467
-	-	Borrowings	32	14,868,337	17,025,858
48,449	-	Other liabilities	34	3,292,183	3,331,400
-	-	Current income tax	15(c)	11,288	5,045
42,986	22,388	Unclaimed dividends	35	42,986	22,388
107,285	**84,073**	**Total liabilities**		**172,622,283**	**171,456,223**
		Equity			
		Capital and reserves attributable to equity holders of the Group			
3,519,701	3,199,728	Share capital	36(a)	3,519,701	3,199,728
2,373,994	2,700,017	Share premium	36(a)	2,373,994	2,700,017
-	-	Revaluation surplus on property	36(b)	175,750	-
-	-	Investments revaluation reserve	36(c)	755,873	(87,896)
-	-	Foreign currency translation reserve	36(d)	(1,083,412)	(886,639)
-	-	Regulatory reserve(s)	36(e)	63,462	1,042,359
-	-	Other reserves	36(f)	(157,172)	(157,172)
23,044,987	23,783,718	Retained earnings	36(g)	28,897,206	27,815,058
879,925	639,946	Proposed dividend	35	879,925	639,946
29,818,607	**30,323,409**	**Total capital and reserves attributable to equity holders of the Group**		**35,425,327**	**34,265,401**
-	-	Non-controlling interests	37	359,807	450,836
29,818,607	**30,323,409**	**Total equity**		**35,785,134**	**34,716,237**
29,925,892	**30,407,482**	**Total liabilities and equity**		**208,407,417**	**206,172,460**

The financial statements on pages 17 to 113 were approved and authorised for issue by the Board of Directors on _______________ 2019 and were signed on its behalf by:

J P M Ndegwa - Chairman | **J Gachora – Group Managing Director**

P R Lopokoiyit - Director | **L Murage - Group Company Secretary**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017

	Note	Share Capital	Share Premium	Revaluation surplus on property	Investments revaluation reserves	Foreign currency translation reserve	Regulatory Reserves	Other Reserves	Retained earnings	Proposed dividend	Capital and reserves attributable to equity holders of the group	Non-controlling interests	Total Equity
		Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
At 1 January 2017		3,199,728	2,700,017	175,202	(208,875)	(760,327)	1,238,486	(157,172)	23,012,504	639,946	29,839,509	505,855	30,345,364
Profit for the year		-	-	-	-	-	-	-	4,176,755	-	4,176,755	(32,337)	4,144,418
Other comprehensive income, net of tax		-	-	-	120,979	(126,312)	-	-	-	-	(5,333)	(22,682)	(28,015)
Total comprehensive income for the year		**-**	**-**	**-**	**120,979**	**(126,312)**	**-**	**-**	**4,176,755**	**-**	**4,171,422**	**(55,019)**	**4,116,403**
Transfer to regulatory reserves		-	-	-	-	-	(196,127)	-	196,127	-	-	-	-
Transactions with owners, recorded directly through equity													
Dividends paid – Final for 2016	35	-	-	-	-	-	-	-	-	(639,946)	(639,946)	-	(639,946)
Dividends Proposed – Final for 2017		-	-	-	-	-	-	-	(639,946)	639,946	**-**	-	-
Group re-organisation													
Revaluation of AFS Bonds		-	-	-	894,416	-	-	-	-	-	894,416	-	894,416
Realised revaluation reserves on transfer		-	-	(175,202)	(894,416)	-	-	-	1,069,618	-	-		-
At 31 December 2017		**3,199,728**	**2,700,017**	**-**	**(87,896)**	**(886,639)**	**1,042,359**	**(157,172)**	**27,815,058**	**639,946**	**34,265,401**	**450,836**	**34,716,237**

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

	Note	Share Capital	Share Premium	Revaluation surplus on property	Investments revaluation reserves	Foreign currency translation reserve	Regulatory Reserves	Other Reserves	Retained earnings	Proposed dividend	Capital and reserves attributable to equity holders of the Group	Non-controlling interests	Total Equity
		Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
At 1 January 2018		**3,199,728**	**2,700,017**	**-**	**(87,896)**	**(886,639)**	**1,042,359**	**(157,172)**	**27,815,058**	**639,946**	**34,265,401**	**450,836**	**34,716,237**
Adjustment on initial application of IFRS 9 net of tax		-	-	-	(3,981)	-	-	-	(2,997,704)	-	(3,001,685)	(26,608)	(3,028,293)
Profit for the year		-	-	-	-	-	-	-	4,262,634	-	4,262,634	(34,264)	4,228,370
Other comprehensive income, net of tax		-	-	175,750	485,202	(196,773)	80,794	-		-	544,973	(30,157)	514,816
Total comprehensive income for the year		**-**	**-**	**175,750**	**485,202**	**(196,773)**	**80,794**	**-**	**4,262,634**	**-**	**4,807,607**	**(64,421)**	**4,743,186**
Transfer of AFS bond revaluation		-	-	-	362,548	-	-	-	(362,548)		-		-
Transfer from regulatory reserve		-	-	-	-	-	(1,059,691)		1,059,691	-	-	-	-
Transactions with owners, recorded directly through equity		.											
Bonus Issue 2018		319,973	(319,973)	-	-	-	-	-	-	-	-	-	-
Bonus Issue expenses		-	(6,050)		-	-	-	-	-	-	(6,050)	-	(6,050)
Dividends paid – Final for 2017	35	-	-	-	-	-	-	-	-	(639,946)	(639,946)	-	(639,946)
Dividends Proposed – Final for 2018		-	-	-	-	-	-	-	(879,925)	879,925	-	-	-
At 31 December 2018		**3,519,701**	**2,373,994**	**175,750**	**755,873**	**(1,083,412)**	**63,462**	**(157,172)**	**28,897,206**	**879,925**	**35,425,327**	**359,807**	**35,785,134**

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

	Note	Share Capital Shs'000	Share Premium Shs'000	Revaluation surplus on property Shs'000	Investments revaluation reserve Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Proposed dividend Shs'000	Total Equity Shs'000
At 1 January 2017		**3,199,728**	**2,700,017**	**175,202**	**(74,781)**	**961,793**	**22,686,358**	**639,946**	**30,288,263**
Profit and other comprehensive income for the year		-	-	-	-	-	36,073	-	36,073
Group reorganisation transaction	43								
Realised Revaluation on Reorganisation		-	-	(175,202)	74,781	-	100,421	-	-
Transfer to regulatory reserve on Group Reorganisation		-	-	-	-	(961,793)	961,793	-	-
Other Group Reorganisation Transactions							639,019		639,019
Transactions with owners, recorded directly through equity									-
Dividends paid – Final for 2016	35	-	-	-	-	-	-	(639,946)	(639,946)
Dividends proposed – Final for 2017	35	-	-	-	-	-	(639,946)	639,946	-
At 31 December 2017		**3,199,728**	**2,700,017**	**-**	**-**	**-**	**23,783,718**	**639,946**	**30,323,409**
At 1 January 2018		**3,199,728**	**2,700,017**	**-**	**-**	**-**	**23,783,718**	**639,946**	**30,323,409**
Profit and other comprehensive income for the year		-	-	-	-	-	141,194	-	141,194
Transactions with owners, recorded directly through equity									
Bonus Issue 2018		319,973	(319,973)				-		-
Bonus Issue Expenses			(6,050)				-		(6,050)
Dividends paid – Final for 2017	35	-	-				-	(639,946)	(639,946)
Dividends proposed – Final for 2018	35	-	-	-	-	-	(879,925)	879,925	-
At 31 December 2018		**3,519,701**	**2,373,994**	**-**	**-**	**-**	**23,044,987**	**879,925**	**29,818,607**

The notes on pages 24 to 113 are an integral part of these financial statements

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2018

Company 2018 Shs'000	Company 2017 Shs'000		Note	Group 2018 Shs'000	Group 2017 Shs'000
		CASH FLOWS FROM OPERATING ACTIVITIES			
229,344	8,981	Cash generated from operations	39 (a)	11,282,000	25,767,111
(16,222)	(446,765)	Income tax paid	15 (c)	(2,303,723)	(2,831,376)
213,122	**(437,784)**	**Net cash generated from/(used in) operating activities**		**8,978,277**	**22,935,735**
		CASH FLOWS FROM INVESTING ACTIVITIES			
(450,000)	-	Investment in Subsidiaries		-	-
		Purchase of Government securities		(11,943,113)	(25,453,795)
		Proceeds from disposal of government securities		8,338,340	1,704,345
-	-	Purchase of property and equipment	27	(367,580)	(412,581)
-	-	Purchase of intangible assets	28 (a)	(444,473)	(731,725)
-	-	Proceeds from Corporate bonds		98,225	53,005
-	-	Proceeds from sale of motor vehicle and equipment	39 (c)	1,274	5,635
-	(5,259,004)	Group Reorganisation Transactions		-	-
(450,000)	**(5,259,004)**	**Net cash used in investing activities**		**(4,317,327)**	**(24,835,116)**
		CASH FLOWS FROM FINANCING ACTIVITIES			
(619,348)	(653,157)	Dividends paid	35	(619,348)	(653,157)
-	-	Repayment of long term borrowings		(3,243,882)	(2,939,626)
(6,050)	-	Bonus and rights issue expenses paid		(6,050)	-
(625,398)	**(653,157)**	**Net cash used in financing activities**		**(3,869,280)**	**(3,592,783)**
(862,276)	**(6,349,945)**	**NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS**		**791,670**	**(5,492,164)**
1,200,000	**7,549,945**	**CASH AND CASH EQUIVALENTS AT 1 JANUARY**		**2,929,861**	**8,541,503**
-	-	Translation difference		(349,523)	(119,478)
337,724	**1,200,000**	**CASH AND CASH EQUIVALENTS AT 31 DECEMBER**	39 (b)	**3,372,008**	**2,929,861**

The notes on pages 24 to 113 are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1) General Information

NIC Group PLC (the "Company/Parent") and its subsidiaries (together, the "Group") provide retail, corporate banking, brokerage, bancassurance, property and investment banking services. NIC Group PLC is incorporated in Kenya under the Kenyan Companies Act 2015 as a public limited liability company and is domiciled in Kenya. The Company's shares are listed on the Nairobi Securities Exchange (NSE). NIC Group PLC and its subsidiaries operate in Kenya, Tanzania and Uganda through its subsidiaries NIC Bank Tanzania Limited and NC Bank Uganda Limited.

The address of its registered office is as follows:
LR Plot No.8182
NIC House, Masaba Road
PO Box 44599-00100
Nairobi

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

2) Significant accounting policies

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

2.1 Basis of preparation

i) Compliance with IFRS

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the interpretations issued by the IFRS Interpretations Committee of the IASB (IFRS IC) applicable to companies reporting under IFRS and the requirements of the Kenyan Companies Act, 2015.

ii) Historical cost convention

The financial statements have been prepared on a historical cost basis, except for the following:

- certain financial assets and liabilities (including derivative instruments),certain classes of property, plant and equipment and investment property – measured at fair value; and
- assets held for sale – measured at fair value less costs to sell.

iii) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the directors to exercise their judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 6.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued)

2.1 Basis of preparation (continued)

iv) Changes in accounting policies and disclosures (continued)

New standards and interpretations not yet adopted (continued)

IFRS 16: Leases

The standard, which was issued in January 2016, will upon implementation result in almost all leases being recognised on the statement of financial position, as the distinction between operating and finance leases is removed. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low-value items. The accounting for lessors will not significantly change.

IFRS 16 replaces existing leases guidance, including IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The Group has assessed the estimated impact that the initial application of IFRS 16 will have on its consolidated financial statements, as described below.

a) Leases in which the Group is a lessee

The Group has completed an initial detailed assessment of the potential impact on its consolidated financial statements. The actual impact of applying IFRS 16 on the financial statements for the financial year ending 31 December 2019 will depend on:

- the final reconciliation of the of the Group's leases' portfolio;
- the Group's assessment of whether it will exercise any lease renewal options; and
- the extent to which the Group chooses to utilise practical expedients and recognition exemptions available under the standard.

The Group will recognise new assets and liabilities for its operating leases of Group premises and equipment. The nature of expenses related to these leases will now change because IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of- use assets and interest expense on lease liabilities. Previously, the Group recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

As at 31 December 2018, the Group's future minimum lease payments under non-cancellable operating leases amounted to Shs 1.6 billion on a discounted basis, which the Group estimates it will recognise as additional lease liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued)

2.2 Basis of preparation (continued)

iv) Changes in accounting policies and disclosures (continued)

New standards and interpretations not yet adopted (continued)

IFRS 16: Leases (continued)

b) Transition

The transition provisions of IFRS 16 allow an entity not to restate comparatives. The Group will elect not to restate comparatives but instead adopt IFRS 16 on 1 January 2019 using a modified retrospective approach. Therefore, the cumulative effect of adopting IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

The Group has assumed an average incremental rate of 7.5% on all its operating leases. Accordingly, on initial transition at 1 January 2019, the Group has estimated the following impact to the financial statement:

	Percentage change
Impact on total assets for right of use asset recognised	0.75% increase
Impact on total liabilities for lease obligation recognised	0.75% increase
Impact on retained earnings on initial application	0.30% decrease

New and amended standards adopted by the Group

The Group has applied the following standards and amendments for the first time for their annual reporting period commencing 1 January 2018:

- IFRS 15 Revenue from Contracts with Customers
- IFRS 9 Financial Instruments
- Annual Improvements 2015-2016 cycle
- Transfers of investment property – amendments to IAS 40
- Interpretation 22 Foreign Currency Transactions and Advance Consideration

The Group changed its accounting policies and made certain retrospective adjustments following the adoption of IFRS 9 and IFRS 15. Most of the other amendments listed above did not have any impact on the amounts recognised in prior periods and are not expected to significantly affect the current or future periods.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued)

2.1 Basis of preparation (continued)

iv) Changes in accounting policies and disclosures (continued)

New and amended standards adopted by the Group (continued)

IFRS 15 revenue from Contracts with Customers (IFRS 15)

IFRS 15 provides a single, principles based five-step model to be applied to all contracts with customers (except for contracts that are within the scope of the standards on leases, insurance contracts or financial instruments). It replaced the existing revenue standards and their related interpretations.

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration of which the entity expects to be entitled in exchange for those goods or services. The standard incorporates a five step analysis to determine the amount and timing of revenue recognition.

Because the standard does not apply to revenue associated with financial instruments, it does not impact the majority of the Group's revenue streams. The Group has reviewed the contracts with customers within the scope of IFRS 15 and concluded that the adoption of IFRS 15 did not have a material impact on the Group's revenue recognition criteria and there were therefore no transition adjustments required.

IFRS 9 - Financial Instruments

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

As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and financial liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period. The comparative financial information was prepared on an IAS 39 basis while the 2018 information is presented under IFRS 9 basis. As such, comparability between the two reporting periods is not achieved but further details on the impact of this transition are included below.

The adoption of IFRS 9 has resulted in changes in the Group's accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments as *IFRS 7 'Financial Instruments: Disclosures'*. The new accounting policies are set out in note 2.2. In accordance with the transitional provisions in IFRS 9 comparative figures have not been restated.

a) Classification and measurement of financial instruments

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued)

2.1 Basis of preparation (continued)

iv) Changes in accounting policy and disclosures (continued)

New and amended standards adopted by the Group (continued)

IFRS 9 - Financial Instruments (continued)

a) Classification and measurement of financial instruments (continued)

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets				
Cash and balances with Central Banks	Loans and receivables	Amortised cost	9,516,131	9,500,462
Items in the course of collection	Loans and receivables	Amortised cost	233,004	233,004
Deposits and balances due from banking institutions	Loans and receivables	Amortised cost	12,425,067	12,405,885
Fixed rate treasury bonds held at fair value through OCI	AFS	FVOCI	31,422,409	30,536,042
Government securities held to maturity (amortised cost)	HTM	Amortised cost	23,293,386	24,126,261
Corporate bonds	HTM	Amortised cost	1,314,052	1,314,052
Equity investment at FVTPL	FVTPL (Mandatory)	FVTPL	99,784	99,784
Loans and advances from customers	Loans and receivables	Amortised cost	116,774,033	112,541,931
Loan notes at FVTPL	FVTPL (Mandatory)	FVTPL	1,672,452	1,672,452
Other assets (financial)	Loans and receivables	Amortised cost	2,100,482	2,100,482
Total financial assets			**198,850,800**	**194,530,355**
Financial liabilities				
Customer deposits	Other liabilities	Amortised cost	138,916,570	138,916,570
Due to banking institutions	Other liabilities	Amortised cost	12,138,495	12,138,495
Borrowings	Other liabilities	Amortised cost	17,025,858	17,025,858
Derivative liabilities	FVTPL (Mandatory)	FVTPL	16,467	16,467
Other liabilities	Other liabilities	Amortised cost	3,292,183	3,292,183
Total financial liabilities			**171,389,573**	**171,389,573**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.1 Basis of preparation (continued)

iv) Changes in accounting policy and disclosures (continued)

New and amended standards adopted by the Group (continued)

IFRS 9 - Financial Instruments (continued)

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

The Group has performed an assessment of its business models for managing financial assets held and has classified its financial instruments into the appropriate IFRS 9 categories. The main effects resulting from this reclassification are as follows:

Financial assets	Opening balance IAS 39 carrying amount 31 December 2017 Shs' 000	Reclassifications Shs' 000	Remeasurements Shs' 000	Closing balance IFRS 9 carrying amount 1 January 2018 Shs' 000
Amortised cost:				
Cash and balances due from financial institutions	9,516,131	-	(15,669)	9,500,462
Items in the course of collection	233,004	-	-	233,004
Deposits and balances due from banking institutions	12,425,067	-	(19,182)	12,405,885
Government securities at amortised cost	23,293,386	855,782	(22,907)	24,126,261
Invesments	1,314,052	-	-	1,314,052
Loans and advances from customers	116,774,033	-	(4,232,103)	112,541,930
Other assets	2,100,482	-	-	2,100,482
Total financial assets measured at amortised cost	**165,656,155**	**855,782**	**(4,289,860)**	**162,222,077**
Fair value through other comprehensive income (FVOCI):				
Available for sale Government securities	31,422,409	(855,782)	(30,585)	30,536,042
Total financial assets at FVOCI	**31,422,409**	**(855,782)**	**(30,585)**	**30,536,042**
Fair value through profit or loss (FVPL):				
Loan notes at FVTPL	1,672,452	-	-	1,672,452
Equity Investment at FVTPL	99,784	-	-	99,784
Total financial assets at FVPL	**1,772,236**	**-**	**-**	**1,772,236**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.1 Basis of preparation (continued)

iv) Changes in accounting policy and disclosures (continued)

New and amended standards adopted by the Group (continued)

IFRS 9 - Financial Instruments (continued)

b) Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 (continued)

	Opening balance IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	Closing balance IFRS 9 carrying amount 1 January 2018
	Shs' 000	Shs' 000	Shs' 000	Shs' 000
Financial Liabilities				
Amortised cost:				
Customer deposits	138,916,570	-	-	138,916,570
Due to banking institutions	12,138,495	-	-	12,138,495
Borrowings	17,025,858	-	-	17,025,858
Other liabilities	3,292,183	-	-	3,292,183
Total financial liabilities measured at amortised cost	**171,373,106**	**-**	**-**	**171,373,106**
Fair value through profit or loss (FVPL):				
Derivative liabilities	16,467	**-**	**-**	**16,467**
Total financial liabilities at FVTPL	**16,467**	**-**	**-**	**16,467**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.1 Basis of preparation (continued)

iv) Changes in accounting policy and disclosures (continued)

New and amended standards adopted by the Group (continued)

IFRS 9 - Financial Instruments (continued)

c) Reconciliation of impairment allowance balances from IAS 39 to IFRS 9

The total remeasurement loss for the Group as at 1 January 2018 was Shs 4,320,446,000.

The tables below provide a detailed reconciliations between the prior period's closing impairment allowances measured in accordance with IAS 39 incurred loss model and to the new impairment allowance measured in accordance with the IFRS 9 expected credit loss model at 1 January 2018.

Measurement category	Loan loss allowance under IAS 39 Shs' 000	Remeasurements Shs' 000	Loan loss allowance under IFRS 9 Shs' 000
Cash and balances with Central Bank of Kenya	-	34,851	34,851
Investment securities at amortised cost	-	22,907	22,907
Investment securities at FVOCI	-	30,585	30,585
Loans and advances to customers	5,987,929	4,153,351	10,141,280
Investments	41,006	-	41,006
Non Financial guarantee contracts (LC's & Guarantee)	-	27,027	27,027
Loan commitments (Undrawn facilities)	-	51,725	51,725
Gross Adjustment on initial application of IFRS 9	**6,028,935**	**4,320,446**	**10,349,381**
Deferred Tax @ 30%	-	(1,296,134)	-
Adjustment on initial application of IFRS 9 net of tax	**6,028,935**	**3,024,312**	**10,349,381**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets

2.2.1 Policy applicable from 1 January 2018

(i) Classification and subsequent measurement

The classification requirements for debt assets are described below:

Debt assets

Debt assets are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse.

Classification and subsequent measurement of debt assets depend on:

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

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

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 3.1.2. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

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

- Fair value through profit or loss: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt assets that were designated at fair value or which are not held for trading, in which case they are presented separately in Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Business model

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.1 Policy applicable from 1 January 2018 (continued)

(i) Classification and subsequent measurement (continued)

For example, the Group's business model for the mortgage loan book is to hold to collect contractual cash flows, with sales of loans only being made internally to a consolidated SPV for the purposes of collateralising notes issued, with no resulting derecognition by the Group. Another example is the liquidity portfolio of assets, which is held by the Group as part of liquidity management and is generally classified within the hold to collect and sell business model. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the 'other' business model and measured at FVTPL.

Solely payments of principal and interest (SPPI):

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

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

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

Equity instruments

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

The Group subsequently measures all equity investments at fair value through profit or loss, except where the Group’s management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Group’s policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Group’s right to receive payments is established.

Gains and losses on equity investments at FVPL are included in the ‘Net trading income’ line in the statement of profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.1 Policy applicable from 1 January 2018 (continued)

(ii) Impairment

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

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. Note 3.1.2 provides more detail of how the expected credit loss allowance is measured.

(iii) Modification of loans

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.1 Policy applicable from 1 January 2018 (continued)

(iv) Derecognition other than a modification

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

The Group enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Group:

- Has no obligation to make payments unless it collects equivalent amounts from the assets;
- Is prohibited from selling or pledging the assets; and
- Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Group retains a subordinated residual interest.

2.2.2 Policy applicable before 1 January 2018

i) Classification

The Group classified its financial assets into the following categories:

- At fair value through profit or loss
- Loans and receivables
- Held-to-maturity investments
- Available for sale investments

Management determined the appropriate classification of its investments at initial recognition.

(a) Loans and receivables

Loans and advances to customers and trade receivables were non-derivative financial assets with fixed or determinable payments and fixed maturities that were not quoted in an active market and which the Group did not intend to sell immediately or in the near term. Loans and advances to customers were recognised when cash was advanced to borrowers.

(b) Held-to-maturity investments

These were non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group had the positive intention and ability to hold to maturity. Where a sale occurred, other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and classified as available for sale.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.2 Policy applicable before 1 January 2018 (continued)

i) Classification (continued)

(c) Financial assets at fair value through profit or loss

This category had two sub-categories: Financial assets classified as held for trading and those designated at fair value through profit or loss at inception.

A financial asset was classified as held for trading if acquired principally for the purpose of selling in the short term. Derivatives were also categorised as held for trading unless they were designated and effective as hedging instruments. Financial instruments included in this category were recognised initially at fair value, transactions costs were taken directly to profit or loss. Gains and losses arising from changes in fair value were included directly in profit or loss.

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

- the application of the fair value option reduces or eliminates an accounting measurement mismatch; or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to key management personnel on a fair value basis.

For the Group, these comprise derivative assets (Note 21), certain government securities as set out in Note 20, quoted shares and unquoted equity investments (Note 25). Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Net gains on financial instruments designated at fair value through profit or loss' under 'net trading income' (Note 10).

(d) Available-for-sale investments

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

Available for sale financial assets were initially recognised at fair value and measured subsequently at fair value with gains and losses being recognised in other comprehensive income and accumulated in the investments revaluation reserve with the exception of;

- impairment losses
- interest calculated using the effective interest rate method
- foreign exchange gains and losses on monetary assets which are recognised in profit or loss.

ii) Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or substantially all the risks and rewards of ownership incidental to the financial asset are transferred. A financial liability is derecognised when its contractual obligations are redeemed or otherwise extinguished.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.3 Policy applicable before 1 January 2018 (continued)

iii) Measurement

Financial instruments are initially recognised at fair value plus transaction costs.

Financial assets at 'fair value through profit or loss' are subsequently carried at fair value. Gains and losses arising from changes in the fair value in those assets are recognised in profit or loss.

Gains and losses arising from changes in the fair value of 'available-for-sale financial assets' are recognised in other comprehensive income in the period in which they arise and accumulated in the investment revaluation reserves.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments previously recognised in the investment revaluation reserves are reclassified to profit or loss.

Dividends on available-for-sale equity instruments are recognised in profit or loss as part of other income when the Group's right to receive payments is established.

The fair values of quoted investments are based on the most representative price within the bid-ask spread. If the market for a financial asset is not active (and for unquoted securities), the Group establishes fair value by using valuation techniques that include the use of various valuation methodology. The fair value of financial instruments where no active market exists or where quoted prices are not otherwise available are determined by using valuation techniques. In these cases, the fair values are estimated from observable data in respect of similar financial instruments or using models. Where market observable inputs are not available, they are estimated based on appropriate assumptions. Where valuation techniques (for example, models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of those that sourced them.

Loans and receivables and held to maturity investments are carried at amortised cost using the effective interest rate method.

Financial liabilities are subsequently measured at amortised cost.

iv) Impairment of financial assets

Amounts classified as available for sale

In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from other comprehensive income and recognised in profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.2 Policy applicable before 1 January 2018 (continued)

iv) Impairment of financial assets (continued)

Amounts carried at amortised cost

The Group reviews regularly, on a case-by–case basis, whether any objective evidence exists of impairment, individually for financial assets that are significant and individually or collectively for financial assets that are not individually significant. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably.

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of loans and receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in profit or loss as 'Credit impairment charges'. When a loan or receivable is uncollectible, it is written off against the related allowance account. Subsequent recoveries of amounts previously written off are credited through profit or loss.

Objective evidence that loans and receivables are impaired includes significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue), the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Group are considered indicators that the loans or receivable is impaired.

In assessing impairment losses, the Group considers the following factors, in each category:

Individually assessed loans

- The aggregate exposure to the Group.
- The viability of the customer's business model and its capacity to trade successfully out of financial difficulties and generate sufficient cash flows to meet its debt obligations.
- The realisable value of the security (or other mitigants) and likelihood of successful repossession net of any costs involved in recovery of amounts.
- The amount and timing of expected receipts and, in cases of liquidation or bankruptcy, dividend available.
- The extent and complexity of other creditors' commitment ranking pari passu with the Group and the likelihood of other creditors continuing to support the customer.

Collectively assessed

- For loans not subject to individual assessment, to cover losses which have been incurred but have not yet been identified.
- For homogeneous groups of loans that are not considered individually significant, where there is objective evidence of impairment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.2 Financial assets (continued)

2.2.2 Policy applicable before 1 January 2018

iv) Impairment of financial assets (continued)

Amounts carried at amortised cost

Homogeneous groups of loans

For homogeneous groups of loans that are not considered individually significant, or in other cases, when the portfolio size is small or when information is insufficient or not reliable enough, the Group adopts a formulaic approach which allocates progressively higher percentage loss rates in line with the period of time for which a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio. These rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Loan write – offs

An uncollectible loan is written off against the relevant provision for impairment, either partially or in full, when there is no realistic prospect of recovery and the proceeds from realising the security have been substantially or fully recovered.

Restructured loans

Restructure of a loan is accommodated only where a borrower provides sufficient evidence of cash flow to support the new repayment schedule The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have sustained a record of performance in accordance with the new repayment terms for six to twelve consecutive months.

2.3 Financial liabilities

(i) Classification and subsequent measurement

In both the current and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and

- Financial guarantee contracts and loan commitments

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.3 Financial liabilities

(ii) Derecognition

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

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

2.4 Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Loan commitments provided by the Group are measured as the amount of the loss allowance. The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.5 Consolidation

i) Subsidiaries

The consolidated financial statements comprise the financial statements of NIC Group PLC and its subsidiary companies made up to 31 December. Subsidiary undertakings have been fully consolidated. All intercompany transactions, balances and unrealised surpluses and deficits on transactions between Group companies have been eliminated.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are deconsolidated from the date that control ceases.

The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

A listing of the Company's subsidiaries is set out in Note 25 (b).

The acquisition method of accounting is used when subsidiaries are acquired by the Group. The cost of an acquisition in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the consideration transferred by the Group, liabilities assumed by the Group from the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

At the acquisition date, the acquired identifiable assets and the liabilities assumed are generally measured and recognized at their fair value.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the Group's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

In the event that the amounts of net assets acquired is in excess of the aggregate of the consideration transferred, the amount of non-controlling interest and the fair value of Group’s previously held equity interest, the difference is recognised immediately in profit or loss as a bargain purchase.

In a business combination achieved in stages, the previously held equity interest is re-measured at the acquisition-date fair value with the resulting gain or loss recognised in profit or loss.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

Additional information required by the regulatory bodies is included where appropriate.

i) Changes in ownership interest in subsidiaries without change of control

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions – that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.6 Foreign currencies

Functional and Presentation currency

The financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings, which is the Group and the Company's Presentation Currency. Except as indicated, financial information presented in Kenya Shillings has been rounded to the nearest thousand.

Transactions and balances

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the respective functional currencies of the operations using the exchange rates prevailing at the dates of the transactions.

At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

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

Translation differences on non-monetary financial instruments, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary financial instruments, such as equities classified as available-for-sale financial assets, are included in other comprehensive income.

2.7 Interest income and expense

2.7.1 Policy applicable from 1 January 2018

Interest income and expense for all interest bearing financial instruments are recognised in profit or loss on accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial instrument.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.7 Interest income and expense (continued)

2.7.1 Policy applicable before 1 January 2018

Interest income and expense for all interest bearing financial instruments were recognised in profit or loss on accrual basis using the effective interest method. The effective interest rate was the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate was established on initial recognition of the financial instrument.

The calculation of the effective interest rate included all fees and points paid or received transaction costs, and discounts or premiums that were an integral part of the effective interest rate. Transaction costs were incremental costs that were directly attributable to the acquisition, issue or disposal of a financial instrument.

Once a financial asset or a group of similar financial assets had been written down as a result of an impairment loss, interest income was recognised using the rate of interest that was used to discount the future cash flows for purposes of measuring the allowance for impairment.

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

2.8 Fee and commission income and expenses

In the normal course of business, the Group 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 instrument are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing 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 incurred as the services are received.

2.9 Net trading income

Net trading income arises from the margins which are achieved through market-making and customer business and from changes in market value caused by movements in interest and exchange rates, equity prices and other market variables. It comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

2.10 Offsetting

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.11 Employee benefits

Retirement benefit obligations

The Group operates a defined contribution plan under which the Group pays fixed contributions into a separate entity. The Group has no obligation, legal or constructive, to pay further contributions if the scheme does not have sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The assets of the scheme are held in a separate trustee administered fund, which is funded by contributions from both the Group and the employees.

In addition, the Group also contributes to the National Social Security Funds.

The Group's contributions to the defined contribution schemes are charged to the profit or loss in the year in which they relate.

Contract staff are entitled to gratuity payment at the completion of the contract. Provision is made for gratuity in line with the contracts.

Short-term benefits

Short-term employee benefit obligations (e.g. medical reimbursements and insurance) are measured on an undiscounted basis and are expensed as the employee renders service.

The monetary benefits for employee accrued leave entitlement at the reporting date are recognised as an expense accrual.

2.12 Leasehold land

Payments to acquire leasehold interest in land are treated as prepaid operating lease rentals and amortised on straight line basis over the period of the lease. When a lease includes land and buildings elements, the Group 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. Therefore the finance lease or operating lease classification of the land is considered a area of judgment.

2.13 Income tax expense

Income tax expense comprises current and deferred tax. Current tax is the expected tax payable on the taxable profit for the year using currently enacted tax rates, and any adjustment to tax payable in respect of previous years.

The current income tax charge is calculated on the basis of tax laws enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

Management establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.14 Income tax expense (continued)

Deferred tax is provided using the liability method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Currently enacted tax rates are used to determine deferred tax.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The tax effects of carry-forwards of unused losses or unused tax credits are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

2.15 Leases

When the Group is the lessor in a lease agreement that transfers substantially all of the risks and rewards incidental to ownership of an asset to the lessee, the arrangement is classified as a finance lease within loans and receivables. All other lessees are classified as operating leases.

Minimum lease payments made under finance leases are apportioned between the finance income and the reduction of the outstanding principal. The finance income is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the asset.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Rentals payable under operating leases are charged to profit or loss over the terms of the relevant lease.

2.16 Repurchase agreements

When the Group purchases a financial asset and simultaneously enters into an agreement to re-sell the asset (or a substantially similar asset) at a fixed price on a future date ("reverse repo or stock borrowing"), the arrangement is accounted for as a loan or receivable, and the underlying asset is not recognised in the Group's financial statements.

2.17 Property and equipment

Recognition and measurement

Items of fixtures and equipment are stated at historical cost less accumulated depreciation. Buildings comprising mainly of the head office are stated in the statement of financial position at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation. Valuations are performed with sufficient regularity to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour and any other costs directly attributable to bringing the asset to a working condition for its intended use. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.17 Property and equipment (continued)

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items of property and equipment.

The gain or loss arising on the disposal or retirement of an item of property or equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss for the year.

Subsequent costs

The cost of replacing part of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are charged to profit or loss for the year as incurred.

In relation to buildings, revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair value at the reporting date. Any increase arising on the revaluation is recognised in other comprehensive income and accumulated in the revaluation surplus on property. Decreases that offset previous increases of the same asset are recognised in other comprehensive income and charged against the revaluation surplus on property; all other decreases are charged to the profit or loss for the year.

Depreciation which is recognised in profit or loss is calculated on a straight-line basis to allocate the costs or revalued amounts over their estimated useful lives as follows:

Building	2.5%
Furniture, fittings and equipment	20.0%
Motor vehicles	20.0%
Computers	33.3%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Excess depreciation, representing the additional depreciation based on revalued amounts over depreciation based on historical costs, is transferred annually from revaluation surplus on property to retained earnings, net of deferred tax.

2.18 Intangible assets

Computer software

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.18 Intangible assets (continued)

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

Computer software development costs recognised as assets are amortised over their estimated useful lives, which is three to five years.

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

License

Separately acquired licences in business combination are initially recognised at their fair value at the acquisition date. Licences with an indefinite useful life are not amortised and are reviewed at each reporting date to determine whether events and circumstances continue to support an indefinite useful life assessment of the asset. Where the Group re-assesses the useful life of an intangible asset as finite rather than indefinite, the asset may be considered to be impaired. The Group tests the asset for impairment annually and whenever there is an indication that the intangible asset may be impaired by comparing its recoverable amount, with the carrying amount and recognising any excess of the carrying amount over the recoverable amount as an impairment.

2.19 Legal and other claims

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

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

2.20 Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition. These includes notes and coins on hand, unrestricted balances held with Central Bank of Kenya, items in the course of collection from other banks, deposits held at call with banks, net of deposits and balances due to banking institutions and treasury bills with original maturities of less than three months. Such assets are generally subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

2.21 Share capital and share premium

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

2.22 Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds, which are credit-related instruments, are generally given by the Group to support performance by a customer to third parties. Nominal principal amounts represent amounts at risk should the Group be required to meet these obligations in the event the customer defaults. These obligations are accounted for as off balance sheet transactions and disclosed as contingent liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.23 Regulatory reserves

IFRS 9 requires the Group to recognise an impairment loss when there is objective evidence that loans and receivables are impaired. However, prudential guidelines issued by banking regulators require the Group to set aside amounts for impairment losses on loans and receivables based on their guidelines. Extra losses over and above those already recognised under IFRS 9 are accumulated under regulatory reserves through appropriations of retained earnings.

The Group maintains a regulatory reserve by appropriating from retained earnings an amount equivalent to at least the excess provision required under the Central Bank of Kenya's prudential guidelines and those computed under IFRS 9.

2.24 Fiduciary activities

The Group provides custody, trustee, corporate administration, investment management and advisory services to third parties, which involve the Group making allocation and purchase and sale decisions in relation to a wide range of financial instruments. Those assets that are held in a fiduciary capacity are not included in these financial statements.

2.25 Derivative financial instruments

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives are intended to acquire, increase, reduce or alter exposure to market risks. The Group uses derivatives for its customers and on its own account to manage exposure to market risks. Derivative assets and liabilities on different transactions are only set off if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

2.26 Segmental reporting

A segment is a distinguishable component of the group that is engaged in providing products or services within a particular economic environment which is subject to risks and rewards that are different from those of other segments. Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker (Group management). The management then allocates resources to each operating segment of the Group and assesses their performance. The operating segments are based on the Group's management and internal reporting structure. All transactions between business segments are conducted on commercial terms with intra-segment revenue and costs being eliminated at Group level.

In accordance with IFRS 8, Operating Segments, the Group has the following business segments; corporate and institutional banking, treasury dealing and brokerage, retail banking, asset finance and investment banking and others (see note 7).

2.27 Proposed dividends

Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are appropriated from retained earnings and shown as a separate component of equity until approved by the shareholders at the Annual General Meeting.

2.28 Other income

Other revenue includes dividends received from subsidiaries and associate investments, fair value gains and losses on investment securities at fair value through profit or loss, dividends relating to those financial instruments, and re-measurement gains and losses from contingent consideration on disposals and purchases.

Dividends on equity instruments are recognised in the profit or loss when the Group's right to receive payment is established.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2) Significant accounting policies (continued

2.29 Comparatives

Except otherwise required, all amounts are reported or disclosed with comparative information. Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

Risk management overview

In the financial services sector, sustainable growth in profitability involves selectively taking and managing risks. The Group's goal is to earn, on behalf of the stakeholders, an optimal, stable and sustainable rate of return for every shilling of risk we take, while continually investing in our business to meet our future growth objectives. The risk management resources and processes are designed to identify, understand, measure and report risks that the Group's businesses are exposed to, and develop governance, controls, and risk management frameworks necessary to mitigate these risks as appropriate. These resources and processes are strengthened by the Group's culture which emphasises transparency, accountability and responsibility for managing the risks we are exposed to.

The Group defines risk as an event or events of uncertainty which can be caused by internal or external factors resulting in the possibility of losses (downside risk). However, the Group appreciates that some risk events may result into opportunities (upside risk) and should therefore be actively sought and exploited.

The Group operates in an environment of numerous risks as shown below that may cause financial and non-financial results to differ significantly from the expected outcomes. The Group has an enterprise-wide approach to the identification, measurement, monitoring and management of risks faced across the region. These financial risks are classified as follows:

- Credit & counterparty risk
- Liquidity & funding risk
- Market risk that fall within:
    - Interest rate risk
    - Foreign exchange risk

3.1. Credit and counterparty risk

Credit and counterparty risk is the potential for loss due to the Group's customers' or counterparties' failure or unwillingness to meet their contractual credit obligations. It is the single largest financial risk that the Group faces. It arises principally from, but is not limited to, commercial and retail loans and advances, commitments from forward foreign exchange contracts , financial guarantees, letters of credit and acceptances, investments in debt securities and other exposures arising from trading and settlement activities with market counterparties.

The amounts presented in these financial statements are net of impairment allowances based on prudent assessment of the customers' or counterparties' abilities to meet their contractual obligations.

The Group's lending principles are laid out in an elaborate series of corporate strategies, policies, standards, guidelines, directives and procedures, all of which are developed, approved and reviewed regularly by the Board Credit Risk Committee and respective Risk Management Committees. This is to ensure policies are current and consistent with the Group's risk appetite. The structure, limits, collateral requirements, ongoing management, monitoring and reporting of credit exposures are all governed by these principles.

i) Who manages credit & counterparty risk

The Board of Directors and Senior Management pay special attention to credit risk exposure at all times. The Board retains the responsibility for under-writing and independent review of the credit risk exposures through specifically constituted Board sub-committees: the Board Credit Risk Committee and the Board Risk Management Committee respectively. To facilitate the day to day management of credit risk i.e. under-writing functions, monitoring and control, there is a specialised, independent and centralised credit review/approval team headed by the Director, Credit risk who reports to the Managing Director. The Board of Directors retains the authority to approve credit facilities that are significant in size or complexity.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

Effective credit risk management begins with experienced and professional lending officers who have been formally mandated to authorise credit exposures for the Group. These individuals are subjected to a rigorous lender qualification process and operate within a disciplined environment with clear delegation of management discretionary limits at both the individual and joint levels depending on the size and complexities of the credit decisions they make.

To facilitate quick credit decisions, the Board Credit Risk Committee has granted formal discretionary limits to several Senior Managers (at individual and committee levels), in line with their skills, experience and ability to make sound credit decisions.

To separate the sales and credit under-writing functions from credit operations, a credit administration unit that reports directly to the Director, Technology and Operations, handles post-approval credit administration as well as the daily monitoring of credit exposures against approved limits. This together with the complete segregation of sales activities from the underwriting process, maintains an adequate governance structure that eliminates conflicts of interest that may occur in the course of business.

Credit risk management key performance indicators, including the quality of our credit portfolios, portfolio concentrations, amongst others, are independently reviewed by the Head of Risk Management & Compliance with oversight from the Board Risk Management Committee.

Regular independent audits of the approval process and adherence to credit risk management programs are carried out by the Internal Audit Department. Adverse findings are submitted to Senior Management and the Board Audit Committee for information and corrective actions implementation. Furthermore, audit programs are carried out using a risk based approach to concentrate activities where high probability and/or high impact risk events are envisaged.

ii) Credit and counterparty risk measurement and assessment

The estimation of credit exposures at the individual and portfolio levels is complex and requires the use of special models, as the value of products or portfolios varies with changes in market variables, expected cash-flows and the passage of time. The assessment of a portfolio of assets' credit exposures entails further estimation of the likelihood of defaults occurring, of associated losses, and of default correlations between borrowers or counterparties, the facilities granted, and their industries. This is achieved using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9.

The Board Credit Risk Committee regularly sets, reviews and approves exposure limits for the larger counterparties as well as tolerance limits on a portfolio basis. In turn, the Group manages the limits and controls concentrations of credit risk exposures against internal and regulatory requirements with respect to individual counterparties or related groups of counterparties, industry sectors, amongst others.

Exposures to any one borrower (including bank counterparties) are further restricted by sub-allocating limits covering separate on and off – balance sheet exposures, as well as daily delivery exposures in relation to trading items e.g. forward foreign exchange contracts.

Lending limits are reviewed regularly in line with the changing business/financial risks of the borrowers, in addition to industry and general economic conditions in which they operate. To enable prudent and consistent credit assessments at the individual level, the Group has robust approval processes and models covering different business segments. This process basically captures the borrower's financial viability, industry / economic performance, geopolitical risks and its managements' ability to steer the organisation. These models are suited to counterparties who are homogeneous in nature for ease of their use.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

ii) Credit and counterparty risk measurement and assessment (continued)

Limits for commercial and corporate clients are reviewed at least once annually. The credit review process ensures that an appropriate facility structure, including covenant monitoring, is in place for each client. The frequency of reviews is increased in accordance with the likelihood and size/complexity of potential credit losses, with deteriorating higher-risk situations referred to independent debt recovery units for closer attention and remediation where appropriate.

The risks in industry sectors are managed through limits and lending criteria / guidelines relevant to each particular industry. Borrower limits are set within the context of established guidelines for individual borrowers and particular industries to ensure the Group does not have excessive concentration in any related group of borrowers or industry. Through this portfolio management process, loans may be syndicated to reduce overall exposure to a single name and/ or industry.

Exposures against tolerance limits in relation to credit risk categories are measured and monitored periodically on an aggregated basis. Actual exposures against limits are monitored daily through the well-established credit management information systems that are in place.

iii) Control and mitigation measures

Although the Group only lends to counterparties that primarily demonstrate adequate capacity to repay loans, it also employs a range of policies, guidelines and models to mitigate credit risk as follows:

Collateral

This is only considered in those cases where the Group would want to take a credit risk mitigant. The Group has developed specific policies and guidelines for the acceptance of different classes of collateral whose estimated fair values are well understood.

Estimates of the collateral's fair values are based on the value of collateral independently and professionally assessed at the time of borrowing, and re-valued with a frequency commensurate with nature and type of the collateral and credit advanced. Collateral structures and covenants are subjected to regular review to ensure they continue to fulfil the intended purpose to the Group.

Collateral is generally not held in respect of deposits and balances due from banking institutions, items in the course of collection, and Government securities, except when securities are held for reverse purchase and securities borrowing activity.

Credit rating

The Group uses an internal rating system for its borrowing clients. The system sets maximum exposure limits for individuals or groups of clients using the rating attained by the borrowers. The rating system will also inform the basis of determining the value and classes of collateral acceptable for the borrower(s).

Settlement risk

This is the risk of loss due to the failure by counterparty to honour its obligations to deliver cash, securities or other assets as contractually agreed. It arises in situations where a payment in cash is made in anticipation of corresponding receipt of cash securities or other assets. Daily settlement limits are approved by the relevant authority levels and established for each counterparty to cover the aggregate of all settlement risks arising from the counterparty's market transactions on a single day. Acceptance of the counterparty's settlement risk is determined on the basis of financial strengths and other non-financial considerations subject to Board Credit Risk Committee's approvals.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

iv) Expected credit loss measurement

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

- **Stage 1:** Assets that are performing. If credit risk is low as of the reporting date or the credit risk has not increased significantly since initial recognition, The Group recognises a loss allowance at an amount equal to 12-month expected credit losses. This amount of credit losses is intended to represent lifetime expected credit losses that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

- **Stage 2:** Assets that have significant increases in credit risk. In instances where credit risk has increased significantly since initial recognition, the Group measures a loss allowance at an amount equal to full lifetime expected credit losses. That is, the expected credit losses that result from all possible default events over the life of the financial instrument. For these debt assets, interest income recognition will be based on the EIR multiplied by the gross carrying amount.

- **Stage 3:** For debt assets that have both a significant increase in credit risk plus observable evidence of impairment i.e. have defaulted.

Purchased or originated credit-impaired financial assets are those financial assets that are credit impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward looking information.

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	**Stage 2**	**Stage 3**
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

iv) Expected credit loss measurement

The key judgments and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

a) Significant Increase in credit risk (SICR)

The Group's decision on whether to recognize 12-month or lifetime expected credit losses depends on whether there has been a significant increase in credit risk since initial recognition. An assessment of whether credit risk has increased significantly is performed at each reporting date.

When making the assessment, the Group uses the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. This forms the basis of stage 1, 2 and 3 classification and subsequent migration.

The Group applies qualitative and quantitative criteria for stage classification and for its forward and backward credit risk migration.

Quantitative Criteria

The quantitative criteria is based on relative and not absolute changes in credit quality driven by counterparty ratings and days past due.

The Group considers that financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of a default occurring over the next 12 months may be a reasonable approximation of the changes in the lifetime risk of a default occurring and could be used to determine whether credit risk has increased significantly since initial recognition.

The appropriateness of using changes in the risk of a default occurring over the next 12 months to determine whether lifetime expected credit losses should be recognised depends on the specific facts and circumstances. Risk of default occurring over the next 12 months is not a suitable basis for determining whether credit risk has increased on a financial instrument with a maturity of more than 12 months when:

- The financial instruments only have significant payment obligations beyond the next 12 months;
- Changes in relevant macroeconomic or other credit-related factors occur that are not adequately reflected in the risk of a default occurring in the next 12 months; or
- Changes in credit-related factors only have an impact on the credit risk of the financial instrument (or have a more pronounced effect) beyond 12 months.

The Group's quantitative credit grading, as compared to respective entity's regulatory guidelines credit grading is as per the table below:

IFRS 9 credit staging / grading	Regulatory Guidelines	Days past due
1	Normal	Up to date and in line with contractual agreements or within 30 days' arrears
2	Watch	31 to 90 days overdue
3	Substandard	91 to 180 days overdue
	Doubtful	181 – 365 days overdue
	Loss	Over 365 overdue

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

iv) Expected credit loss measurement (continued)

a) Significant Increase in credit risk (SICR) (continued)

Qualitative Criteria

In addition to the above, the Group considers other qualitative factors in determining the classification above, and may accelerate the classification of credit facilities where deemed appropriate. They include but not limited to:

- Significant changes in the terms of the same instrument if it were issued at the reporting date that indicate a change in credit risk since initial recognition, e.g.: increase in credit spread; more stringent covenants; increased amounts of collateral or guarantees; or higher income coverage.
- Significant changes in external market indicators of credit risk for the same financial instrument (or similar instrument of the borrower), e.g.: credit spread; credit default swap prices; length of time or the extent to which the fair value of a financial asset has been less than its amortized cost; other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments; or external credit rating (actual or expected).
- Changes in the Group's credit management approach in relation to the financial instrument (e.g. based on emerging indicators of changes in the credit risk of the financial instrument, the Group's credit risk management practice is expected to become more active or focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the Group specifically intervening with the borrower).
- Actual or expected adverse changes in business, financial or economic conditions significantly affecting borrower's ability to meet its debt obligations (e.g. increase in interest rates or unemployment rates); operating results of the borrower e.g. declining revenues or margins, increasing operating risks, working capital deficiencies, decreasing asset quality, increased balance sheet leverage, liquidity, management problems or changes in the scope of business or organisational structure (such as the discontinuance of a segment of the business) that results in a significant change in the borrower's ability to meet its debt obligations; or regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations (e.g. a decline in the demand for the borrower's sales product because of a shift in technology).
- Significant changes in the value of collateral or in the quality of third-party guarantees or credit enhancements, which are expected to reduce the borrower's economic incentive to pay or otherwise affect the probability of default; or quality of a guarantee provided by a shareholder (or an individual's parents) if the shareholder (or parents) have an incentive and financial ability to prevent default by capital or cash infusion.
- Expected changes in the loan documentation (e.g. breach of contract leading to covenant waivers or amendments, interest payment holidays, interest rate step-ups, requiring additional collateral or guarantees).
- Significant changes in the expected performance and behavior of the borrower, including changes in the payment status of borrowers in the Group (e.g. increase in delayed contractual payments or number of credit card borrowers expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

3. The borrower is in long-term forbearance
4. The borrower is deceased

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

iv) Expected credit loss measurement (continued)

b) Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent or becoming probable that the borrower will enter bankruptcy
- The borrower is in breach of financial covenants
- An active market for that financial asset has disappeared because of financial difficulties
- Concessions have been made by the lender relating to the borrower's financial difficulty
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses

The above criteria have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

c) Measuring expected credit loss – inputs, assumptions and estimation techniques

Loans and advances and other credit commitments

"ECL" is defined as the amount on a probability-weighted basis as the difference between the cash flows that are due to the Group in accordance with the contractual terms of a financial instrument and the cash flows that the Group expects to receive.

ECL is formula driven, i.e. **ECL= PD x LGD x EAD**

ECLs are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12-month PD) or over the remaining lifetime (Lifetime PD) of the obligation.

- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12 months EAD) or over the remaining lifetime (Lifetime EAD).

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

iv) Expected credit loss measurement (continued)

c) Measuring expected credit loss – inputs, assumptions and estimation techniques (continued)

Loans and advances and other credit commitments (continued)

The ECL is determined by projecting the PD, LGD and EAD for each future year and for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The lifetime PD is developed by applying a maturity profile to the current 12 month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans.

The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and a credit grade. This is supported by a historical analysis.

The 12 month and lifetime EADs are determined based on the expected payment profile, which varies by product type:

- For amortising products or bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12-month or lifetime basis. This will also be adjusted for any expected overpayments made by the borrower. Early repayments/refinance assumptions are also incorporated.

- For revolving products, the exposure at default is predicted by taking the current drawn-down balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Group's recent default data.

  The 12-month and lifetime LGDs are determined based on the factors which impact the recoverable amount post default. These vary by product type:

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.

- For unsecured products, LGDs are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGDs are influenced by collection strategies, including contracted debt sales and prices.

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. These assumptions vary by the industry segmentation.

The assumptions underlying the ECL calculation – such as how the maturity profile of the PDs and how collateral values change etc. – are monitored and reviewed on an annual basis.

Other non-loan financial assets

ECL on non-loan financial assets such as government securities, other investments at armotised cost and at FVOCI and other financial assets is not measured using the general model. Instead, the Group:

- uses simple external credit ratings as proxies to infer approximate PDs;
- assumes 100% LGDs
- EADs are estimated based on the expected maturities of the instruments, and depending on whether these are stage 1 or stage 2.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

iv) Expected credit loss measurement (continued)

d) Forward-looking information incorporated in the ECL

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

Forecasts of the base economic scenario and the possible best and worst scenarios along with scenario weightings (64.7%, 17.65% and 17.65% respectively) are prepared by an expert economic team. The impact of these economic variables on the PD, EAD and LGD is determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to an inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Group’s different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible outcomes.

The key macro-economic factors that were evaluated by the Group and deemed to be most correlated to the historical and forecasted default statistics include Industry NPL ratios, exports of goods, GDP and inflation.

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have been considered, but are not deemed to have a material impact on therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness annually.

e) Grouping of instruments for losses measured on a collective basis

For expected credit losses provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogenous. In performing this grouping, there must be sufficient information for the group to be statistically credible. In concluding on how to group its exposures, the Group considered its approach to credit risk management and grouped its loans and advances at armotised cost based on market segments such as Corporate, Retail and Staff portfolios.

f) Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group’s recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

The Group may write-off financial assets that are still subject to enforcement activity. The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

v) Credit risk exposure

a) Maximum exposure to credit risk before collateral held

The following table sets out information about the credit quality and credit risk exposure of loans and advances

Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is included in Note 3.1 (v).

		2018					2017	
		Stage 1 12 months ECL	Stage 2 Life time ECL	Stage 3 Life time ECL	Total			
	Note	Shs'000	Shs'000	Shs'000	Shs'000	%	Shs'000	%
Credit exposures								
On – balance sheet items								
Balances with Central Banks	17	9,726,627	-	-	9,726,627	5	7,592,957	4
Items in the course of collection	18	400,689	-	-	400,689	-	233,004	-
Due from banking institutions	19	5,237,549	-	-	5,237,549	2	12,425,067	6
Loans and advances to customers	22	83,060,366	24,166,774	9,625,863	116,853,003	56	118,405,479	57
Government securities	20	61,706,465	-	-	61,706,465	29	54,715,795	26
Other assets – trade receivables	23	137,569	-	-	137,569	-	42,855	-
Derivative assets	21	161,554	-	-	161,554	-	-	-
		160,430,819	**24,166,774**	**9,625,863**	**194,223,456**	**93**	**193,415,157**	**93**
Off-balance sheet items								
Letters of credit	38	3,051,887	1,188,383	-	4,240,270	2	4,001,932	2
Guarantees and performance bonds		10,102,999	930,729	156,655	11,190,383	5	11,629,531	5
		13,154,886	**2,119,112**	**156,655**	**15,430,653**	**7**	**15,631,463**	**7**
		173,585,705	**26,285,886**	**9,782,518**	**209,654,109**	**100**	**209,046,620**	**100**

The above represents the worst case scenario of credit exposure for both years, without taking into account collateral held or other credit enhancements/mitigants. The Group Loans and advances to customers and other trade related items (off-balance sheet items) comprise of 63% (2017: 64%) of the total credit exposure.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1 Credit and counterparty risk (continued)

v) Credit risk exposure (continued)

a) Maximum exposure to credit risk before collateral held (continued)

The above represents the worst case scenario of credit exposure for both years, without taking into account collateral held or other credit enhancements/ mitigants.

The Loans and advances to customers and other trade related items (off-balance sheet items) comprise of 63% (2017: 64 %) of the total credit exposure.

Collateral

The Group routinely obtains collateral and security to mitigate credit risk. The Group ensures that any collateral held is sufficiently liquid, legally effective, enforceable and regularly reassessed.

Before attaching value to collateral, business holding approved collateral must ensure that they are legally perfected devoid of any encumbrances. Security structures and legal covenants are subject to regular review, at least annually, to ensure that they remain fit for purpose and remain consistent with accepted local market practice.

The principal collateral types held by the Group for loans and advances are:

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

Valuation of collateral taken will be within agreed parameters and will be conservative in value. The valuation is performed only on origination or in the course of enforcement actions. Within the corporate sectors, collateral for impaired loans including guarantees and insurance is reviewed regularly and at least annually to ensure that it is still enforceable and that the impairment allowance remains appropriate given the current valuation.

The Group will consider all relevant factors, including local market conditions and practices, before any collateral is realized.

While collateral is an important mitigate to credit risk, the Group's underwriting policy ensures that loans are strictly granted on a going concern basis with upfront adequate demonstration of repayment capacity. Other than exposures amounting to Shs 3,115,128,000 (2017: Shs 4,632,736,000) that are unsecured, all other facilities are secured by collateral in the form of charges over cash, land and buildings, marketable securities, plant and machinery, amongst others. The fair value of collateral held for impaired loans and advances is Shs 8,750,789,000 (2017: Shs 7,127,556,000).

Collateral repossessed

It is the Group's policy to dispose repossessed properties on the open market, at fair market value. The proceeds are used to reduce or repay the outstanding claim. In general, the Group does not occupy or foreclose repossessed properties for its own business use.

The Group is confident that its credit policies and programs provide sufficient safeguards against the credit risk exposure held.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

v) Credit risk exposure (continued)

b) Movement in gross loans and advances

Loan and advances	Stage 1 12 months ECL Shs '000	Stage 2 Life time ECL Shs '000	Stage 3 Life time ECL Shs '000	Total Shs '000
Balance at 1 January	89,215,379	20,439,942	13,106,641	122,761,962
– Transfer to stage 1	952,532	(853,559)	(98,973)	-
– Transfer to stage 2	(7,480,778)	7,779,611	(298,833)	-
– Transfer to stage 3	(2,087,646)	(4,100,308)	5,973,342	(214,612)
Net financial assets originated or purchased	27,721,864	10,737,286	(262,735)	38,196,415
Financial assets derecognised	(24,234,661)	(8,307,231)	(3,161,212)	(35,703,104)
	84,086,690	**25,695,741**	**15,258,230**	**125,040,661**

c) Movement in loss allowance on loans and advances

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

	Stage 1 12 months ECL Shs '000	Stage 2 Life time ECL Shs '000	Stage 3 Life time ECL Shs '000	Total Shs '000
Balance at 1 January	1,192,908	3,761,414	5,265,710	10,220,032
– Transfer to stage 1	95,230	(67,976)	(27,254)	-
– Transfer to stage 2	(149,440)	211,466	(62,026)	-
– Transfer to stage 3	(101,393)	(821,812)	923,205	-
Net financial assets originated or purchased	321,484	2,180,491	817,046	3,319,021
Financial assets derecognised	(445,787)	(1,697,905)	(1,170,991)	(3,314,683)
	913,002	**3,565,678**	**5,745,690**	**10,224,370**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

vi) Credit quality of loans and advances

Loans and advances at amortised cost less than 30 days past due date are not considered to have experienced SICR, unless other information is available to indicate the contrary. The breakdown of loans and advances based on their staging is summarised below:

	Group			
	Kenya	Tanzania	Uganda	Total
At 31 December 2018	**Shs `000**	**Shs `000**	**Shs `000**	**Shs `000**
Gross loans and advances				
Stage 1	77,876,027	2,576,256	3,634,407	84,086,690
Stage 2	25,207,205	394,327	94,208	25,695,740
Stage 3	14,318,014	471,835	468,381	15,258,230
	117,401,246	**3,442,418**	**4,196,997**	**125,040,660**
Impairment allowances				
Stage 1	(834,167)	(44,852)	(33,982)	(913,001)
Stage 2	(3,548,100)	(14,563)	(3,015)	(3,565,678)
Stage 3	(5,298,538)	(251,924)	(195,228)	(5,745,690)
Impairment allowances	**(9,680,805)**	**(311,339)**	**(232,225)**	**(10,224,369)**
	107,720,441	**3,131,079**	**3,964,771**	**114,816,291**
Fair-value				
Loan notes at FVTPL	2,036,712	-	-	2,036,712
Net loans and advances	**109,757,153**	**3,131,079**	**3,964,771**	**116,853,003**
Coverage ratio for stage 3	37%	53%	42%	38%
At 31 December 2017				
Gross loans and advances				
Neither past due nor impaired	81,339,427	3,192,504	3,010,996	87,542,927
Past due but not impaired	21,548,055	434,385	129,954	22,112,394
Individually impaired	12,050,508	638,309	417,824	13,106,641
Total gross loans advanced	**114,937,990**	**4,265,198**	**3,558,774**	**122,761,962**
Impairment allowances				
Neither past due nor impaired	-	-	-	-
Past due but not impaired	(679,514)	(32,715)	(9,990)	(722,219)
Individually impaired	(4,922,952)	(258,747)	(84,011)	(5,265,710)
Impairment allowances	**(5,602,466)**	**(291,462)**	**(94,001)**	**(5,987,929)**
Net loans and advances	**109,335,524**	**3,973,736**	**3,464,773**	**116,774,033**
Fair-value				
Loan notes at FVTPL	1,672,452	-	-	1,672,452
Net Loans	**111,007,976**	**3,973,736**	**3,464,773**	**118,446,485**
Coverage ratio of the individually impaired	41%	41%	20%	40%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.1. Credit and counterparty risk (continued)

vii) Concentrations of risk

The Group monitors concentration of risk exposures in its lending and other asset portfolios by individuals or groups of related borrowers and industry sector concentrations in line with Board of Directors' approved limits. These limits are reviewed regularly using economic risk indicators identified in particular industrial sectors. An analysis of concentrations within the loans and advances to customers and off balance sheet items are as follows:

Company			Group	
2018	2017		2018	2017
%	%		%	%
-	-	Manufacturing	22	20
-	-	Social community and personal services	13	15
-	-	Wholesale and retail	16	17
-	-	Transport and communication	19	16
-	-	Agriculture	5	5
-	-	Financial	5	4
-	-	Electricity	2	3
-	-	Other	18	20
-	**-**		**100**	**100**

3.2 Liquidity and funding risk

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations when they fall due or to fund increases in asset without incurring unacceptable costs or losses. Effective liquidity risk management is essential in order to maintain the confidence of depositors and counterparties, and to enable our core business to continue operating even under adverse liquidity circumstances.

i) Who manages liquidity and funding risk

The Assets and Liabilities Committee (ALCO), a management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met as and when they fall due, and that the Group will not encounter difficulties in meeting its current and future financial obligations or financial liabilities as they fall due.

ALCO relies substantially on the Group's Treasury Department to coordinate and ensure discipline across the Group and business units, certify sufficient liquidity under both normal and stressed conditions, without incurring unacceptable losses and/or risking damage to the Group's reputation.

The Board Executive Committee has oversight over ALCOs activities through regular review of its minutes and significant reports outlining the Group's current exposures against approved risk limits. These reports are also reviewed by the Board Risk Management Committee on a regular quarterly basis.

Liquidity policies / guidelines and limits are reviewed periodically, or as the need arises.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.2. Liquidity and funding risk (continued)

i) How liquidity and funding risk is managed

The Group's liquidity and funding policies require that it:

- Enters into lending contracts subject to availability of funds.
- Projects cash flows by major currencies and consider the level of liquid assets necessary in relation thereto.
- Monitors liquidity ratios against internal and regulatory requirements and guidelines.
- Maintains an array of a diverse range of funding sources as contingency back–up facilities.
- Monitors depositor concentration to avoid undue reliance on large individual depositors and ensure a satisfactory funding mix is attained.
- Invests in short term liquid instruments, which can easily be sold in the market when the need arises.
- Ensure investments in large cash outlay projects e.g. property and equipment purchases are budgeted for and carried out only when the Group has sufficiently liquid cash flows.
- Maintains liquidity and funding contingency plans. These plans and key risk indicators clearly identify early stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crisis while minimising adverse long-term implications.

ii) Sources of funding

The Group's major source of funding is customer deposits. To this end, the Group maintains a diversified and stable funding base comprising of the core retail and corporate customers and wholesale banking clientele. The Group places considerable importance on the stability of these deposits, which is achieved through the Group's corporate, institutional and retail banking activities and by maintaining depositor confidence in the Group's business strategies and financial strength. An analysis of concentrations within the customer deposits is as follows:

Company			Group	
2018	**2017**		**2018**	**2017**
%	**%**		**%**	**%**
-	-	Private enterprises	91	91
-	-	Non-profit institutions and individuals	5	5
-	-	Insurance companies	4	4
-	**-**		100	100

The Group also borrows from the inter-bank and wholesale markets such as pension funds and insurance companies to meet its short term liquidity and other investment objectives.

The Group does not maintain cash reserves to meet all its obligations as experience over time has shown that a minimum level of reinvestment of maturing customer funds can be predicted with a high level of certainty. Although the contractual repayments of many customer accounts are on demand or short notice, in practice from a behavioral perspective, short-term deposit balances remain stable as inflows and outflows broadly match.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.2. Liquidity and funding risk (continued)

ii) Sources of funding (continued)

The key measure used by the Group for managing liquidity is the ratio of net liquid assets to deposits from customers (liquidity ratio). For this purpose, net liquid assets include cash and cash equivalents and investments in securities for which there is an active and liquid market less any deposits from banks, as well as other borrowings and commitments maturing within the next month. The banking regulators also require that the Group maintains a cash reserve ratio computed as percentage of eligible customer deposits.

The banking regulations require that the Group maintains a minimum liquidity ratio of 20%. The Group complied with the liquidity requirements during the year.

The average liquidity ratio for the year was 48% (2017: 45 %).

The maturity analysis of assets and liabilities report is presented in the next pages. The Group uses the maturity mismatch ladders to compare cash inflows and outflows each month and over a series of time-bands. The maturity mismatch ladder shows the net cash flows of the Group in various time bands. The Group net funding requirements are determined by analysing present and future cash flows of the entire statement of financial position at selected maturity dates, based on assumptions of the behaviour of assets, liabilities and off-balance sheet items. Calculations will include the cumulative net excess or shortfall over the time frame of the liquidity assessment.

iii) Exposure to liquidity risk

The Group also monitors its liquidity exposures through an array of internally developed risk indicators such as several types of advances to deposit ratios, proportion of largest depositors to total deposits, liquidity gap analysis ratios, and interbank borrowings as a proportion of total deposits, amongst others. At the end of 2014, the Group begun to use the Basel Accord preferred Liquidity Coverage ratio and Net Stable Funding ratio to assess its short and long term liquidity stability. This enables the Group to arrest any early warning signs and take timely corrective action.

As part of the ALCO function, Treasury receives information from business units regarding the liquidity profile of their financial assets and liabilities plus details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment grade securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole. The liquidity requirements of business units and subsidiaries are met through various funding options to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

The table below presents the undiscounted cash flows receivable and payable by the Group under financial assets and liabilities by remaining contractual maturities at the reporting date.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.2. Liquidity and funding risk (continued)

iii) Exposure to liquidity risk (continued)

As at 31 December 2018	Up to 1 Month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Years Shs'000	Total Shs'000
FINANCIAL LIABILITIES						
Customer deposits	87,487,069	39,091,315	16,681,406	3,605,640	313,348	**147,178,778**
Due to banking institutions	9,892,968	13,461	-	-	-	**9,906,429**
Borrowings	-	-	9,760,376	2,522,651	4,711,204	**16,994,231**
Total financial liabilities	**97,380,037**	**39,104,776**	**26,441,782**	**6,128,291**	**5,024,552**	**174,079,438**
FINANCIAL ASSETS						
Cash and balances with Central Banks	11,972,902	-	-	-	-	**11,972,902**
Items in the course of collection	400,689	-	-	-	-	**400,689**
Due from banking institutions	5,253,062	-	-	-	-	**5,253,062**
Government securities	3,041,575	11,614,636	4,019,334	10,449,852	62,378,108	**91,503,505**
Loans and advances to customers	26,631,656	8,586,234	13,633,810	8,277,781	69,357,792	**126,487,273**
Total financial assets	**47,299,884**	**20,200,870**	**17,653,144**	**18,727,633**	**131,735,900**	**235,617,431**
Net liquidity gap	**50,080,153**	**18,903,907**	**8,788,638**	**(12,599,343)**	**(126,711,347)**	**(61,537,993)**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.2. Liquidity and funding risk (continued)

iii) Exposure to liquidity risk (continued)

As at 31 December 2017	Up to 1 Month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Years Shs'000	Total Shs'000
FINANCIAL LIABILITIES						
Customer deposits	86,063,494	39,952,950	13,954,711	91,685	77,683	**140,140,523**
Due to banking institutions	11,553,490	622,426	-	-	-	**12,175,916**
Borrowings	-	-	243,124	6,817,903	14,565,908	**21,626,935**
Total financial liabilities	**97,616,984**	**40,575,376**	**14,197,835**	**6,909,588**	**14,643,591**	**173,943,374**
FINANCIAL ASSETS						
Cash and balances with Central Banks	9,516,131	-	-	-	-	**9,516,131**
Items in the course of collection	233,004	-	-	-	-	**233,004**
Due from banking institutions	12,432,315	-	-	-	-	**12,432,315**
Government securities	-	360,035	8,504,581	19,971,420	40,521,981	**69,358,017**
Loans and advances to customers	30,234,263	8,969,865	12,912,960	21,248,005	65,471,960	**138,837,053**
Total financial assets	**52,415,713**	**9,329,900**	**21,417,541**	**41,219,425**	**105,993,941**	**230,376,520**
Net liquidity gap	**(45,201,271)**	**(31,245,476)**	**7,219,706**	**34,309,837**	**91,350,350**	**56,433,146**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market risk

Market risk is the risk that the values of assets and liabilities or revenues will be adversely affected by changes in market conditions or market movements. Market risks in the Group arise from movements in market prices particularly changes in interest rates, foreign currency exchange rates, fixed rate securities and equity prices which we are exposed to. It is often propagated by other forms of financial risks such as credit and market liquidity risk events. The objective of market risk management programs is to manage and control market risk exposures in order to optimise return on risk taken while maintaining a good market profile as a provider of financial products and services.

Management of market risk

The Board Risk Management Committee reviews and approves market risk policies and limits periodically or as the need arises. The Treasury Department in consultation with the Risk Management Department are responsible for the development of detailed market risk management policies, subject to review and support by ALCO and approval by the Board Risk Management Committee.

The Board receives quarterly reports of market risk exposures or activities through relevant ALCO minutes, and Treasury reports outlining current risk exposures against approved risk limits or appetite.

How market risk is managed

The Group’s Asset & Liability Committee (ALCO) oversees the application of the framework set by the Board of Directors and monitors the Group’s market risk exposures as well as activities that give rise to these exposures. Overall responsibility for the management of market risks rests with ALCO which reviews market risk activity reports monthly. Treasury is responsible for the day to day implementation of those policies or programs and limits.

In view of the fact that our market risk operations are not very complex, we basically use interest rates variance analysis models (against budget and prior month), interest rate gap analysis, proportion of interest sensitive deposits to total deposits, amongst other methodologies and key performance indicators, appropriate for our Group’s operations. The management of market risk is supplemented by the monitoring of key market risk and economic performance variables.

The distinct market risk exposures faced by the Group are:
- Interest rate risk.
- Foreign exchange risk.
- Price risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market risk (continued)

3.3.1 Interest rate risk

Interest rate risk represents exposures to instruments whose values vary with the level or volatility of interest rates. These instruments include, but are not limited to loans, debt securities, certain traded assets and liabilities, deposits, borrowings and derivative instruments. Generally, hedging instruments used by banks to mitigate such risks include related derivatives such as options and swaps.

The Group is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rates, as funds are sourced and invested at both fixed and floating rates. The maturities of assets and liabilities, plus the ability to replace interest bearing liabilities at an acceptable cost as they mature, are important factors in assessing the Group's exposure to changes in interest rates. In addition to maintaining an appropriate mix between fixed and floating rates deposit base, interest rates on advances to customers and other risk assets are mainly pegged to the Kenya Bankers Reference Rate (KBRR) - for floating rate loans. On 30 January 2017, CBK decided to suspend the KBRR framework, in view of the adoption of the new law capping interest rates.

Interest rates on customer deposits are negotiated between the Group and its customers, with the Group retaining the discretion to re-negotiate the rates at maturity in line with changes in market trends. The interest rates given or charged to clients therefore fluctuate depending on the movements in the market interest rates. The Group also invests in fixed interest rate instruments issued by the Government of Kenya through the Central Bank of Kenya.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group's interest rate risk. It is unusual for a bank ever to completely be matched due to the nature of business terms and types of products offered.

Interest rate risk – stress tests

The Group monitors the impact of risks associated with the effects of fluctuations in prevailing interest rates. At 31 December 2018, the following table summarises the estimated impact of an immediate hypothetical increase or decrease in interest rates of 125 basis points on consolidated profit before income tax expense, and current interest rate risk profile.

Company			Group	
2018	2017		2018	2017
Shs'000	Shs'000		Shs'000	Shs'000
-	-	125 basis points increases in interest rates	405,466	241,947
-	-	125 basis points decrease in interest rates	(405,466)	(241,947)

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market risk (continued)

3.3.1 Interest rate risk (continued)

31 December 2018

	Effective Rates %	Up to 1 month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Years Shs'000	non-interest bearing Shs'000	Total Shs'000
FINANCIAL ASSETS								
Cash and balances with Central Banks		-	-	-	-	-	11,955,411	**11,955,411**
Items in the course of collection		-	-	-	-	-	400,689	**400,689**
Due from banking institutions	1.18	5,227,498	10,051	-	-	-	-	**5,237,549**
Government securities	11.51	1,496,754	2,341,007	14,253,630	8,843,137	34,771,937	-	**61,706,465**
Loans and advances to customers	9.71	110,060,889	968,189	2,401,276	3,340,819	81,828	-	**116,853,001**
Total financial assets		**116,785,141**	**3,319,247**	**16,654,906**	**12,183,956**	**34,853,765**	**12,356,100**	**196,153,115**
FINANCIAL LIABILITES								
Customer deposits	5.10	34,470,130	38,675,879	16,271,396	97,186	207,408	54,779,061	**144,501,060**
Due to banking institutions	5.52	9,749,125	152,212	5,092	-	-	-	**9,906,429**
Borrowings	7.91	-	229,467	-	5,860,666	8,778,205	-	**14,868,338**
Total financial liabilities		**44,219,255**	**39,057,558**	**16,276,488**	**5,957,852**	**8,985,613**	**54,779,061**	**169,275,827**
Interest rate sensitivity gap		**72,565,886**	**(35,738,311)**	**378,418**	**6,226,104**	**25,868,152**	**(42,422,961)**	**26,877,288**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market risk (continued)

3.3.1 Interest rate risk (continued)

31 December 2017

	Effective Rates %	Up to 1 month Shs'000	1 to 3 Months Shs'000	4 to 12 Months Shs'000	1 to 3 Years Shs'000	Over 3 Years Shs'000	Non-interest bearing Shs'000	Total Shs'000
FINANCIAL ASSETS								
Cash and balances with central banks		-	-	-	-	-	9,516,131	**9,516,131**
Items in the course of collection		-	-	-	-	-	233,004	**233,004**
Due from banking institutions	0.70	12,425,067	-	-	-	-	-	**12,425,067**
Government securities	11.37	144,591	230,249	7,583,160	15,741,268	31,016,527	-	**54,715,795**
Loans and advances to customers	11.10	110,954,116	2,028,131	1,944,736	2,877,014	504,258	97,224	**118,405,479**
Total financial assets		**123,523,774**	**2,258,380**	**9,527,896**	**18,618,282**	**31,520,785**	**9,846,359**	**195,295,476**
FINANCIAL LIABILITES								
Customer deposits	5.30	22,027,952	19,400,159	28,656,703	13,968,484	82,898	54,780,374	138,916,570
Due to banking institutions	3.52	11,519,699	618,796	-	-	-	-	12,138,495
Borrowings	7.34	-	-	227,573	5,658,011	11,140,274	54,780,374	17,025,858
Total financial liabilities		**33,547,651**	**20,018,955**	**28,884,276**	**19,626,495**	**11,223,172**	**963,975**	**168,080,923**
Interest rate sensitivity gap		**89,976,123**	**(17,760,575)**	**(19,356,380)**	**(1,008,213)**	**20,297,613**	**(44,934,015)**	**27,214,553**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market Risk (continued)

3.3.2 Foreign exchange risk

Foreign currency exchange risk refers to the potential changes in current and future earnings or capital arising from movements in foreign exchange market rates. The Group, through stringent intra-day and overnight exposure limits, ensures that the potential risk of loss arising from foreign exchange fluctuations to the Group's earnings and capital is within prudential guidelines and internal policies. Any material overnight position is covered by stop loss orders with our international counter-parties.

The Group is exposed to the risk that the value of foreign currency denominated financial instruments it holds will fluctuate due to changes in market foreign exchange rates. The Board of Directors periodically approves policies and limits on the maximum level of exposures by currency and in total for both overnight and intra-day positions. Foreign currency risk is addressed through the following measures:

- On a daily basis, the overall foreign exchange risk exposure is measured using spot mid-rates and does not exceed 10% of the Group's core capital.

- Any single currency exposure, irrespective of short or long positions does not exceed the limit of 10% of core capital.

- Intra-day and overnight foreign exchange positions are limited within strictly defined exposure and stop loss limits approved periodically by the Board Risk Management Committee.

At 31 December 2018, if the functional currencies in the economic environment in which the Group operates i.e. the Kenya Shilling had weakened or strengthened by 10% against the world's major currencies, with all other variables held constant, consolidated profit before income tax expense would have been higher or lower as depicted in below table:

Company			Group	
2018	2017		2018	2017
Shs'000	Shs'000		Shs'000	Shs'000
		10% depreciation/appreciation		
-	-	USD	5,448	4,948
-	-	GBP	56	65
-	-	EUR	79	81
-	-	Others	77	148
-	**-**	Total	**5,660**	**5,242**

3.3.3 Price risk

Shares quoted in the Nairobi Securities Exchange ("NSE") i.e. "listed shares'' are stated at their fair value on the last day of business in the year. These values are subject to frequent variations due to changes in their market prices.

At 31 December 2018, if the prices at the NSE had appreciated/depreciated by 5% with all other variables held constant, the impact on the statement of profit or loss, and shareholders' equity would have been Shs 2,728,595 (2017: Shs 3,787,428) higher/lower.

The Group's carries its unquoted equity investment in Tanzania Mortgage Refinance Company at fair value (Note 25). The fair value of the Group's investment in Tanzania Mortgage Refinance Company is equal to the cost of shares purchased in the company. The variability in the range of reasonable fair value estimates for this investment is not significant.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market Risk (continued)

3.3.2 Foreign exchange risk (continued)

The tables below summarise the Group's exposure to foreign currency exchange rate risks.

31 December 2018

	USD	GBP	EURO	Others	TOTAL
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
FINANCIAL ASSETS					
Cash and balances with Central Banks	1,006,292	273,048	162,458	516,453	**1,958,251**
Due from banking institutions	1,128,462	2,397,863	794,988	609,836	**4,931,149**
Loans and advances to customers	44,804,926	552,323	786,854	1,946	**46,146,049**
Other assets	45,285,566	856,423	136,641	110,319	**46,388,949**
Total financial assets	**92,225,245**	**4,079,657**	**1,880,941**	**1,238,554**	**99,424,397**
FINANCIAL LIABILITES					
Customer deposits	35,138,733	3,625,879	1,762,957	5,861,380	**46,388,949**
Due to banking institutions	5,669,546	-	-	248,085	**5,917,631**
Other liabilities	48,519,311	479,380	187,091	664,995	**49,850,776**
Borrowings	9,121,267	-	-	-	**9,121,267**
Total financial liabilities	**98,448,857**	**4,105,259**	**1,950,047**	**6,774,460**	**111,278,623**
Net balance sheet position	**(6,223,612)**	**(25,602)**	**(69,106)**	**(5,535,906)**	**(11,854,226)**
OFF BALANCE SHEET POSITION	**(5,912,231)**	**158,387**	**(317,983)**	**(314,745)**	**(6,386,572)**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3) Financial risk management (continued)

3.3. Market Risk (continued)

3.3.2 Foreign exchange risk (continued)

31 December 2017

	USD	GBP	EURO	Others	TOTAL
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
FINANCIAL ASSETS					
Cash and balances with central banks	3,005,576	59,223	376,415	1,060,685	**4,501,899**
Due from banking institutions	6,146,986	4,882,812	788,818	445,461	**12,264,077**
Loans and advances to customers	47,841,603	644,135	811,285	2,608,674	**51,905,697**
Other assets	264,778	391	1,467	137,791	**404,427**
Total financial assets	**57,258,943**	**5,586,561**	**1,977,985**	**4,252,611**	**69,076,100**
FINANCIAL LIABILITES					
Customer deposits	38,318,716	4,773,136	1,795,887	4,888,633	**49,776,372**
Due to banking institutions	1,559,137	116,935	124	12,099	**1,688,295**
Other liabilities	1,516,283	14,765	197,486	235,132	**1,963,666**
Borrowings	11,746,634	-	-	-	**11,746,634**
Total financial liabilities	**53,140,770**	**4,904,836**	**1,993,497**	**5,135,864**	**65,174,967**
Net balance sheet position	**4,118,173**	**681,725**	**(15,512)**	**(883,253)**	**3,901,133**
Off-balance sheet position	**524,921**	**43,581**	**(121,568)**	**44,824**	**491,759**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

4) Capital management

The Group's objectives when managing capital are:

- To safeguard the Group's ability to continue as a going concern in order to provide acceptable returns to the shareholders and benefits for other stakeholders while maintaining an optimal capital structure.
- To comply with capital requirements set by our regulators within the markets that the Group operates in.
- To maintain a strong capital base to support continued business development.
- To create an acceptable buffer catering for unexpected losses that the Group may incur in adverse market scenarios during the course of its business.
- To manage its capital structure and make adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The Group's objectives when managing capital are broadly covered as follows:

Banking

In line with our industry, the broader concept of capital and its adequacy is based on guidelines developed by the Basel Committee's Accords and implemented for supervisory purposes by the central banks.

Central Bank of Kenya (CBK), Bank of Tanzania (BOT) and Bank of Uganda (BOU) largely segregate the total regulatory capital into two tiers;

- Tier 1 Capital (Core Capital), which includes ordinary share capital, share premium and retained earnings. The investment in subsidiaries or other financial institutions is deducted in arriving at Tier 1 capital.
- Tier 2 Capital (Supplementary Capital) includes among others, 25% of property revaluation reserves (subject to regulatory approval) and collective impairment allowances.

The risk weighted assets are measured by means of a hierarchy of four risk weights classified according to the nature of, and reflecting an estimate of, the credit risk associated with each asset and counterparty.

A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

During the year, the Group had complied in full with all its externally imposed capital requirements. The table below summarises the composition of regulatory capital and the ratios of the Group as at 31 December:

		Group	
	Kenya	**Tanzania**	**Uganda**
	Shs'000	**Shs'000**	**Shs'000**
Tier 1 capital	28,030,736	1,091,825	1,098,129
Tier 1 + Tier 2 capital	30,856,983	1,120,119	1,136,276
Risk-weighted assets:			
On-balance sheet	156,241,922	3,780,309	4,251,302
Off-balance sheet	8,884,676	184,206	614,102
Total risk-weighted assets	**165,126,598**	**3,964,515**	**4,865,404**
Regulatory ratios:			
Core capital/Total risk weighted assets	16.98%	27.54%	22.57%
Minimum requirement	10.50%	12.50%	10.00%
Excess/(Deficit)	**6.48%**	**15.04%**	**12.57%**
Total capital/Total risk weighted assets	18.69%	28.25%	23.35%
Minimum requirement	14.50%	14.50%	12.00%
Excess/(Deficit)	**4.19%**	**13.75%**	**11.35%**
Core capital/Total deposits	20.60%	-	-
Minimum requirement	8.00%	-	-
Excess/(Deficit)	**12.60%**	-	-

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investment banking and stock brokerage businesses

The Capital Markets Authority, which regulates the Group's Investment Banking and Stock Brokerage businesses i.e. NIC Capital Limited and NIC Securities Limited respectively, prescribes minimum capitalisation requirements and a working capital of not below 20% of the prescribed minimum shareholders' funds or three times the average monthly operating costs whichever is higher. The subsidiaries maintained their capital together with the other requirements well above the minimum requirements as outlined below;

	NIC Capital Shs'000	NIC Securities Shs '000
Minimum capital	**250,000**	**50,000**
Capital held as at;		
31 December 2018	395,676	414,097
31 December 2017	499,331	418,426

5) Fair value of financial assets and liabilities

IFRS 13 specifies a hierarchy of valuation techniques based on whether inputs used in the valuation techniques of financial instruments are observable or unobservable. Financial instruments are grouped into 3 levels based on the degree to which fair value data / input is observable.

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

ii) Level 2 fair value measurements are those derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as a price) or indirectly (i.e. derived from prices). Input data for this category is sourced mainly from Reuters and the Nairobi Securities Exchange. The external valuation of buildings has been performed using a sales comparison approach.

iii) Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data (unobservable inputs). The fair value of the Group's investment in Tanzania Mortgage Refinance Company is equal to the cost of shares purchased in the company. The variability in the range of reasonable fair value estimates for this investment is not significant.

The table below shows an analysis of financial instruments at fair value by level of the fair value hierarchy.

Company 2018 Shs'000	Company 2017 Shs'000		Note	Group 2018 Shs'000	Group 2017 Shs'000
		Level 1			
-	-	Treasury bonds – FVOCI (2017 – AFS)	20	37,100,207	31,391,142
-	-	Equity investment	25	55,572	76,749
-	**-**			**37,155,779**	**31,467,891**
		Level 2			
		Loan notes at FVTPL		**2,036,712**	**1,672,452**
		Level 3			
-	-	Buildings	27	555,000	370,000
-	-	Unquoted equity security in Tanzania Mortgage Refinance Company	25	35,862	23,035
-	**-**			**590,862**	**393,035**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

5) Fair value of financial assets and liabilities (continued)

Valuation method and assumptions for level 2 – loan notes at FVTPL

The fair value of the loan notes are based on a weighted average price derived from three market approaches comprising of Enterprise value (EV) to Earnings before interest, taxes, depreciation and amortisation (EBITDA) (EV/EBITDA), Market capitalization and Sales to price ratio approach.

EV/EBITDA is a ratio that compares a company's EV to its EBITDA. The ratio of EV/EBITDA is used to compare the entire value of a business with the amount of EBITDA it earns on an annual basis. This ratio tells investors how many times EBITDA they have to pay, were they to acquire the entire business.

Under the market capitalization method, the value of the company is derived by applying the current share price as quoted on the Nairobi Securities Exchange (NSE) to the outstanding shares of the Company.

The price-to-sales ratio is a valuation ratio that compares a company's stock price to its revenues. The price-to--sales ratio is an indicator of the value placed on each shilling of a company's sales or revenues. The valuation approach applies a multiple to the company's annual gross revenue to approximate the value of a company.

The use of market multiples is based on the assumption that there are listed companies similar to the company being valued which will be helpful in deriving multiples. The target company's financials are then multiplied by the appropriate multiples to derive the business value.

Financial instruments not measured at fair value

The table below shows an analysis of the fair value of financial instruments that are not carried at fair value by level of the fair value hierarchy.

Company				Group	
2018	**2017**			**2018**	**2017**
Shs'000	**Shs'000**		**Note**	**Shs'000**	**Shs'000**
		Level 1			
-	**-**	Government securities – amortised cost	20	**25,611,928**	**23,324,653**
		Level 2			
		Financial assets			
-	-	Cash and balances with central banks	17	11,955,411	9,516,131
-	-	Items in the course of collection	18	400,689	233,004
-	-	Due from banking institutions	19	5,237,549	12,425,067
-	-	Loans and advances to customers	22	116,853,003	118,405,479
-	53,955	Due from group companies	24	-	-
-	-	Investments	25	1,256,833	1,355,058
-	**53,955**			**135,703,485**	**141,934,739**
		Financial liabilities			
-	-	Customer deposits	30	144,501,060	138,916,570
-	-	Due to banking institutions	31	9,906,429	12,138,495
-	-	Borrowings	32	14,868,337	17,025,858
15,850	61,685	Due to group companies	33	-	-
15,850	**61,685**			**169,275,826**	**168,080,923**

There were no transfers between levels 1, 2 and 3 in the period and for level 3, there was no movement.

i) Level 1 – We have determined the fair value using quoted prices (unadjusted) from the Nairobi Securities Exchange.

ii) Level 2 – The fair value of these balances approximates their amortised cost.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

6) Critical accounting estimates and judgments

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgement in applying the Group's accounting policies.

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

Measurement of the expected credit loss allowance

Assets accounted for at amortised cost and fair value through other comprehensive income are evaluated for impairment on a basis described in accounting policy note 2.2.
The Group recognises loss allowance at an amount equal to either 12-month expected credit losses (ECLs) or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

For credit exposures where there have not been significant increases in credit risk since initial recognition, an entity is required to provide for 12-month ECLs. These are classified as Stage 1 assets.

For credit exposures where there have been significant increases in credit risk since initial recognition on an individual or collective basis, a loss allowance is required for lifetime ECLs. These are classified as Stage 2 assets.

For credit exposures that are credit impaired and in default, similar to stage 2 assets, a loss allowance is required for lifetime ECLs however the probability of default for these assets is presumed to be 100% less any determined recovery.

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

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

Valuation of loan notes at fair value

As per IFRS 13, where the Group measures a financial instrument at fair value, the fair value should represent the price that would be received to sell an asset in an orderly transaction in the principal (or most advantageous) market between market participants at the measurement date. Fair value is a market-based measurement which uses the assumptions that market participants would use when pricing an asset or liability under current market conditions.

The Group holds loan notes that are measured at fair value through profit or loss. For these, fair value comprises two key cash flow components, being the interest receivable on the mandatorily convertible component of the loan notes and valuation of the shares upon whose sale the principal amount will be realised.

To determine the value of the shares, the Group has utilised a complex model that incorporates observable inputs such as quoted prices of other airlines, and unobservable inputs like market appreciation multiples. Changes in assumptions about these inputs could affect the reported fair value of the loan notes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

6) Critical accounting estimates and judgments (continued)

Income taxes

The Group is subject to taxation laws and regulations in the various jurisdictions where it operates. Significant estimates are required in determining the provision for income taxes. There may be transactions and calculations, during the normal course of business, whose ultimate tax impact determination has an element of uncertainty. In determining the interpretation and/or application of the various tax rules, disputes may arise with the relevant tax authorities, of which the outcome may not be favourable to the Group. In such cases, the Group relies on internal management expertise and where relevant, seeks expert advice to determine whether the unfavourable outcome is probable or possible.

Where objective estimates of the potential tax liabilities that may crystallise from such tax disputes are determinable, the Group recognises provision in line with IAS 37 - Provisions, Contingent Liabilities and Contingent Assets principles. In such cases, if the final tax determination is different from the amounts that were initially recorded, the difference will impact the current income tax and deferred income tax provisions in the period in which such determination is made.

Where payment is determined to be possible but not probable, the tax exposure is disclosed as a contingent liability

7) Operating segments

The Group operations are within three geographical segments, Kenya, Tanzania and Uganda Further to the geographical segmentation, Kenya operations are maintained in the the following business segments for allocation of resources and assessment of performance.

(i) Corporate, Commercial and Institutional banking

Targets medium to large corporate clientele and institutions, with a focus on liability mobilization and asset growth.

(ii) Treasury dealing and brokerage

Treasury dealing targets corporate clientele and institutions, with a focus on those with a foreign exchange component in their business, whereas the stock brokerage focuses on the execution of transactions at the Nairobi Securities Exchange on behalf of high net worth and institutional clients.

(iii) Retail banking (SME and Personal banking)

Targets the mass affluent to high net worth and business banking clientele, with a focus on becoming the customers' core deposit, transactional banker and financier. This also includes our asset finance product.

(iv) Investment banking

Targets large and medium sized companies for research, advisory and capital restructuring requirements.

The segment information provided to the Executive Committee of management for the reported segments is contained on the next page. There were no changes in the reportable segments during the year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7) Operating segments (continued)

Statement of profit or loss

31 December 2018	Corporate & Institutional banking	Treasury Dealing & Brokerage	Retail Banking	Investment banking & others	Total Kenya	Uganda	Tanzania	Group
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
Interest income	7,327,620	6,582,214	4,677,528	1,042,666	19,630,028	649,552	719,921	20,999,501
Interest expense	(2,958,645)	(2,050,949)	(2,333,960)	(870,724)	(8,214,278)	(230,918)	(270,909)	(8,716,105)
Net Interest Income	**4,368,975**	**4,531,265**	**2,343,568**	**171,941**	**11,415,749**	**418,634**	**449,012**	**12,283,396**
Other income	1,373,209	486,981	1,624,396	129,429	3,614,015	70,839	121,475	3,806,329
Operating Income	**5,742,185**	**5,018,246**	**3,967,964**	**301,370**	**15,029,764**	**489,473**	**570,487**	**16,089,725**
Credit impairment charges	(2,383,546)	-	(973,161)	308,3679	(3,048,338)	(107,902)	(182,358)	(3,338,598)
Operating Expenses	(297,898)	(117,140)	(519,093)	(4,951,441)	(5,885,572)	(488,088)	(554,602)	(6,928,262)
Segment profit/(loss) before tax	**3,060,740**	**4,901,106**	**2,475,710**	**(4,341,703)**	**6,095,853**	**(106,516)**	**(166,473)**	**5,822,865**
Income tax(expense)/credit	-	-	-	(1,645,587)	(1,645,587)	(1,767)	52,859	(1,594,495)
Segment profit/(loss) for the year	**3,060,740**	**4,901,106**	**2,475,710**	**(5,987,289)**	**4,450,267**	**(108,283)**	**(113,614)**	**4,228,370**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7) Operating segments (continued)

Statement of profit or loss

31 December 2017	Corporate & Institutional banking	Treasury Dealing & Brokerage	Retail Banking	Investment banking & others	Total Kenya	Uganda	Tanzania	Group
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
Interest income	7,613,074	4,789,411	4,587,448	972,551	17,962,484	585,911	867,735	19,416,130
Interest expense	(2,745,977)	(1,689,971)	(1,802,600)	(787,820)	(7,026,368)	(204,330)	(410,922)	(7,641,620)
Net Interest Income	**4,867,097**	**3,099,440**	**2,784,848**	**184,731**	**10,936,116**	**381,581**	**456,813**	**11,774,510**
Other income	676,462	406,688	1,092,120	93,979	2,269,249	121,630	169,829	2,560,708
Operating Income	**5,543,559**	**3,506,128**	**3,876,968**	**278,710**	**13,205,365**	**503,211**	**626,642**	**14,335,218**
Credit impairment charges	(1,254,125)	-	(973,161)	(52,439)	(2,279,725)	(35,549)	(164,261)	(2,479,535)
Operating Expenses	(290,266)	(113,711)	(507,461)	(4,260,672)	(5,172,110)	(464,504)	(618,119)	(6,254,733)
Segment profit/(loss) before tax	**3,999,168**	**3,392,417**	**2,396,346**	**(4,034,401)**	**5,753,530**	**3,158**	**(155,738)**	**5,600,950**
Income tax(expense)/credit	-	-	-	(1,517,890)	(1,517,890)	12,847	48,511	(1,456,532)
Segment profit/(loss) for the year	**3,999,168**	**3,392,417**	**2,396,346**	**(5,552,291)**	**4,235,640**	**16,005**	**(107,227)**	**4,144,418**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7) Operating segments (continued)

Statement of financial position as at 31 December 2018

31 December 2018	Corporate & Institutional banking Shs '000	Treasury Dealing &Brokerage Shs '000	Retail Banking Shs '000	Investment banking & others Shs '000	Total Kenya Shs '000	Uganda Shs '000	Tanzania Shs '000	Group Shs '000
Assets								
Cash and balances with Central banks	-	10,529,498	-	-	10,529,498	831,214	594,699	11,955,411
Government securities	-	57,988,860	-	-	57,988,860	1,568,625	2,148,980	61,706,465
Due from banking institutions	-	4,439,342	-	-	4,439,342	492,946	305,261	5,237,549
Customer loans and advances	71,185,355	-	37,156,961	2,327,543	110,669,859	3,964,771	3,437,042	118,071,672
Investment in associates	-	-	-	-	-	-	-	-
Investment in subsidiaries	-	-	-	-	-	-	-	-
Other assets	-	-	-	10,340,704	10,340,704	638,066	457,550	11,436,320
Total assets	**71,185,355**	**72,957,700**	**37,156,961**	**12,668,247**	**193,968,263**	**7,495,623**	**6,943,532**	**208,407,417**
Liabilities								
Customer deposits	72,953,340	-	54,228,738	8,889,684	136,071,763	4,121,322	4,307,975	144,501,060
Due to banking institutions	-	9,147,958	-	-	9,147,958	466,824	291,647	9,906,429
Other liabilities	-	-	-	1,093,510	1,093,510	1,597,445	655,502	3,346,458
Borrowings	-	14,868,336	-	-	14,868,336	-	-	14,868,336
Total liabilities	72,953,340	24,016,294	54,228,738	9,983,195	161,181,567	6,185,591	5,255,124	172,622,282
Shareholders' funds	-	-	-	32,581,320	32,581,320	1,751,380	1,452,434	35,785,134
Total liabilities and shareholders' funds	**72,953,340**	**24,016,294**	**54,228,738**	**42,564,514**	**193,762,887**	**7,936,972**	**6,707,558**	**208,407,417**
Additions to non-current assets								
Property and equipment	-	-	-	287,474	287,474	27,331	52,775	367,580
Intangible assets	-	-	-	421,118	421,118	6,896	16,459	444,473
	-	**-**	**-**	**708,592**	**708,592**	**34,227**	**69,234**	**812,052**
Depreciation and amortisation								
Depreciation	-	-	-	225,212	225,212	25,869	28,703	279,784
Amortisation	-	-	-	171,060	171,060	19,798	3,150	194,008

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

8) Operating segments (continued)

Statement of financial position as at 31 December 2017

31 December 2017	Corporate & Institutional banking Shs '000	Treasury Dealing &Brokerage Shs '000	Retail Banking Shs '000	Investment banking & others Shs '000	Total Kenya Shs '000	Uganda Shs '000	Tanzania Shs '000	Group Shs '000
Assets								
Cash and balances with Central banks	-	8,143,110	-	-	8,143,110	584,177	788,844	9,516,131
Government securities	-	51,495,068	-	-	51,495,068	855,782	2,364,945	54,715,795
Due from banking institutions	-	11,438,868	-	-	11,438,868	810,566	175,634	12,425,068
Customer loans and advances	72,272,297	-	37,156,961	2,426,819	111,856,077	3,464,772	4,439,689	119,760,538
Investment in associates	-	-	-	-	-	-	-	-
Investment in subsidiaries	-	-	-	(0)	(0.46)	-	-	(0.46)
Other assets	-	-	-	8,865,683	8,865,683	494,664	394,583	9,754,930
Total assets	**72,272,297**	**71,077,046**	**37,156,961**	**11,292,501**	**191,798,805**	**6,209,962**	**8,163,695**	**206,172,462**
Liabilities								
Customer deposits	72,149,788	-	50,805,857	7,605,236	130,560,881	3,243,330	5,112,360	138,916,571
Due to banking institutions	-	11,445,014	-	-	11,445,014	61,293	632,187	12,138,494
Other liabilities	-	-	-	1,836,451	1,836,451	1,408,159	130,692	3,375,302
Borrowings	-	17,025,858	-	-	17,025,858	-	-	17,025,858
Total liabilities	72,149,788	28,470,872	50,805,857	9,441,688	160,868,204	4,712,782	5,875,239	171,456,225
Shareholders' funds	-	-	-	31,426,076	31,426,076	1,925,448	1,364,714	34,716,237
Total liabilities and shareholders' funds	**72,149,788**	**28,470,872**	**50,805,857**	**40,867,763**	**192,294,280**	**6,638,229**	**7,239,952**	**206,172,462**
Additions to non-current assets								
Property and equipment	-	-	-	377,781	377,781	19,501	15,299	412,581
Intangible assets	-	-	-	662,604	662,604	69,121	-	731,725
	-	-	-	1,040,385	1,040,385	88,622	15,299	1,144,306
Depreciation and amortisation								
Depreciation	-	-	-	210,846	210,846	30,406	33,323	274,575
Amortisation	-	-	-	191,634	191,634	14,804	16,100	222,538

There are no customers individually accounting for more than 10% of the business.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

8 (a) Interest income

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
		From customers		
-	-	Loans and advances	12,322,225	13,145,500
-	-	Credit related fees and commissions	1,136,401	1,000,708
-	-	Unwinding of discounts on stage 3	584,277	-
-	**-**		**14,042,903**	**14,146,208**
		Government Securities		
-	-	At fair value through OCI	4,144,574	3,655,372
-	-	At amortised cost	2,691,576	1,554,671
-	**-**		**6,836,150**	**5,210,043**
59,124	**-**	**Due from banking institutions**	**120,448**	**59,879**
59,124	**-**		**20,999,501**	**19,416,130**

8 (b) Interest expense

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Customer deposits	7,183,476	5,955,774
-	-	Due to banking institutions	217,781	319,111
-	-	Borrowings	1,314,848	1,366,735
-	**-**		**8,716,105**	**7,641,620**

9) Net fee and commission income

a) Fee and commission income

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Trade finance	361,091	369,367
-	-	Other service/transaction fees	1,026,335	925,019
-	**-**		**1,387,426**	**1,294,386**

Other service/transactions fees relate to fees charged for normal banking services such as monthly banking charges, transaction fees, cheque charges and over the counter withdrawals among other.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

9) Net fee and commission income (continued)

b) Fee and commission expense (continued)

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Credit card related expenses	60,183	42,667
-	-	Transactional Expenses	52,619	60,068
-	**-**		**112,802**	**102,735**

10) Net trading income

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Foreign exchange income	1,277,501	1,158,930
-	-	Bond trading income	13,900	26,443
-	-	Fair value gain on investment in quoted shares (note 25(a))	(3,152)	722
-	**-**		**1,288,249**	**1,186,095**

11) Other operating income

The following items are included in other operating income:

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Gain on loan note at FVTPL	500,189	(500,189)
-	-	Interchange fees	294,001	266,762
-	-	Trust and other fiduciary fees	160,161	131,281
200,000	-	Dividend Income	-	-
145,811	46,708	Management Fees	-	-
-	-	Gain on disposal of motor vehicle and equipment	5,409	2,042
-	-	Other	283,696	283,066
345,811	**46,708**		**1,243,456**	**182,962**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

12) (a) Credit impairment charges

2018 Shs '000'	2017 Shs '000'		2018 Shs '000'	2017 Shs '000'
		Credit impairment charge		
-	-	Stage 1	(272,080)	-
-	-	Stage 2 (2017 – Unidentified)	(137,893)	541,305
-	-	Stage 3 (2017 – Identified)	3,264,135	2,438,419
-	-	Bad debts Recoveries	(99,841)	-
-	-	Adjustment for unwinding of discount	584,277	-
-	-	**Total Impairment charges**	3,338,598	2,979,724
		Total impairment charges, may be analysed as follows:		
-	-	Loans and advances to customers	3,336,454	2,979,724
-	-	Investments - Corporate bonds	(2,842)	-
-	-	Other financial assets	4,986	-
-	-		**3,338,598**	**2,979,724**

12) (b) Impairment movement for other financial assets

	2018 Shs '000'
Movement in Impairment for Other Financial Assets	
At start of year	-
Adjustment on initial application of IFRS 9	88,343
Net increase in impairment provision	4,986
Exchange difference on Translation	(277)
At end of year	**93,052**

13) Employee benefits

The following items are included under employee benefits:

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
53,873	19,523	Salaries and wages	2,916,387	2,481,637
3,750	-	Directors' emoluments - fees	26,997	31,600
93,182	24,206	- other	93,182	164,889
644	978	Pension costs - defined contributions	201,016	198,028
12	-	Pension costs - statutory contributions	34,631	33,728
48,000	-	Incentive compensation provision	557,513	460,712
1,171	-	Gratuity provision	5,256	3,191
200,632	**44,707**	At 31 December	**3,834,982**	**3,373,785**

The total number of employees as at 31 December 2018 for the Group was 1,302 (2017: 1,107).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

14) (a) Depreciation and amortisation

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Depreciation(note 27)	279,785	274,575
-	-	Amortisation of computer software(note 28 (a))	194,007	222,538
-	-	Amortisation of operating lease(note 29)	125	125
-	-	**At 31 December**	**473,917**	**497,238**

14) (b) Other operating expenses

The following items have been charged before arriving at profit before income tax:

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
Shs '000'	Shs '000'		Shs '000'	Shs '000'
1,543	-	Rental charges	386,670	358,059
-	-	Other premises costs	160,141	144,510
-	-	IT expenses	422,596	274,426
-	-	Publicity and advertising	263,153	164,161
-	-	Deposit protection fund	252,071	174,027
25,104	-	Share registration costs	25,104	30,420
914	870	Auditors remuneration	20,190	17,190

15) Income tax

a) Income tax expense

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
		Current tax		
32,081	375	Current year	1,626,448	2,112,654
(269)	(35,197)	Prior year under provision	(331)	9,182
31,812	**(34,822)**		**1,626,117**	**2,121,836**
		Deferred tax (note 26)		
-	-	Current year	(29,366)	(647,527)
-	-	Prior year under provision	(2,256)	(17,777)
			(31,622)	**(665,304)**
31,812	**(34,822)**		**1,594,495**	**1,456,532**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

15) Income tax (continued)

b) Reconciliation of tax expense to expected tax base based on accounting profit

The tax on the profit before income tax differs from the tax charge that would apply if all profit had been taxed using the statutory income tax rate:

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
173,006	**1,251**	**Profit before tax**	**5,822,865**	**5,600,950**
51,902	375	Income tax - at the statutory rate of 30 % (2017: 30%)	1,746,860	1,680,286
40,179	-	Tax effect of expenses not deductible for tax	119,279	3,254,809
(60,000)	-	Tax effect of revenues that are not taxable	(269,057)	(3,469,968)
-	-	Prior year under provision :	-	-
(269)	(35,197)	Current tax	(331)	9,182
-	-	Deferred tax	(2,256)	(17,777)
31,812	**(34,822)**		**1,594,495**	**1,456,532**

c) Current income tax payable/(recoverable) movement

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
(34,822)	446,765	**As 1 January**	(390,468)	318,646
-	-	Exchange difference on translation	4,186	426
32,081	375	Tax Charge(note 15(a)) - current year	1,626,448	2,112,654
(269)	(35,197)	Tax Charge(note 15(a)) - prior year	(331)	9,182
(16,222)	(446,765)	Income taxation paid	(2,303,723)	(2,831,376)
(19,232)	**(34,822)**	**At 31 December**	**(1,063,888)**	**(390,468)**
		Comprising:		
19,232	(34,822)	Current income tax recoverable	(1,075,176)	(395,513)
-	-	Current income tax payable	11,288	5,045
19,232	**(34,822)**	**At 31 December**	**(1,063,888)**	**(390,468)**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16) Earnings per share

Earnings per share is calculated by dividing the profit attributable to equity holders of the parent company by the weighted average number of ordinary shares outstanding during the year.

Company			Group	
2018	**2017**		**2018**	**2017**
Shs '000'	**Shs '000'**		**Shs '000'**	**Shs '000'**
141,194	**36,073**	Profit attributable to equity holders of the Group (Shs'000)	**4,262,634**	**4,176,755**
		Number of shares for purposes of calculating earnings per share:		
703,940,163	703,940,163	Issued ordinary shares	703,940,163	703,940,163
0.20	**0.05**	Earnings Per Share (Shs)	**6.06**	**5.93**

The calculation of basic and diluted earnings per share is based on continuing operations attributable to the ordinary equity holders of the parent company. There were no discontinued operations during the year.

The issued shares as at 31 December 2018 are 703,940,163 (2017: 639,945,603) and are fully paid. The EPS for 2017 has been restated to take into account the bonus issue of shares in the year ended 31 December 2018.

17) Cash and balances with central banks

Company			Group	
2018	**2017**		**2018**	**2017**
Shs '000'	**Shs '000'**		**Shs '000'**	**Shs '000'**
337,455	1,200,000	Cash on hand	2,228,784	1,923,174
		Balances with central banks (unrestricted):		
-	-	Other (available for use by the Group)	2,046,283	184,858
337,455	**1,200,000**	**Included in cash and cash equivalents (note 39 (b))**	**4,275,067**	**2,108,032**
-	-	Balances with central banks (restricted):	7,680,344	7,408,099
337,455	**1,200,000**		**11,955,411**	**9,516,131**

Banks are required to maintain a prescribed minimum cash balance with the Central Banks that is not available to finance the banks' day-to-day activities. The amount is determined as as a ratio to the average outstanding average outstanding customer deposits over a cash reserve cycle period of one month. As at 31 December 2018, the cash ratio requirement was 5.25% (2017: 5.25%) in Kenya, 8.0% (2017 – 8.0%) in Tanzania and 8.5% (2017 – 8.5%) in Uganda.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

18) Items in the course of collection

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Clearing account balances	400,689	233,004

Items in the course of collection are current and are classified as 'loans and receivables'.

19) Due from banking institutions

Balances dues from banking institutions are current and are classified as 'loans and receivables'.

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Deposits due from banking institutions	803,205	990,617
-	-	Balances due from banking institutions	4,434,344	11,434,450
-	**-**		**5,237,549**	**12,425,067**
-	**-**	Weighted average effective interest rate as at year end	**1.41%**	**0.70%**

20) Government securities

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
-	-	Treasury bonds at FVOCI (2017 – AFS)	37,100,207	31,391,142
-	-	Treasury bonds at amortised cost (2017: HTM)	24,665,932	23,324,653
		Less: Impairment loss allowance	(59,674)	-
-	**-**		**61,706,465**	**54,715,795**

The table below summarises the weighted average effective interest rate for government securities.

Company 2018 %	Company 2017 %		Group 2018 %	Group 2017 %
-	-	Treasury bonds at FVOCI (2017 – AFS)	12.03	11.87
-	-	Treasury bonds at amortised cost	11.03	10.86

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

20) Government securities (continued)

The maturity profile of Government securities is as follows:

Group	At FVOCI	At amortised cost	Total
	Shs '000'	Shs '000'	Shs '000'
2018			
Included in cash and cash equivalents	104,928	4,437,137	4,542,065
Less than 1 year	1,865,523	1,488,641	3,354,164
1-5 years	14,937,137	16,333,714	31,270,851
Over 5 years	20,192,619	2,406,440	22,599,059
Less: Impairment loss allowance	(35,951)	(23,723)	(59,674)
	37,040,533	**24,665,932**	**61,706,465**

	Available for sale	Held to maturity	Total
	Shs '000'	Shs '000'	Shs '000'
2017			
Included in cash and cash equivalents	31,631	341,518	373,149
Less than 1 year	1,072,824	9,168,850	10,241,674
1-5 years	13,937,676	12,993,747	26,931,423
Over 5 years	16,380,278	789,271	17,169,549
	31,422,409	**23,293,386**	**54,715,795**

The movement in Government securities was as follows:

Group	At FVOCI	At amortised cost	Total
	Shs '000'	Shs '000'	Shs '000'
2018			
1 January	**31,422,409**	**23,293,386**	**54,715,795**
Additions during the year	5,892,995	6,782,161	12,675,156
Maturities and disposals	(993,588)	(5,385,892)	(6,379,480)
Changes in fair value (note 33)	754,668	-	689,395
Less: Impairment loss allowance	(35,951)	(23,723)	(59,674)
31 December	**37,040,533**	**24,665,932**	**61,706,465**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

21) Derivative assets

The amount represents the fair value of forward foreign exchange contracts. These derivative assets and liabilities are measured at fair value through profit or loss. Notional principal amounts are the amounts underlying the contract at the reporting date.

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Fair value of forward contracts	(161,554)	16,467
-	-	National value of forward contracts	6,656,906	12,052,253

Derivative (liabilities)/assets are current.

22) Loans and advances to customers

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Finance lease receivables	27,591,399	27,167,148
-	-	Commercial loans	87,507,310	88,522,689
-	-	Bills discounted	9,941,952	7,072,125
-	**-**	**Gross loans and advances to customers**	**125,040,661**	**122,761,962**
		Provisions for impairment		
-	-	Stage 1	913,002	-
-	-	Stage 2 (2017 – (Unidentified)	3,565,678	722,219
-	-	Stage 3 (2017 – Identified)	5,745,690	5,265,710
-	**-**	**Total impairment**	**10,224,370**	**5,987,929**
		Fair value		
		Loan notes at FVTPL	**2,036,712**	**1,672,452**
-	**-**	**Net loans and advances to customers**	**116,853,003**	**118,446,485**
-	-	Current	53,756,912	53,854,861
-	-	Non Current	63,096,091	64,591,624
-	-		**116,853,003**	**118,446,485**

The Group and the Company enter into finance leasing arrangements for certain plant, equipment, motor vehicles and aircraft. The average term of finance leases entered into is 3 years. Unguaranteed residual values of assets leased under finance leases are estimated at nil (2017: nil).

There are no contingent rents recognised as income in 2017 and 2018.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

22) Loans and advances to customers (continued)

Finance lease receivables, may be analysed as follows:

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
-	-	Not later than 1 year	5,178,141	5,178,141
-	-	Later than 1 year and not later than 5 years	22,413,258	21,989,007
-	**-**	**Present value of minimum lease payments receivable**	**27,591,399**	**27,167,148**
-	**-**	**Accumulated allowance for uncollectible minimum lease payments receivable**	**27,597,600**	**1,024,295**

Credit impairment movement:

	Stage 1 12 months ECL Shs'000	Stage 2 Life time ECL Shs'000	Stage 3 Life time ECL Shs'000	Total Shs'000
For the year ended 31 December 2018				
At start of year	-	722,219	5,265,710	5,987,929
IFRS 9 transition adjustment	1,192,908	3,039,195	-	4,232,103
Net increase in impairment provision	(274,224)	(137,893)	3,848,412	3,436,295
Write-offs	-	-	(3,368,432)	(3,368,432)
Exchange difference on Translation	(5,682)	(57,843)	-	(63,525)
At end of year	913,002	3,565,678	5,745,690	10,224,370
For the year ended 31 December 2017				
At start of year	-	692,237	5,022,089	5,714,326
Net increase in impairment provision	-	110	2,438,419	2,438,529
Write-offs	-	-	(2,194,776)	(2,194,776)
Exchange difference on Translation	-	29,872	(22)	29,850
At end of year	-	722,219	5,265,710	5,987,929

The weighted average effective interest rates on loans and advances to customers at year end were as follows

Company			Group	
2018	2017		2018	2017
%	%		%	%
-	-	Finance lease receivables	11.60	11.98
-	-	Commercial loans	9.65	10.50
-	-	Bills Discounted	7.59	8.28

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

23) Other assets

Company			Group	
2018	2017		2018	2017
Shs '000'	Shs '000'		Shs '000'	Shs '000'
500	-	Prepayments	320,770	256,198
-	-	Other receivables	1,132,193	2,057,627
-	-	Trade receivables	137,569	42,855
500	**-**		**1,590,532**	**2,356,680**

Other assets are current. Other assets, excluding prepayments, are classified at amortised cost.

24) Due from group companies

	Company	
	2018	**2017**
	Shs '000'	**Shs '000'**
NIC Bank Kenya PLC	-	53,955
	-	**53,955**

The Company has related party transactions with certain of its subsidiaries. These transactions which are primarily short term in nature, include cash accounts, charges for operational support and the borrowing or lending of funds, and are entered into in the ordinary cause of business. These are on the same terms as comparable transactions with third parties.

25) Investments

Company				Group	
2018	**2017**			**2018**	**2017**
Shs '000'	**Shs '000'**			**Shs '000'**	**Shs '000'**
29,568,705	29,118,705	Investment in subsidiaries	25b	-	-
-	-	Corporate bonds at amortised cost		1,256,833	1,355,058
-	-	Quoted equity investment at FVTPL		51,925	69,950
-	-	Unquoted equity security in Tanzania Mortgage Refinance at FVOCI		35,862	23,035
-	-	Equity instruments at FVOCI (2017 – AFS)		3,647	6,799
-	-	Less: Impairment loss allowance		(38,164)	(41,006)
29,568,705	**29,118,705**			**1,310,103**	**1,413,836**

Investment in subsidiaries is non-current. The other investments are current.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

25) Investments (Continued)

a) The movement in investments is as follows:

Company 2018 Shs '000'	Company 2017 Shs '000'		Group 2018 Shs '000'	Group 2017 Shs '000'
29,118,705	**6,783,112**	**At start of year**	1,413,836	1,507,847
350,000	-	Investment in NIC Tanzania Limited	-	-
100,000	-	Investment in NIC Leasing LLP	-	
-	315,000	Investment in NC Bank Uganda Limited	-	-
-	(1,425,411)	Repayments of corporate bonds at amortised cost	(98,225)	(70,353)
-	23,446,004	Investment in NIC Bank Kenya PLC	-	-
-	-	Fair value (loss)/gain on quoted equity investment at FVTPL	(18,025)	17,675
-	-	Fair value gain/(loss) on unquoted equity security in Tanzania Mortgage Refinance Company at FVOCI (2017 – AFS)	12,827	(495)
-	-	Equity investment at FVOCI (2017 – AFS)	(3,152)	168
-	-	Impairment loss allowance	2,842	(41,006)
29,568,705	**29,118,705**	**At end of year**	**1,310,103**	**1,413,836**

b) Investment in subsidiaries (at cost)

Company

Name	Country of incorporation	Principal Activity	Holding %	2018 Shs '000'	2017 Shs '000'
NIC Bank Kenya PLC	Kenya	Banking	100	24,446,004	24,446,004
NC Bank Uganda	Uganda	Banking	100	1,828,738	1,828,738
NIC Bank Tanzania	Tanzania	Banking	69.84	2,042,462	1,692,462
NIC Capital	Kenya	Financial advisory	100	500,000	500,000
NIC Insurance Agents	Kenya	Insurance agency	100	1,000	1,000
National Industrial Credit Trustees	Kenya	Dormant	100	500	500
Mercantile Finance Company	Kenya	Dormant	100	50,000	50,000
NIC Ventures Limited	Kenya	Financial innovation	100	1	1
NIC Properties	Kenya	Property	100	550,000	550,000
NIC Leasing LLP	Kenya	Leasing	100	150,000	50,000
				29,568,705	**29,118,705**

NIC Capital Limited has a subsidiary, NIC Securities Limited whose results have been incorporated in these financial statements. Details of NIC Securities Limited at cost are as follows:

Name		Principal Activity	Holding	2018	2017
NIC Securities Limited	Kenya	Brokerage services	100%	456,240	456,240

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

25) Investments (continued)

The total non-controlling interest at 31 December 2018 is Shs 359,807,000 (2017: Shs 450,836,000), all of which Relate to NIC Bank Tanzania Limited. Transactions with non-controlling interests during the year are as detailed under Note 37.

Significant restrictions

There are no restrictions on the Group's ability to access or use assets and settle liabilities in the countries the Group operates in.

Summarised financial information on subsidiaries with material non-controlling interests

	NIC Bank Tanzania Limited	
	Shs' 000	Shs' 000
Summarised balance sheet	2018	2017
Total assets	**6,943,532**	**8,163,695**
Liabilities	5,491,098	6,798,981
Shareholders' funds	1,452,434	1,364,714
Total liabilities and equity	**6,943,532**	**8,163,695**
Summarised statement of profit or loss		
Total operating income	570,487	626,643
profit before tax	(166,473)	(155,737)
Income tax credit	52,859	48,511
Loss for the year	**(113,614)**	**(107,225)**
Total profit allocated to non controlling interest	(34,264)	(32,337)
Summarised statement of cash flows		
Cash used in operations	(245,151)	(269,464)
Net cash used in investing activities	(49,499)	(25,376)
Net cash generated from / (used in) financingactivities	175,021	(160,186)
Net decrease in cash and cash equivalents	(119,630)	(455,025)
Cash and cash equivalents at start of the year	442,324	916,648
Exchange differences in cash and cash equivalents	(17,761)	(19,299)
Cash and cash equivalents at end of the year	**304,934**	**442,324**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

25) Investments (continued)

All the subsidiary companies have their financial year ended 31 December and are incorporated as limited liability companies a part from NIC Leasing, which is incorporated as a limited liability partnership. Except for NIC Bank Tanzania Limited and NC Bank Uganda Limited which are incorporated and domiciled in Tanzania and Uganda respectively, all other subsidiaries are incorporated and domiciled in Kenya.

NC Bank Uganda Limited was established in 2012 to offer banking services for our customers in Uganda. The audited financial statements for the year ended 31 December 2018 show that the company made a loss equivalent to Shs 103,720,000 (2018: a profit of Shs 16,002,000).

NIC Group PLC acquired 51% of Savings & Finance Commercial Bank Limited now renamed NIC Bank Tanzania Ltd with effective control being passed on 1 May 2009. The audited financial statements for the year ended 31 December 2018 show that the company made a loss equivalent to Shs 79,042,000 (2017: a loss of Shs 107,220,000).

NIC Capital Limited was established in 2005 to offer investment banking services. The audited financial statements for the year ended 31 December 2018 show that the company made a profit of Shs 4,649,000 (2017: a loss of Shs 6,463,000).

On 31 December 2007, the company acquired NIC Securities Limited (NICSL) (formerly Solid Investment Securities Limited) through its wholly owned subsidiary NIC Capital Limited. Through combinations of direct buy-outs and additional rights issues, the group increased its shareholding in the subsidiary to 91.34% in 2009, and further to 100% in 2014. NICSL offers brokerage services and is a registered broker with the Nairobi Securities Exchange. The audited financial statements for the year ended 31 December 2018 show that the company made a profit of Shs 13,1982,000 (2017: Shs 6,864,000). The results of NIC Securities Limited are consolidated in these financial statements.

NIC Insurance Agents Limited was a 68% subsidiary of Mercantile Finance Company Limited (MFC). In 2010, NIC Group PLC acquired the non-controlling interest and now directly owns 100% of the company. The company offers Bancassurance services. The audited financial statements for the year ended 31 December 2018 show that the company made a profit of Shs 73,851,000(2017: Shs 48,602,000).

National Industrial Credit Trustees Limited functions in a trustee capacity. The audited financial statements show that the company made no profit or loss for the year (2017: Shs nil).

The African Mercantile Banking Company Limited a wholly owned subsidiary of NIC Group PLC having, with the sanction of a special Resolution of the said Company, and with the approval of the Registrar of Companies, changed its name to NIC Ventures Limited ("the Company") on 13th November 2017 and is incorporated in Kenya under the Kenya Companies Act as a private limited liability company. NIC Ventures Limited did not trade during the year ended 31 December 2018. Its activities are limited to provision of innovative solutions through partnerships and investments in financial technology. The audited financial statements show that the company made no profit or loss for the year (2017: Shs nil).

In April 2014, NIC Group PLC (formerly NIC Bank Limited) acquired a 100% shareholding in Codicote Limited for a consideration of Shs 550 million. The Company name was subsequently changed to NIC Properties whose sole activity is the ownership of the Land. Its sole asset is Land LR NO. 209/13628 adjacent to the headquarters of the Group in Upperhill, Nairobi. The audited financial statements for the year ended 31 December 2018 show that the company made a loss of Shs 278,000(2017: Shs 278,000).

NIC Leasing Limited Liability Partnership was formed during the year ended 31 December 2015 for leasing of motor vehicles and equipment. The audited financial statements for the year ended 31 December 2018 show that the company made a profit of Shs 17,824,000 (2017: Shs 3,120,000).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

26) Deferred income tax

The net deferred income tax computed at the enacted rate of 30%, is attributable to the following items:

Year ended 31 December 2018	1-Jan-2018	Credit Charge to profit or loss	Charge/ Credit to OCI	Adjustment on initial application of IFRS 9	31-Dec-18
	Shs '000'	Shs '000'	Shs '000'	Shs '000'	Shs '000'
Assets					
Leave pay accrual	(6,599)	(1,174)	-	-	(7,773)
Gratuity provision	(3,316)	(1,226)	-	-	(4,542)
Bonus deferred	(150,250)	(11,158)	-	-	(161,408)
Excess depreciation over capital allowances	(539,558)	(3,605)		-	(543,163)
Financial assets at FVOCI	48,952	-	274,994	-	323,946
Collective allowance for impairment	(2,682,912)	46,922	-	(1,296,134)	(3,932,124)
Tax losses in NC Uganda	(82,121)	(61,381)	-	-	(143,502)
	(3,415,804)	**(31,622)**	**274,994**	**(1,296,134)**	**(4,468,566)**
Liabilities:					
Revaluation surplus	-	-	75,321	-	75,321
Exchange differences on translation	(2,372)	-	-	-	(2,372)
Deferred income tax asset	**(3,418,176)**	**(31,622)**	**350,315**	**(1,296,134)**	**(4,395,617)**

As at 31 December 2018, the Group had accumulated tax losses available for future relief relating to NC Bank Uganda Limited. In Uganda, tax losses can be carried forward for an indefinite period.

		Group		
Year ended 31 December 2017	**1-Jan-2017**	**Credit / charge to profit or loss**	**Charge/credit to OCI**	**31-Dec-17**
	Shs'000	**Shs'000**	**Shs'000**	**Shs'000**
Assets				
Leave pay accrual	(7,268)	669	-	(6,599)
Gratuity Provision	(1,396)	(1,920)	-	(3,316)
Bonus provision	(74,018)	(76,232)	-	(150,250)
Excess depreciation over capital allowances	(416,012)	(123,546)	-	(539,558)
Available-for-sale financial assets	(350,810)	399,762		(276,677)
Provision for impairment	(1,929,138)	(753,774)	-	(2,359,388)
Tax losses in NC Uganda	(50,532)	(31,589)	-	(82,121)
	(2,831,279)	**(586,630)**	**-**	**(3,417,909)**
Liabilities:				
Revaluation surplus	75,789	(75,789)	-	-
Exchange differences on translation	513	(2,886)	-	(2,372)
Deferred income tax asset	**(2,752,871)**	**(665,305)**	**-**	**(3,418,176)**

As at 31 December 2017, the Group had accumulated tax losses available for future relief relating to NC Bank Uganda Limited. In Uganda, tax losses can be carried forward for an indefinite period.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

27) Property and equipment

	Buildings Shs '000'	Furniture equipment Shs '000'	Motor Vehicles Shs '000'	Work in progress Shs '000'	Total Shs '000'
COST OR VALUATION					
At 1 January 2017	**370,000**	**2,476,877**	**79,064**	**101,545**	**3,027,486**
Additions	-	92,454	16,503	303,624	**412,581**
Transfers	-	44,173	-	(44,173)	-
Disposals	-	(7,084)	(7,906)	-	**(14,990)**
At 31 December 2017	**370,000**	**2,606,420**	**87,661**	**360,996**	**3,425,077**
At 1 January 2018	370,000	2,606,420	87,661	360,996	3,425,077
Additions	-	190,011	32,658	144,911	367,580
Revaluations	185,000	-	-	-	185,000
Transfers	-	225,632	-	(337,787)	(112,155)
Disposals	-	(13,207)	(2,487)	-	(15,694)
At 31 December 2018	**555,000**	**3,008,856**	**117,832**	**168,120**	**3,849,808**
Comprising:					
Cost	144,617	3,008,856	117,832	168,120	**3,439,425**
Valuation - 2013	225,383	-	-	-	**225,383**
Valuation - 2018	185,000	-	-	-	**185,000**
	555,000	**3,008,856**	**117,832**	**168,120**	**3,849,808**
DEPRECIATION					
At 1 January 2017	**39,643**	**1,893,505**	**50,841**	-	**1,983,989**
Charge for the year	13,214	250,293	11,068	-	**274,575**
Eliminated on disposals	-	(7,023)	(4,374)	-	**(11,397)**
Translation adjustment	-	31,804	(2,606)	-	**29,198**
At 31 December 2017	**52,857**	**2,168,579**	**54,929**	**-**	**2,276,365**
At 1 January 2018	52,857	2,168,579	54,929	-	2,276,365
Charge for the year	13,214	254,416	12,154	-	279,784
Eliminated on disposals	-	(13,129)	(2,487)	-	(15,616)
Eliminated on revaluation	(66,071)		-	-	(66,071)
Translation adjustments	-	5,772	-	-	5,772
At 31 December 2018	**-**	**2,415,638**	**64,596**	**-**	**2,480,234**
NET BOOK VALUE					
At 31 December 2018	**555,000**	**593,219**	**53,236**	**168,120**	**1,369,575**
At 31 December 2017	**317,143**	**437,841**	**32,732**	**360,996**	**1,148,712**

Buildings were revalued at Shs 550 million as at 31 December 2018 by registered, professional valuers, Knight Frank Kenya Limited, on an open market value basis by reference to market evidence of recent transactions for similar properties. At 31 December 2018, the net book value of buildings based on original cost was Shs 94,644,208 (2017: Shs 99,809,104).

Included in motor vehicles and furniture, fittings and equipment are assets with a cost of Shs 1,695,661,030 (2017: Shs 1,516,908,792) which were fully depreciated. The notional depreciation charge on these assets would have been Shs 374,263,896 (2017: Shs 303,380,053). Computer equipment is included under furniture, fittings and equipment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

27) Intangible assets

Intangible assets comprise the following**:**

	2018 Sh '000	2017 Sh '000
Computer software	1,419,692	1,170,885
Goodwill	409,426	409,426
Total	**1,829,118**	**1,580,311**

a) Computer software

Group	Capitalised Shs '000'	Work in progress Shs '000'	Total Shs '000'
COST			
At 1 January 2017	**1,610,929**	**234,177**	**1,845,106**
Addition	195,155	536,570	**731,725**
Transfers	161,323	(161,323)	**-**
At 31 December 2017	**1,967,407**	**609,424**	**2,576,831**
At 1 January 2018	**1,967,407**	**609,424**	**2,576,831**
Addition	107,239	337,234	**444,473**
Transfers	505,743	(505,743)	**-**
At 31 December 2017	**2,580,389**	**440,915**	**3,021,304**
AMORTISATION			
At 1 January 2017	**1,183,091**	**-**	**1,183,091**
Translation adjustments	317	-	**317**
Charge for the year	222,538	-	**222,538**
At 31 December 2017	**1,405,946**	**-**	**1,405,946**
At 1 January 2018	**1,405,946**	**-**	**1,405,946**
Translation adjustments	1,658	-	**1,658**
Charge for the year	194,008	-	**194,008**
At 31 December 2018	**1,601,612**	**-**	**1,601,612**
Net Book Value			
At 31 December 2018	**978,777**	**440,915**	**1,419,692**
At 31 December 2017	**561,461**	**609,424**	**1,170,885**

All software is externally generated.

Assets of the Group with a gross value of Shs 1,205,010,674 (2017: Shs 1,110,366,835) are fully amortised but still in use. The notional amortisation charge on the assets would have been Shs 241,251,288 (2017: Shs 222,874,974).The weighted average remaining useful life of intangible assets 3.2 years (2017: 2.1 years).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

28) Intangible assets (continued)

b) Goodwill

The goodwill consists of equity interest held by the Group in:

	2018 Ownership %	Amount Shs '000'	2017 Ownership %	Amount Shs '000'
NIC Bank Tanzania	69.84	251,996	69.84	251,996
NIC Securities	100	123,430	100	123,430
NIC Properties	100	34,000	100	34,000
AS 31 December		**409,426**		**409,426**

Management reviews the business performance of the above subsidiaries. The subsidiaries are deemed Cash Generating Units (CGU) by the Group. The recoverable amount of all CGUs has been determined based on value-in-use calculations which are based on key assumptions about budgeted performance. The budget assumptions reflect current trends, anticipated growth driven by the Group's strategy and management experience.

Based on the results of the impairment tests performed, management believes that there is no impairment of the carrying value of the goodwill in any CGU. In addition, no impairment of the Company's investments in subsidiary undertakings as referred to in note 25 was considered necessary.

The table below shows the various variables used in management' impairment assessment:

	NIC Bank Tanzania Shs '000'	NIC Securities Shs '000'	NIC Properties Shs '000'
Value in use	838,150	465,520	76,180
Weighted average cost of capital	15%	15%	15%

Key assumptions used in value in use calculations and sensitivity to changes in assumptions:

• Budgeted EBITDA – Budgeted EBITDA has been based on past experience adjusted for growth and benefits expected from implementation of Group initiatives including additional capital injection.

• Budgeted capital expenditure –capital expenditure are based on planned growth strategies and includes cash outflows for purchase of property, equipment and computer software.

• Long term growth rate is based on an annual growth rate in EBITDA estimated by management for each of the respective subsidiary.

• Discount rate is generally based on the rate of government securities in the East African region adjusted for a risk premium to reflect the higher risk in the respective entities

Sensitivity analysis

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of any CGU to exceed its recoverable amount.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

29) Operating lease prepayments – Leasehold land

Company 2018 Shs '000	Company 2017 Shs '000		Group 2018 Shs '000	Group 2017 Shs '000
		Cost		
-	-	**At 1 January and 31 December**	**526,000**	**526,000**
		Amortization		
-	-	**At 1 January**	3,250	**3,125**
-	-	Charge for the year	125	125
-	-	**At 31 December**	**3,375**	**3,250**
-	-	**Net book value**	**522,625**	**522,750**

30) Customer deposits

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	-	Current	54,779,061	54,780,374
-	-	Savings	5,663,340	4,951,299
-	-	Term	80,887,173	77,811,530
-	-	Other	3,171,486	1,373,367
-	-	**At 31 December**	**144,501,060**	**138,916,570**
-	-	Weighted average effective interest as at year end	**5.37%**	**5.30%**

The breakdown between current and non current deposits is as below:

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	-	Current	142,111,640	138,747,202
-	-	Non Current	2,389,420	169,368
-	-		**144,501,060**	**138,916,570**

Customer deposits are financial instruments classified as liabilities at amortised cost. Included in term deposits are deposits which are at fixed interest rates whereas all other deposits are at variable rates. Other deposits are those held as collateral for irrevocable commitments mainly under import letters of credit and performance bonds. Their fair value approximates the carrying amount.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

31) Due to banking institutions

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
		Maturing within 90 days:		
-	-	**Due to banking institutions**	**9,906,429**	**12,138,495**
0.00%	**0.00%**	Weighted average effective interest rate as at year end	**3.52%**	**3.52%**

Deposits due to banking institutions are financial instruments classified as liabilities at amortised cost.
Balances due to banking institutions are current.

32) Borrowings

a) The Group has unsecured revolving medium term lines of credit for onward lending with:

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	-	The International Finance Corporation (IFC)	4,312,297	5,033,680
-	-	European Investment Bank (EIB)	4,266,113	4,946,122
-	-	The Dutch Development Finance Institution, FMO	343,067	694,521
-	-	Societe de Promotion et de Participation pour la Cooperation Economique S.A (PROPARCO)	199,792	606,361
-	-	Medium term note	5,747,068	5,745,174
-	**-**		**14,868,337**	**17,025,858**
		Analysis of movement:		
-	-	At start of year	17,025,860	18,976,960
-	-	Accrued interest	1,250,723	1,262,927
-	-	Repayments during the year	(3,243,883)	(3,279,574)
-	-	Translation differences	(164,363)	65,545
-	**-**	At end of year	**14,868,337**	**17,025,858**
		Maturity Profile:		
-	-	Payable within one year	7,704,851	2,155,942
-	-	Payable after one year and within three years	4,708,880	5,576,527
-	-	Payable after three years	2,454,606	9,293,389
-	**-**		**14,868,337**	**17,025,858**
-	**-**	Weighted average effective interest	**7.91%**	**7.16%**

Borrowings are financial instruments classified as a liability at amortised cost.
The terms of the borrowings are as follows:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

32) Borrowings (continued)

NIC Bank Kenya PLC

i) Subordinated debts

NIC Bank Kenya PLC has two sets of long-term subordinated debts facilities obtained to enhance the Bank's capital base:

- US$ 20 million unsecured facility raised from IFC in December 2014, with a tenure of 7 years. Outstanding principal balance at 31 December 2018 was US$ 20 million (2017: US$ 20 million). This facility bears interest at rates referenced to the six months Libor; and

- Shs 5.5 billion raised from the Medium Term Note issued in September 2014 at an interest rate of 12.5%, with a tenure of 5 years. Outstanding principal balance at 31 December 2018 was Shs 5.5 billion (2017: Shs 5.5 billion).

ii) Other borrowings

NIC Bank Kenya PLC has four long-term senior loans as below:

- US$ 35 million unsecured facility raised from IFC in December 2014, with a tenure of 7 years. Outstanding principal balance at 31 December 2018 was US$ 22 million (2017: US$ 29million);

- US$ 35 million unsecured facility raised from FMO in April 2014, with a tenure of 5 years. Outstanding principal balance at 31 December 2018 was US$ 3 million (2017: US$ 7 million);

- US$ 21 million unsecured facility raised from PROPARCO in April 2012, with a tenure of 7 years. Outstanding principal balance as at 31 December 2018 was US$ 2 million (2017: US$ 6million); and

- US$ 54 million unsecured facility raised from EIB in December 2016, with a tenure of 7 years. Outstanding principal balance as at 31 December 2018 was US$ 42 million (2017: US$ 47 million)

These facilities bear interest at rates referenced to the six months Libor.

b) Compliance with debt covenants

During the year, the Group met all its loan repayment obligations.
The Group was in compliance with all financial covenants with all its lenders.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

33) Due to group companies

Company

	2018 Shs `000	2017 Shs `000
NIC Bank Kenya PLC	**15,850**	**61,685**

Balances due to group companies are current.

34) Other liabilities

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	-	Bills payable	183,466	182,831
-	-	Trade Payables	92,082	242,561
-	-	Preference Shares	30,589	29,946
-	-	Leave pay provision	23,604	20,039
-	-	Legal and Other claims	2,200	4,200
48,449	-	Other payables and accruals	2,960,242	2,851,823
48,449	**-**	At 31 December	**3,292,183**	**3,331,400**

Other liabilities are current. Other liabilities, excluding non-financial assets, are classified as liabilities at amortised cost.

Legal and other claims relate substantially to a provision for charges brought against the Group by customers of the stock brokerage subsidiary, NIC Securities Limited. In the directors' opinion, after taking appropriate legal advice, the outcome of these legal claims will not give rise to any significant loss beyond the amounts provided at 31 December 2018.

The preference shares relate to East African Development Bank (EADB) which invested TShs 650 million in 8% non-redeemable and non-cumulative preference shares issued by NIC Bank Tanzania in November 2004. The preference shareholders have the discretion to transfer to the existing shareholders or may convert their shares into ordinary shares upon attainment of certain covenants. Dividends on the preference shares are payable when there are sufficient cash resources at the date of declaration, subject to the business and industry requirements of the company, making of prudent reserves and provisions in general and complying with all applicable legislation.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

35) Dividends

At the Annual General Meeting scheduled for 17 April 2019, a first and final dividend in respect of 2018 of Shs 1.25 per share (2017: final dividend of Shs 1.00 per share) amounting to a total of Shs 879,925,204 (2017: Shs 639,946,000) is to be proposed by the directors.

The final proposed dividend for the year is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

Group and Company

The movement in unclaimed dividends is as follows:

	2018	2017
	Shs '000	Shs '000
At 1 January	**22,388**	**35,599**
Final dividend declared	639,946	639,946
Dividends paid	(619,348)	(653,157)
At 31 December	**42,986**	**22,388**

Payment of dividends to members with shareholding of up to 12.5% is subject to withholding tax at the rate of 5.0% for residents and 10.0% for non-residents.

36) Share capital and reserves

(a) Share capital and share premium

Group and Company	Number of shares	Share capital	Share premium
		Shs `000	Shs `000
1 January 2017 and 31 December 2017	639,945,603	3,199,728	2,700,017
Bonus issue	63,994,560	319,973	(319,973)
Bonus issue expenses			(6,050)
31 December 2018	**703,940,163**	**3,519,701**	**2,373,994**

As at 31 December 2018, the authorised share capital of the Company comprised of 800,000,000 (2017: 800,000,000) ordinary shares with a par value of Shs 5. The issued shares as at 31 December 2018 are 703,940,163 (2017: 639,945,603) and are fully paid. Issued and fully paid ordinary shares, which have a par value of Shs 5, carry one vote per share and carry a right to dividend.

In May 2018, the Group issued Bonus shares at the rate of one (1) new fully paid up bonus share of par value Shs 5 for every ten (10) shares of par value Shs 5.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at General Meetings of the Company.

Premiums from the issue of shares are reported as share premiums. During the year a portion of this was utilized to cater for the bonus issue expenses.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

36) Share capital and reserves (continued)

(b) Revaluation surplus on property

Revaluation reserve is made up of the periodic adjustment arising from the valuation of buildings, net of the related deferred taxation. The reserve is not available for distribution to the shareholders:

Group and Company

The movement in revaluation surplus on property is as follows:

	2018 Shs`000	2017 Shs'000
At 1 January	**-**	**175,202**
Revaluation surplus on building	251,071	-
Deferred income tax	(75,321)	-
Realised on transfer to group	-	(175,202)
At 31 December	**175,750**	**-**

(c) Investments revaluation reserve

This represents the unrealized increase or decrease in the fair value of available-for-sale investments after deduction of deferred income taxes, excluding impairment losses. The reserve is not available for distribution to the shareholders.

The gains from disposals of FVOCI investments amounted to Shs 24,917,000.

(d) Foreign currency translation reserve

The reserves represent exchange differences arising from translation of the net assets of the Group's foreign operations which are NIC Bank Tanzania Limited and NC Bank Uganda Limited from their functional currency (Tanzania Shillings and Uganda Shillings respectively), to the Group's presentation currency (Kenya Shillings). These differences are recognised directly through other comprehensive income and accumulated in the foreign currency translation reserve in equity. The reserve is not available for distribution to the shareholders.

(e) Regulatory reserves

Where impairment losses required by prudential guidelines issued by the banking regulators exceed those computed under the International Financial Reporting Standards (IFRS), the excess is recognised as a regulatory reserve and accounted for as an appropriation from retained earnings. The reserve is not available for distribution to the shareholders.

Movement in regulatory reserves

Group	2018 Shs '000'	2017 Shs '000'
1 January	**1,042,359**	**1,238,486**
Translation differences	80,794	-
Trnasfers in the year	(1,059,691)	(196,127)
31 December	**63,462**	**1,042,359**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

36) Share capital and reserves (continued)

(f) Other reserve

The reserve relates to transactions with non-controlling interests that do not result in loss of control. It is the difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary. See the respective disclosures under notes 37 (a) and (b).

37) Non-controlling interests

The total non-controlling interest consists of equity interest in NIC Tanzania.

38) Off balance sheet financial instruments, contingent liabilities and commitments

a) Contingent liabilities

Company			Group	
2018	2017		2018	2017
Shs'000	Shs'000		Shs'000	Shs'000
-	-	Letters of credit	-	4,001,932
-	-	Letters of guarantee & performance bonds	3,051,887	11,629,531
-	**-**	**At 31 December**	**3,051,887**	**15,631,463**

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

Letters of credit are commitments by the Group to make payments to third parties, on production of documents, on behalf of customers and are reimbursed by customers. Letters of guarantee and performance bonds are issued by the Group, on behalf of customers, to guarantee performance by customers to third parties. The Group will only be required to meet these obligations in the event of default by the customers.

(b) Operating lease prepayments

i) The group as a lessor

At the end of the reporting period, the Group had contracted with tenants for the following future lease receivables:

Group and Bank	**2018**	**2017**
	Shs'000	**Shs'000**
Within one year	10,268	8,940
In the second to fifth year inclusive	41,073	35,760
At 31 December	**51,341**	**44,700**

Leases are negotiated for an average term of 6 years and rentals are reviewed every two years. The leases are cancellable with a penalty when the tenants do not give three months' notice to vacate the premises.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

38) Off balance sheet financial instruments, contingent liabilities and commitments (continued)

ii) The group as a lessee

At the end of the reporting period, the Group had non-cancellable operating leases which fall due as follows:

	Group	
	2018	**2017**
	Shs'000	**Shs'000**
Premises		
Within one year	305,531	306,120
In the second to fifth year inclusive	658,080	759,231
At 31 December	**963,611**	**1,065,351**
Office equipment		
Within one year	3,132	1,248
In the second to fifth year inclusive	1,305	-
At 31 December	**4,437**	**1,248**

Operating lease payments represent rentals payable by the Group for its business premises and office equipment. Premises leases are negotiated for an average term of 6 years, while office equipment is for an average term of 3 years. For these contingent liabilities, no reimbursement is expected.

c) Capital commitments

	Group	
	2018	**2017**
	Shs'000	**Shs'000**
Authorized and contracted for	444,721	814,474
Authorized but not contracted for	229,853	348,510
At 31 December	**674,574**	**1,162,984**

The capital commitments largely relate to branch expansion activities and software acquisition. The Group's management is confident that future net revenues and funding will be sufficient to cover this commitment.

d) Legal proceedings

Various claims against the Group are considered without merit, and the Group is defending them vigorously. It is not possible to estimate the Group's possible loss in relation to these matters, nor the effect that they might have upon operating results in any particular financial period. No contingent liability associated with legal actions has been disclosed as professional advice indicates that it is unlikely that any significant loss will arise.

e) Other credit commitments

Commitments to lend are agreements to lend to customers in future subject to certain conditions. Such commitments are normally made for fixed periods.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39) Notes to the statement of cash flows

a) Cash used in operations

Company			Group	
2018	2017		2018	2017
Shs'000	Shs'000		Shs'000	Shs'000
		Reconciliation of profit before income tax to cash from/(used in) operations		
173,006	1,251	Profit before income tax	5,822,865	5,600,950
		Adjustments for:		
-	-	Depreciation (note 27)	279,784	274,575
-	-	Amortization of operating lease prepayments	125	125
-	-	Amortization of intangible assets (note 28)	194,008	222,538
-	-	Gain on sale of motor vehicle and equipment (note 39 (c)	(1,196)	(2,042)
173,006	**1,251**	**Profit before working capital changes**	**6,295,586**	**6,096,146**
		Decrease/(Increase) in balances with central banks		
-	-	– Mandatory reserve deposits	(271,214)	(1,354,896)
-	-	Decrease/(Increase) in loans and advances to customers	1,552,476	(5,364,616)
-	-	Increase in derivatives held for risk management	(178,021)	(41,085)
(500)	-	Decrease in other assets	887,900	(1,018,067)
53,955	(53,955)	Due (from)/ to group companies	-	-
(45,835)	61,685	Due to group companies	-	-
-	-	(Decrease)/Increase in customer deposits	5,584,490	27,091,885
48,718	-	Decrease in other liabilities	(39,217)	(667,326)
-	-	Accrued interest on borrowings	1,250,723	-
-	-	Fair value movement on government securities	519,723	1,025,070
-	-	Adjustment on initial application of IFRS 9	(4,320,446)	-
229,344	**8,981**	**Cash from operations**	**11,282,000**	**25,767,111**

b) Cash and cash equivalents

Analysis of balances of cash and cash equivalents as shown in the consolidated statement of financial position and notes.

Company				Group	
2018	2017			2018	2017
Shs'000	Shs'000		Note	Shs'000	Shs'000
337,455	1,200,000	Cash and balances with central banks	17	4,205,199	2,037,136
-	-	Items in course of collection	18	400,689	233,004
-	-	Due from banking institutions	19	5,237,549	12,425,067
-	-	Government securities	20	3,435,000	373,149
-	-	Due to banking institutions	31	(9,906,429)	(12,138,495)
337,455	**1,200,000**	**At 31 December**		**3,372,008**	**2,929,861**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

39) Notes to the statement of cash flows (continued)

c) Proceeds from sale of motor vehicle and equipment

		Group	
		2018	2017
	Note	Shs'000	Shs'000
Proceeds from sale of motor vehicle and equipment		1,274	5,635
Disposal at cost	27	(15,695)	(14,990)
Depreciation eliminated on disposal	27	15,617	11,397
Gain on disposal of motor vehicle and equipment	**11**	**1,196**	**2,042**

40) Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operation decisions, or one other party controls both. There are other companies which are related to NIC Group PLC through common shareholdings or common directorships.

In the normal course of business, a number of banking transactions are entered into with related parties i.e. staff, directors, their associates and companies associated with directors. These include loans, deposits and foreign currency transactions. Loans and advances to customers include loans and advances to staff and to companies associated with directors. Contingent liabilities include guarantees and letters of credit for companies associated with directors

a) Loans and advances to customers

Companies associated with directors

Company			Group	
2018	2017		2018	2017
Shs'000	Shs'000		Shs'000	Shs'000
-	181,769	At 1 January	416,785	350,448
-	(181,769)	Net movement during the year	(216,504)	66,337
-	**-**	**At 31 December**	**200,281**	**416,785**
-	**-**	**Interest earned**	**50,795**	**16,341**
-	**-**	**Guarantees and letters of credit to companies associated with directors**	**363,539**	**384,378**

The above outstanding balances arose from the ordinary course of business and are substantially on the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

40) Related party transactions (continued)

a) Loans and advances to customers (continued)

Directors and key management personnel

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
		Loans and advances to customers:		
-	59,328	At 1 January	132,834	68,859
-	(59,328)	Net movement during the year	25,566	63,975
-	**-**	**At 31 December**	**158,400**	**132,834**
-	**-**	**Interest earned**	**11,913**	**11,096**

These loans and advances are performing and are adequately secured.

b) Customer deposits

Companies associated with directors

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	6,353,307	At 1 January	3,476,332	6,540,124
-	(6,353,307)	Net movement during the year	1,200,474	(3,063,792)
-	**-**	**At 31 December**	**4,676,806**	**3,476,332**
-	**-**	**Interest paid**	**291,119**	**237,071**

Directors and key management personnel

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
-	300,204	At 1 January	247,971	318,594
-	(300,204)	Net movement during the year	98,789	(70,623)
-	**-**	**At 31 December**	**346,760**	**247,971**
-	**-**	**Interest paid**	**20,122**	**15,262**

The above outstanding balances arose from the ordinary course of business and are substantially on the same terms, including interest rates and security, as for comparable transactions with third-party counterparties.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

40) Related party transactions (continued)

c) Directors and key management compensation

The remuneration of directors and other members of key management during the year was as follows:

Company 2018 Shs'000	Company 2017 Shs'000		Group 2018 Shs'000	Group 2017 Shs'000
164,035	**33,526**	Salaries and other benefits	**465,930**	**497,863**
		Directors' remuneration		
3,750	-	Fees for services as directors	26,997	34,441
128,908	21,349	Other emoluments (included in salaries and other benefits above)	128,908	144,919
132,658	**21,349**		**155,905**	**179,360**

In line with policy, the above compensation is a consolidated salary package encompassing all employment benefits.

41) Assets pledged as security

As at 31 December 2018, there were no assets pledged by the Group to secure liabilities and there were no secured Group liabilities (2017: nil).

42) Fiduciary activities

The Group holds asset security documents on behalf of customers with a value of Shs 130,791,413,663 (2017: Shs 106,494,284,723). These securities are held by the custody services department and comprise deposits with financial institutions, government securities and quoted and unquoted securities, among others.

43) Group reorganisation

On 11 October 2016, the shareholders approved the creation of a new operating company, a new wholly owned subsidiary company of the Bank named 'NIC Bank Kenya PLC'. Under the reorganization plan, the Kenyan banking business and net assets of NIC Bank Limited were to be transferred to NIC Bank Kenya PLC. The Central Bank of Kenya (CBK) approved the formation of the Non-Operating Holding Company on 15 February 2017. NIC Bank Limited changed its name to 'NIC Group PLC'. NIC Group PLC operates as a Non-operating holding company under section 13(1) of the Banking Act.

NIC Group PLC (previously NIC Bank Limited) transferred some of its assets and liabilities to the new subsidiary; NIC Bank Kenya PLC, at a consideration to be paid partly by cash and partly by issue of shares, as per the transfer of assets agreement between NIC Group PLC and NIC Bank Kenya PLC. The assets and liabilities transferred were those held by NIC Bank Limited as at 31 August 2017. The following accounting entries were made in the books of NIC Group PLC (previously NIC Bank Limited) and NIC Bank Kenya PLC to recognise the above transaction.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

i) Transfer of assets and liabilities other than the excluded assets and liabilities to NIC Bank Kenya PLC;

Net asset before transfer	**Shs'000**
Assets	186,715,071
Liabilities	(153,108,118)
Net assets at 31 August 2017	33,606,953
Excluded assets & liabilities	
Investments in subsidiaries (excluding Shs 1 billion investment in NIC Bank Kenya PLC before re-organisation)	4,672,701
Deferred tax	3,318,821
Dividends	(30,573)
Total excluded net assets	7,960,949
Net assets transferred	25,646,004

ii) Recognition of consideration made on transfer of net assets;

The consideration for the transfer of shares constituted 15 million shares at Shs 1,000 per share, Share premium of Shs 9.4 billion and cash consideration of Shs 1.2 billion as below:

	Shs'000
Share capital	15,000,000
Share premium	9,446,004
Cash	1,200,000
Total consideration	25,646,004

iii) The following balances were effected through retained earnings:

Investment in subsidiaries	(4,672,701)
Dividends payable	30,573
Realized revaluation reserve	894,415
Cash consideration	(1,200,000)
Total	4,947,713

44) Events after reporting period

On 6 December 2018, NIC Group PLC (NIC) and Commercial Bank of Africa Limited (CBA) announced that their Board of Directors authorized the commencement of discussions regarding a potential merger of the two entities. On 31 January 2019 NIC and CBA announced that their respective Boards of Directors approved the proposed merger and resolved to recommend to their respective shareholders a merger of the two Groups.

The proposed merger will be completed upon fulfilment of a certain set of conditions precedent, customary to transactions of this nature, including but not limited to, the parties obtaining applicable shareholder and regulatory approvals, and the parties entering into and completing various transactional agreements to complete the merger.

The proposed merger will be executed through a share swap, and it is proposed that the shareholders of CBA will exchange their shares in CBA for new shares in NIC, which will be the holding company of the merged businesses and remain a publicly listed company quoted on the Nairobi Securities Exchange. It is envisioned that the share exchange ratio will be based on a 47:53 relative valuation of NIC and CBA respectively. As such, it is expected that the CBA shareholders will in aggregate own 53% of the then issued shares in NIC, whilst existing NIC shareholders will own 47% of the then issued shares in NIC.

Up until the merger becomes effective the two entities will continue to operate independently. The merger is expected to be completed in the second half of 2019.