National Bank

Our Road to 100

2018 | Annual Integrated Report

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Integrated Reporting Principles

Our commentary covers the period January 1, 2018 to December 31, 2018 and has been published on the National Bank Ltd website. The report takes an integrated approach that highlights NBK's contribution to its stakeholders by providing both financial and non-financial information guided by our value creation model.

In preparing the 2018 Integrated Annual Report, we have taken into consideration the principles of the International Integrated Reporting Framework of the International Integrated Reporting Council (IIRC).

Regulatory Framework

This report has also been prepared and presented in accordance with the requirements of The Capital Markets Authority (CMA), Central Bank of Kenya (CBK) Corporate governance requirements, and the Companies Act (2015). For the Corporate Social Responsibility information included in this commentary, we have also followed the relevant aspects of the Global Reporting Initiative G4 sustainability guidelines (GRI-G4 Sustainability). The financial statements have been prepared in accordance with the appropriate reporting standards and guidelines such as the CBK Prudential guidelines and International Financial Reporting Standards (IFRS).

Scope and Boundaries

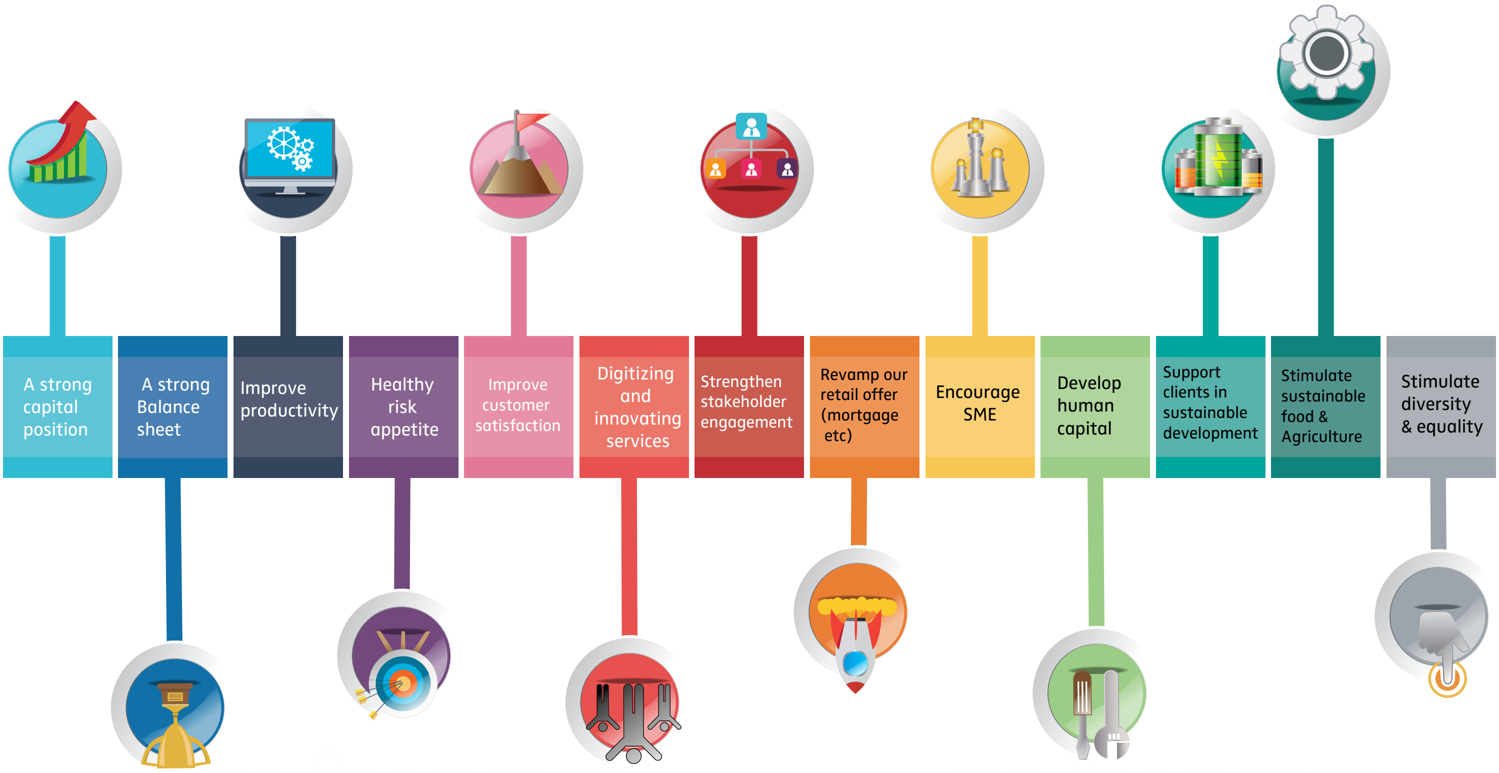
National Bank's 2018 commentary relates to the reporting period January 1, 2018 to December 31, 2018, which can be downloaded from the official website. Material analysis warrants that we cover key economic, social and environmental topics within our Annual Report. The information disclosed concerns our progress on the most significant material topics for the Financial Year 2018. The commentary consolidates data from all the Bank's divisions and subsidiaries with a view to providing a complete, concise and accurate view of our performance

Materiality

The Bank has a defined list of thirteen (13) themes identified through a materiality matrix informed via an internal and external survey conducted by a consultant. The impact of each theme, therefore was determined based on National Bank's strategy and validated by the Board of Directors.

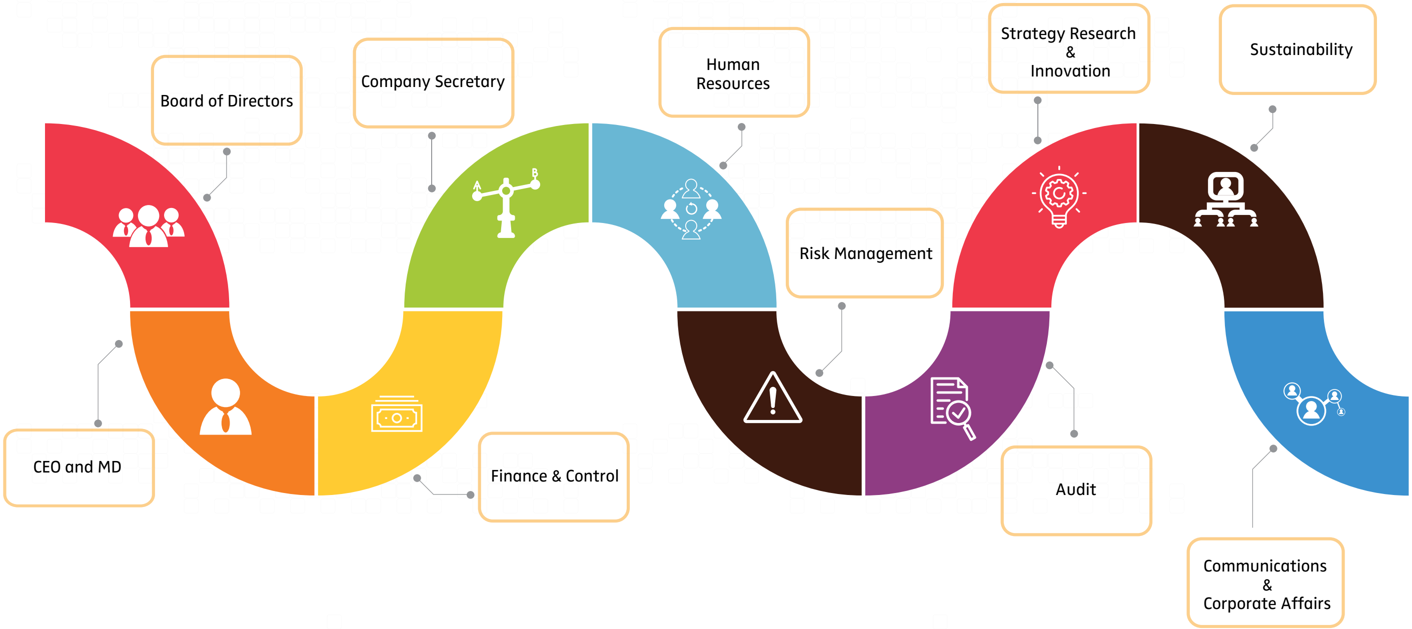
Stakeholder Engagement

National Bank of Kenya is committed to continuous strategic, constructive and proactive dialogue with all our stakeholders. Our material reporting themes are based on specific engagements we conducted during 2018 with our customers, employees, government agencies, regulators, community media and our shareholders who provided valuable feedback in regard to our operations.



Preparation of the Report

As the first step to ensuring a smooth production process, the working group usually has a meeting called by the Chair of the Annual Report Steering Group and MD to decide on the commentary structure and key messages and to assign the roles. The working group then embarks on their different roles and produces a draft which is consequently reviewed by the steering group and other key partners. The draft texts of the commentary are then discussed in Board Meetings and other supporting committees for approval.



Assurance

The Bank takes cognizance of the importance of the information provided in this commentary for both our internal and external publics. For this reason, assurance is provided for the 2018 National Bank Integrated Report by the Board of Directors and Management.

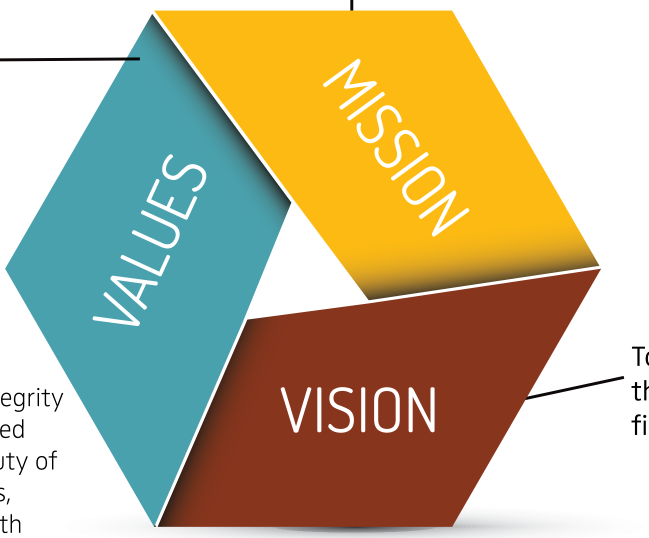
The Annual Financial Statements for 2018 were audited by PricewaterhouseCoopers (PwC). For more information on PwC assurance, we refer to the Independent Auditor's report.

It is our hope that our 2018 commentary provides our stakeholders with an overview look into our business – the nature of our operations, where we are and where we target to go in the future. We anticipate and invite our readers to share feed-back on pertinent issues through our website *www.nationalbank.co.ke*

WHO WE ARE AND OUR BUSINESS

Mission, Vision, Ethics and Values

At National Bank, we are dedicated to excellence in providing competitive financial solutions, meeting the changing needs of our customers, being a responsible corporate citizen, providing attractive opportunities to our employees and improving shareholders value.



- Courage

Always do the right thing, never tolerating the wrong, and to be accountable for our decisions.

- Honesty

Act fairly, ethically and with integrity at all times. Acting with a shared sense of purpose, an abiding duty of care, and serving our customers, stakeholders and colleagues with integrity, fairness and transparency.

- Innovation

Create effective solutions that meet the needs of our customers and objectives of our stakeholders and ensuring that finance markets for smaller businesses work effectively.

- Collaboration

Connecting across the organization respecting and valuing those we work with, engaging with all the stakeholders and markets to better deliver on sustainable growth and improve shareholder value. It is about building trust and promoting collaboration.

To be the preferred Bank in the provision of comprehensive financial solutions in the region.

Impacting Lives to Enable Progress

ETHICS

We at National Bank promote the highest code of ethical conduct across the entire organization, from the board, senior management and other staff. This has ensured that our clients and stakeholders trust in us and are confident to engage with us.

Our Journey

Like all nations, Kenya has been founded on the efforts of many people, institutions, organizations, professions and respectable corporations.

National Bank was established by the Kenyan Government on June 19th, 1968 to serve as a vehicle for financial assistance to Kenyans and various sectors of development. At its inception the government owned 99.999 shares while one share was issued to John Matere Keriri. The Bank was then officially opened in November 1968 by the then Vice President Daniel Arap Moi and Minister for Finance James Gichuru at Development House.

In the year 1968, the Bank made some accomplishments. It received the official approval to join the Kenya Banker's (Employer's) Association and opened operational accounts. It was under Stanley Githunguri's tutelage that the Bank's headquarters were occupied and officially opened by Mzee Jomo Kenyatta. In 1980 the Bank was in a major financial problem caused by debts but the government had to move in and bail out the Bank by contributing an

His excellency Mzee Jomo Kenyatta admires a gift presented to him by the National Bank Executive Chairman Mr. Stanley Githunguri. Present is the 1st lady Mama Ngina.The gift was a small scale Mt. Kenya in a glass case

Vice President Moi cuts the tape to officially open the National Bank of Kenya on Government road. With him is the National Bank Manager Andrew Alexander Hanson Phimister

extra Kshs 60 million in share capital. By December 1985 the Bank had installed computers at its branches and would later install computers at the Harambee Avenue branch in order to serve customers betterOnce again in the year 1998 the Bank had major financial turbulence due to non-performing loans. The situation was so bad that the Kenyan Government called an extraordinary general meeting (EGM) to deal with the situation.

The Central Bank of Kenya appointed a new Bank board and a new managing director, Reuben Marambii. Fundamental changes needed to be made on the Banks' structure, policies, procedures and operations. These changes made it possible for the National Bank in 2001 to turn into profitability after 3 years of a loss position.

In 2012 that Marambii and his senior management team left the Bank and a new MD Munir Sheikh Ahmed with a new team was appointed. In 2013, National Bank rebranded itself using the phrase "Bank on Better" and it was the year the Bank executed rapid branch expansion and also introduced Islamic banking. Between 2013 and 2016 the Bank launched PIN delivery through SMS messages with support from Compass Plus, being one of the first Banks in the region to offer that service to its customers. The Bank also launched an in-house card personalization facility for efficient card issuing. In 2016, the Bank, under the leadership of the Managing Director, Wilfred Musau made major banking accomplishments. It renewed SME up-take and increased its diaspora commitments. It improved staff engagement, wellness and capacity and introduced a seamless voluntary early retirement scheme. It introduced branch rationalization and gave the branches more space in which to operate.

The Bank has also won a number of awards including, "Best Bank in Service" , best Islamic Window in the East African award, best in internal communication campaign and also won the best M-Visa Consumer Experience award. As the National Bank of Kenya enters the second half century of its operations it is bound to face many challenges in its operations, but from its record so far there is no doubt that such challenges will be overcome and the National Bank will continue to live up to the expectations of Kenyans as a Bank that continues to cater for the needs of most Kenyans

Our Journey

• 1968
Foundation Days
Incorporated as a State owned Bank

• 1985 - 1994
The Glory Days
- Pioneers the introduction of computerized online services in 1985.
- Privatized in 1994

• 2013
Transformation
- Set out to become Top Tier Bank by 2017.
- Highly profitable and high returns to share-holders

• 2014
New Outlets Look
- New Branch look;
- Retail, Amanah and Premium Look.
- Agency Banking;
- Offsite ATMs

• 2014 - 2015
Digital Transformation
- Pioneers of the County
- Solution offering, University
- Smart Card. Roll out of
- NatConnect and NatMobile.

Revamped products
- Business Club
- Launch Premium
- Banking National
- Amanah Small
- Enterprise Banking
- 50 Years

• 2015 - 2018

Who We Are And Our Business

As a fully diversified financial services provider, we are fully cognizant that our sustainability is dependent on our ability to assist our clients and customers to fulfill their economic potential by providing financial solutions, creating and preserving wealth in a responsible manner.

In this regard, we strive to offer competitive and relevant products and services to individuals, entrepreneurs, corporates and institutions to protect and grow their assets.

Growth of National Bank

The year in review presented a couple of trends and developments that impacted our work; such as consumer behavior, technology, innovation, market players, regulations, the economy and society. The trends presented several opportunities and challenges for National Bank and its stakeholders.

An overview of the 2018 trends:

• To meet our customer needs, the Bank continued to proactively monitor innovations in the financial sub-sectors as well as in the Food and Agribusiness enabling the Bank enter into strategic partnerships to deliver on its strategic objectives.

• During the year 2018, customer needs and preferences continued to change according to digital advances made in the market. This therefore directed the Bank's focus on investing in enhanced quality and further innovation of our digital services. To this end the Bank enhanced its products to MSMEs and its mobile banking platform to improve customer experience.

• With the current economy, driven by a low interest rate environment and other regulations, the Bank continued to operate on a cost-effective basis to improve its efficiency and productivity.

• To ensure growth the Bank embarked on developing a diversified loan portfolio in different sectors. Our Risk Appetite Statement sets sector limits that we use to closely monitor the businesses that we lend to.

• With an aging and growing of middle class we anticipate that the demand for food will increase in both volume and quality. This trend will be an important growth driver for our customers in the food and agribusiness industry and therefore the Bank will continue to support them by improving the product.

• Climate change is a major determinant of food security. To ensure we are aligned to global expectations, the Bank embarked to using the UN Sustainable Development Goals as guidelines in its efforts to reduce hunger and poverty in the communities it is represented.

• Due to vulnerability and other uncertainties in the society, banks are called upon to be socially responsible and in this regard National Bank embarked on various activities to address the societies concerns inspired by our CSR mission to 'Transforming lives, one story at a time'.

Emerging Trends To Anticipate

- New technologies may move the market in new directions
- Cut throat competition; in the banking industry and from substitute goods e.g. Sacco's and other formal and informal financial institutions.
- Very competitive digital platforms and channels by competition;
- Very Competitive Agency Banking propositions by competition
- Legislation capping banks' interest rates; This threat controls both interest income and expense; Consumers can now easily switch to other banks with little cost or consequence
- High unemployment rate in Kenya and declining consumer disposable income.
- Mergers and aquisitions in the Financial Services industry.

Our Stakeholders

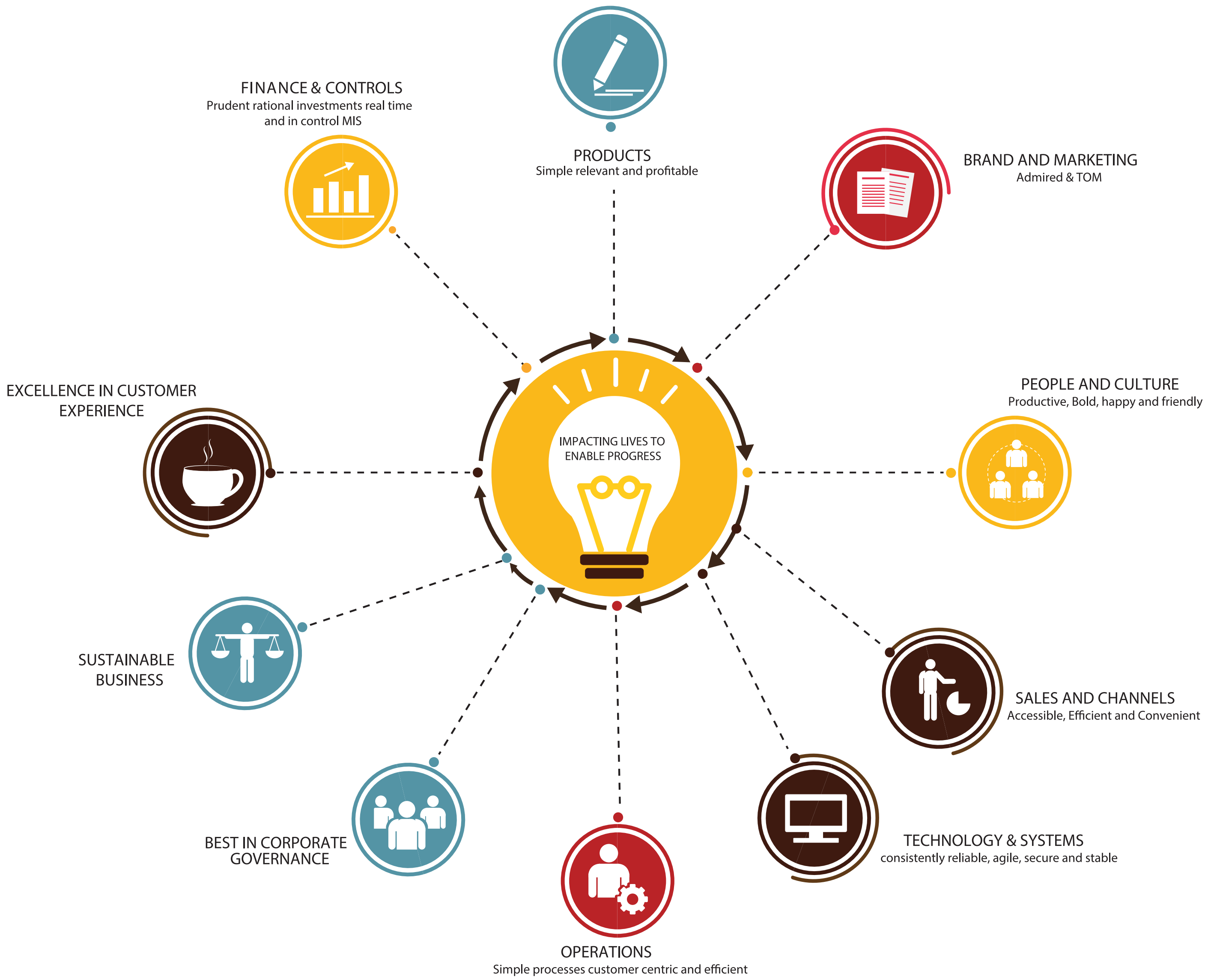
The value we have added to the society and wider macroeconomic environment can easily be felt, and is something we are immensely proud of.

Our Strategy

National Bank has an important role in contributing to financial stability & economic growth. Our strategy sets forth ten bold themes. With such a bold commitment, it is our aim to foster financial confidence while providing accessible finance for everyone by enabling people to make sound financial decisions and ensuring a responsible transition to future financial services.

Furthermore, we will continue working to integrate our corporate citizenship in our core business by contributing to society, fostering responsible customer relationships, being a responsible employer, reducing our environmental footprint and ensuring responsible supplier relationships.

Bank's 2018 /2022 Strategic Pillars



Measuring Strategic Progress

1 Business Growth

Profit before tax & exceptional items
2018 – 456 million
2017 – 785 million

Strategic partnerships; AGPO, Universities, Insurance companies

New products: Revamped business club, Agribusiness, fund management

2 Client Service

System uptime – 99.8%
Paperless Banking for deposit
Core banking system stability

Improved customer satisfaction index.
2018 –78% **2017** - 62%

Reduction in TAT
Improved customer complaint resolution

3 People & Culture

Restructuring for staff optimization
Improved staff engagement levels - 75% in year 2018.

Talent, Learning and Development – Team building, Roll out of coaching program, performance management, 360 degree assessment, leadership programs & capacity building.

Staff Retention
2018 - 80% 2017 - 97%

4 Cost & Risk Management

Credit Risk
Reduction of NPL and loan loss charge:
Gross NPL ratio
2018 – 49% 2017 – 42%
Loss ratio
2018 – 0.3% 2017 – 1%

Cost management:
2018 – 7.3 Billion 2017 – 7.6 Billion

Risk management & controls:
Branch space optimization
Restructuring to save costs.
Implementation of whistle blowing policy.
Training on anti-money laundering & combating the financing of terrorism

5 Brand

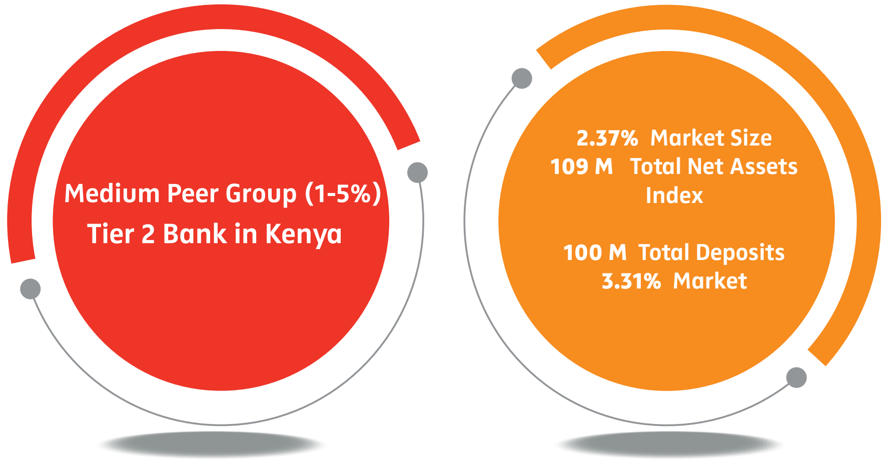
Improved brand equity
Improved customer engagement
Increased activity in digital media
Increase customer engagement with brand.

Positioned the Bank as customer focused leading to enhanced customer loyalty and retention.

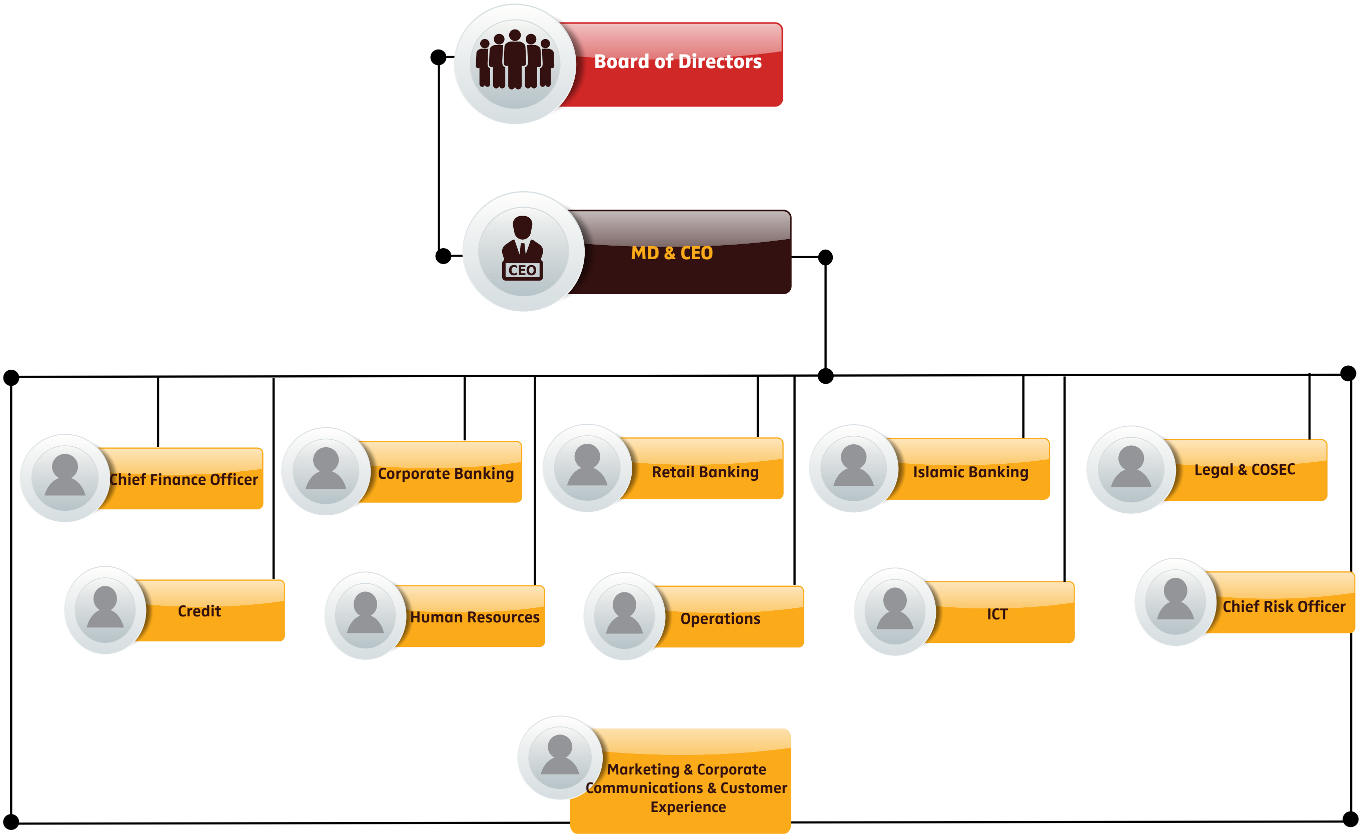
Staff alignment to the Brand Values.

Market Presence

National Bank of Kenya Ltd



Structure of the Organization



Corporate Information

Board of Directors

Non-Executive	
Mr. Mohamed Hassan	Chairman
Cabinet Secretary, National Treasury	(CS - National Treasury)
Managing Trustee, National Social Security Fund	(MT - NSSF)
Dr. Francis Atwoli	
Mr. Joseph Kering'	
Ms. Linnet Mirehane	
Mr. Jones Nzomo	
Mr. Mark Obuya	

Executive	
Mr. Wilfred Musau	Managing Director & CEO

Board Committees

Board Audit Committee
Mr. Jones Nzomo*
Mr. Joseph Kering'
Ms. Linnet Mirehane
Mr. Mark Obuya
CS - National Treasury
MT NSSF

Board Credit Committee
Mr. Joseph Kering'*
Mr. Mark Obuya
Ms. Linnet Mirehane
Mr. Jones Nzomo
MT NSSF
CS - National Treasury
Mr. Wilfred Musau

Board Nomination & Remuneration Committee
Dr. Francis Atwoli*
Mr. Mark Obuya
Ms. Linnet Mirehane
Mr. Joseph Kering'
Mr. Jones Nzomo
CS - National Treasury
MT NSSF
Mr. Wilfred Musau

Board Risk Committee
Ms. Linnet Mirehane*
Mr. Mark Obuya
Mr. Jones Nzomo
MT NSSF
Mr. Wilfred Musau

** - Chairperson of the Board Committee*

Company Secretary

H A Waswani (CPS No B/1650)

Certified Public Secretary (Kenya)
Harambee Avenue
P O Box 72866 City Square
00200 Nairobi

Registered Office

National Bank Building

18 Harambee Avenue
P O Box 72866 City Square 00200 Nairobi
Tel: 020-2828000
Fax: 020-311444/222304
E-Mail: info@nationalbank.co.ke
Website: www.nationalbank.co.ke

Auditors

PricewaterhouseCoopers
Certified Public Accountants (Kenya)
PwC Tower, Waiyaki Way/Chiromo Road
P O Box 43963 GPO 00100 Nairobi

Share Registrar

Image Registrars Limited
5th Floor, Barclays Plaza, Loita Street
P.O. Box 9287 GPO, 00100 Nairobi
Tel: 020 - 2230330, 2212065, 2246449
Mobile: 0724699667, 0735565666, 0770052116
Email: info@image.co.ke
Website: www.image.co.ke

National Bank

Serving You The **National** Way.

Our Commitment to you is that you may always Bank on better.

GOVERNANCE AND ACCOUNTABILITY

Board of Directors

1 **Mr. Mohamed Hassan**
Chairman, Non-Executive Director

2 **Dr. Anthony Omerikwa**
Ag. Managing Trustee,
National Social Security Fund
Non-Executive Director

3 **Mr. Henry K. Rotich**
Cabinet Secretary, The National
Treasury, Non-Executive Director

4 **Mark J. Obuya**
Non-Executive Director

5 **Mr. Joseph Kering'**
Non-Executive Director

6 **Ms. Beatrice Gathirwa**
Representative of the Cabinet Secretary to The National Treasury, Non-Executive Director

7 **Dr. Francis Atwoli**
Non-Executive Director

8 **Mr. Jones Nzomo**
Non-Executive Director

9 **Ms. Linnet Mirehane**
Non-Executive Director

10 **Mr. Wilfred Musau**
Managing Director & CEO

11 **Mr. Habil A. Waswani**
Company Secretary

Board of Directors

1

Mr. Mohamed Hassan (47)
Chairman, Non-Executive Director

2

Mr. Wilfred Musau (45)
Managing Director & CEO

3

Mr. Henry K. Rotich (50)
Cabinet Secretary, The National, Treasury, Non-Executive Director

4

Dr. Anthony Omerikwa (42)
Ag. Managing Trustee, National Social Security Fund, Non-Executive Director

Mr. Hassan joined the Board in June 2011. He holds a Master of Science degree in Finance, (MSc.) of the University of Strathclyde, Glasgow.

He also holds a Bachelor of Commerce (BCom. Hons.) Finance major, of the University of Nairobi, is a Chartered Financial Analyst® (CFA®) designate and a graduate of the Advanced Management Programme (AMP) from Strathmore Business School and IESE Business School, Universidad de Navarra, Barcelona.

Mr. Hassan has over 21 years experience in the international and regional capital markets. He is a former Joint Managing Director and CEO of Dyer and Blair Investment Bank and Chairman of KenyaNationalTradingCorporation.

He is a member of the Board of Trustees, Northern Kenya Education Trust, and a former Director of the Kenya Community Development Foundation, and NEPAD Kenya National Steering Committee.

Mr. Musau Mr. Musau joined the Bank in September 2015 as the Director responsible for Retail and Premium Banking. He was appointed as the Managing Director and CEO in April 2016 and confirmed to the position in October 2016. He has 20 years extensive banking experience in Consumer and Business Banking. He has worked for Barclays Bank Kenya Limited, Standard Chartered Bank, KCB Bank Group in Kenya and Rwanda and NIC Bank PLC in various senior leadership roles.

Wilfred is a B.Com holder from Kenyatta University - Major in Banking and Finance, holds a Masters Class certification in Strategy - USB University of Stellenbosch Business School - SA, Extensive training in Banking and is an alumnus of Strathmore Business School (SBS) in leadership training programs and the Advanced Management Leadership Program in the same institution in 2017. He is an SME Champion and has managed successful business turnaround assignments in his various Banking roles in the last 10years. He is a member of the Bank's subsidiary boards; NatBank Trustees and Investment Services and NBK Insurance Agency.

Mr. Rotich is the Cabinet Secretary - The National Treasury. He holds a Masters Degree in Economics and a Bachelors Degree in Economics (First Class Honours), both of The University of Nairobi. He also holds a Masters Degree in Public Administration (MPA) of the Kennedy School of Government, Harvard University.

Prior to his appointment as Cabinet Secretary, he had been the Head of Macroeconomics at the Treasury, Ministry of Finance since March 2006. Under this capacity, he was involved in the formulation of macroeconomic policies that ensured an affordable and sustainable path of public spending aimed at achieving the Government's development priorities.

In addition, he was also involved in the preparation of key budget documents including the Budget Statements, as well as providing strategic coordination of structural reforms in the fiscal and financial sector. Prior to joining the Ministry of Finance, Mr. Rotich worked at the Research Department of the Central Bank of Kenya from 1994. Between 2001 and 2004, he was attached to the International Monetary Fund (IMF) local office in Nairobi to work as an economist. Mr. Rotich has also been a Director on several Boards of State Corporations, including; Insurance Regulatory Board, Industrial Development Bank, Communication Commission of Kenya and Kenya National Bureau of Statistics.

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

He holds a Doctoral degree of the University of Georgia, a specialist advanced degree in workforce development of Pittsburg State University, Masters of Science degree in human resource development, a Bachelor of Arts degree in Economics and a diploma in IT of the Institute for the Management of Information Systems (UK).

Dr. Omerikwa is a member of the Institute of Human Resource Management, Institute of Directors and the Kenya Institute of Management.

Board of Directors

5

Mark J. Obuya (62)
Non-Executive Director

6

Dr. Francis Atwoli (69)
Non-Executive Director

7

Mr. Jones Nzomo (65)
Non – Executive Director

8

Ms. Linnet Mirehane (52)
Non-Executive Director

Mr. Obuya joined National Bank of Kenya Board of Directors in May, 2017. He holds a Bachelor of Laws Degree (LLB) and Master of Laws Degree (LLM) in Law Science and Technology from the University of Nairobi majoring in Intellectual Property, Telecommunications and Medical Law. He also holds a Diploma in Law from the Kenya School of Law and a Certificate in Environmental Impact Assessment/ Audit.

He is an Advocate of the High Court of Kenya, Associate of the Chartered Insurance Institute (ACII) London, an Associate of the Insurance Institute of Kenya (AIIK), a Chartered Insurer and a Patent Agent(KIPI). Currently he is the Chief Executive Officer/Principal Officer of Corporate Insurance Company Limited.

He is the National President of the Federation of Kenya Employers (FKE), a Trustee of the National Social Security Fund and a Board Member of the National Aids and Control Council. He is a past Chairman of the Association of Kenya Insurers (AKI), past Deputy Governor (Finance) of the Kenya Private Sector Alliance, a past Board Member and Trustee of the Insurance Training and Education Trust (College of Insurance) and a past Director of the Insurance Institute of Kenya. He is a seasoned professional with a wealth of experience in corporate governance, finance, law, insurance and social security protection.

Dr. Atwoli was appointed to the National Bank Board in April 2003. He is a long serving career trade unionist and a member of the Board of Trustees of National Social Security Fund (NSSF).

He was awarded an Honorary Doctorate Degree of Humane Letters (Labour Relation) (Honors Causa) by the Masinde Muliro University of Science and Technology on 14th December, 2018. The award was in Honor of his outstanding Services to mankind and Workers in particular.

He is a member of ILO Governing Body, General Secretary, Kenya Plantation and Agricultural Workers Union (KPAWU) Secretary General, Central Organisation of Trade Union - Kenya (COTU K) Chairman/ Spokesperson East African Trade Union Confederation (EATUC) - Arusha, President - Trade Union Federation of Eastern Africa (TUFEA) - Khartoum, President Organisation of African Trade Union Unity (OATUU) - Ghana, President International Trade Confederation Brussels, Vice President, International Labour Conference "ILC" (ILO 2012) - Geneva and Chairman Flat International.

Mr. Nzomo joined the National Bank Board of Directors in June 2016. He holds a Bachelor of Commerce Degree in Accounting from the University of Nairobi and is a Certified Public Accountant. Jones has attended numerous Executive Development Programmes and capacity building seminars both locally and internationally ranging from Kenya Institute of Management, Kellogg School of Management, Northwest University and Kennedy School of Government, Harvard University. Mr. Nzomo has over 38 years working experience in various organizations in Audit and Finance Capacities. He worked as an audit assistant at PriceWaterhouseCoopers from July 1979 to 1980 before moving to Bamburi Portland Cement Limited in 1980 as the Cost and Financial Accountant. He later became the Chief Accountant and Company Secretary in July 1985. He worked as the Financial Controller for Johnson & Johnson from April 1991 to May 1994 and then moved to Central Bank of Kenya where he held several positions including Finance Director, Chief Banking Manager, Director Bank Supervision, Director Finance and Resource Planning and Director HR & Services. During his stint at the CBK, Mr. Nzomo also served as the Alternate Director to the Governor in the following institutions; Export Promotion Council, University of Nairobi Enterprises & Services Limited (UNES), Capital Markets Authority (CMA), Insurance Regulatory Authority (IRA), The Export Processing Zone Authority (EPZA) and Council member Kenya Institute of Bankers (KIB). Mr. Nzomo chairs the Audit Committees at Fountain Global Investors Plc and AAR Insurance Holdings (AARIH).

Ms. Mirehane was appointed to the National Bank of Kenya Board as a non-executive Director in 2015.
Ms. Mirehane holds a Bachelor of Education degree in Education from Kenyatta University, Diploma in Management of NGO's from Kenya Institute of Management, and is a Trainer of Trainers in leadership matters.

She has over 25 years' experience in public, political and civil society having worked with the Teachers Service Commission, Constitutional Review and Education Consortium (NGO), and the Nairobi City Council.

She has vast experience in designing, implementing and managing programmes in areas of good governance, gender, human rights, democracy and HIV/ AIDS related issues. She has attended various professional management, corporate governance and capacity building courses locally and internationally.

Board of Directors

9

Mr. Joseph Kering' (50)
Non-Executive Director

10

Ms. Beatrice Gathirwa (63)
Representative of the Cabinet Secretary to The National Treasury, Non-Executive Director

11

Mr. Habil A. Waswani (42)
Company Secretary

Mr. Kering' joined National Bank Board in March 2015. He holds an MBA from Strathmore University and a Bachelor of Science (Hons) Chemistry, from Kenyatta University. He also holds a Certificate in Global Business Strategy from IESE Business School, Universidad de Navarra, Barcelona.

Mr. Kering' is an energy consultant with a wealth of experience in the energy sector gained over the past 20 years in the oil industry in both the public and private sector.

He is highly specialized in negotiations, stakeholder management, project management, business evaluation and turnaround. In addition to his role at National Bank, Mr. Kering' is a Board Member at Lites Kenya, a division of CPF Group.

Ms. Gathirwa is the representative of the Cabinet Secretary to The National Treasury. She is currently the Senior Deputy Accountant General / Director Investment at the Department of Government Investment and Public Enterprises at The National Treasury.

She holds a Masters of Business Administration Degree from Moi University, Bachelor of Commerce Degree in Accounting from The University of Nairobi and is a Certified Public Accountant. She has also attended short term courses in Management, Leadership, Accounting, Finance, Corporate Governance, and Audit.

Ms. Gathirwa has over 30 years experience in the public sector, having previously worked in various departments at the Ministry of Finance and State Corporations. She has represented the Cabinet Secretary to The National Treasury on various Boards in the past and currently on Communication Authority of Kenya and Privatisation Commission.

Ms. Gathirwa also represents the National Treasury in the Registration and Quality Assurance Committee of the Institute of Certified Public Accountants of Kenya and serves on the Secretariat of the Public Accounting Standards Board.

Mr. Waswani joined National Bank in August 2013. He holds a Bachelor of Laws (LL.B) Degree from The University of Nairobi, a Diploma in law from the Kenya School of Law and is a graduate of the Global Executive Master of Business Administration (GEMBA) Degree programme from United States International University in collaboration with the Columbia Business School, Columbia University, New York.

He has attended various professional management and corporate governance capacity building courses. Habil is an Advocate of the High Court of Kenya and a registered Certified Public Secretary. He is a member of the Law Society of Kenya (LSK), the Institute of Certified Public Secretaries of Kenya (ICPSK) and the Institute of Directors (IOD- Kenya).

Mr. Waswani was previously the Corporation Secretary and Head of Legal at Kenya Reinsurance Corporation Limited, a publicly listed reinsurance company, for 4 years, prior to which, he held a similar position at Diamond Trust Bank Kenya Limited (DTB).

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callcentre@nationalbank.co.ke National Bank of Kenya National_Bank Nationalbank_ke

Regulated by the Central Bank of Kenya

Senior Management

1 **Mr. Paul Mureithi**
Director, Operations

2 **Mr. Peter M. Kioko**
Chief Finance Officer

3 **Mr. Wilfred Musau**
Managing Director & CEO

4 **Mr. Habil A. Waswani**
Director , Legal Services &
Company Secretary

5 **Mr. Rodgers Mungumi**
Director, Human Resources

6 **Mr. Cromwell Kedemi**
Director, Retail Banking

7 **Mr. Shadrack Kiamuko**
Ag. Director, Information and Communications Technology

8 **Ms. Bernadette Ngara**
Director, Marketing, Corporate Communications & Customer Experience

9 **Mr. Duncan M. Okun**
Chief Risk Officer

11 **Mr. Stephen Gathongo**
Director, Credit

10 **Mr. Zablon Jowi**
Director, Internal Audit

12 **Mr. Musa A. Adan**
Director, Islamic Banking

13 **Mr. Reuben K. Koech**
Director, Corporate Banking

Senior Managers

1

Mr. Wilfred Musau
Managing Director & CEO

2

Mr. Peter M. Kioko
Chief Finance Officer

3

Mr. Habil A. Waswani
Director, Legal Services & Company Secretary

Mr. Musau Mr. Musau joined the Bank in September 2015 as the Director responsible for Retail and Premium Banking. He was appointed as the Managing Director and CEO in April 2016 and confirmed to the position in October 2016. He has 20 years extensive banking experience in Consumer and Business Banking. He has worked for Barclays Bank Kenya Limited, Standard Chartered Bank, KCB Bank Group in Kenya and Rwanda and NIC Bank PLC in various senior leadership roles.

Wilfred is a B.Com holder from Kenyatta University - Major in Banking and Finance, holds a Masters Class certification in Strategy - USB University of Stellenbosch Business School - SA, Extensive training in Banking and is an alumnus of Strathmore Business School (SBS) in leadership training programs and the Advanced Management Leadership Program in the same institution in 2017. He is an SME Champion and has managed successful business turnaround assignments in his various Banking roles in the last 10years. He is a member of the Bank's subsidiary boards; NatBank Trustees and Investment Services and NBK Insurance Agency.

Mr. Kioko joined the Bank in November 2016 as the Chief Finance Officer (CFO). He holds a B.Com (Accounting Option) from the University of Nairobi, is a Certified Public Accountant and a Post graduate Diploma from the University of Bradford.

Peter has 21 years' experience in various companies within the broader financial management domain of banking, FMCG and manufacturing sectors. These include Kenya Shell/BP Ltd (Group Financial Controller), Shell International (Global Internal Auditor), CfC Stanbic Bank (Finance Manager - Corporate and Investment Banking), EABL Group (Head of Risk & Audit).

Prior to joining National Bank, he worked at EABL International Ltd as Finance Director.

He is a member of ICPAK

Mr. Waswani joined National Bank in August 2013. He holds a Bachelor of Laws (LL.B) Degree from the University of Nairobi, a Diploma in law from the Kenya School of Law and is a graduate of the Global Executive Master of Business Administration (GEMBA) Degree programme at United States International University in collaboration with the Columbia Business School, Columbia University, New York. He has attended various professional management and corporate governance capacity building courses.

Habil is an Advocate of the High Court of Kenya and a registered Certified Public Secretary. He is a member of the Law Society of Kenya (LSK), the Institute of Certified Public Secretaries of Kenya (ICPSK) and the Institute of Directors (IOD- Kenya).

Mr. Waswani was previously the Corporation Secretary and Head of Legal at Kenya Reinsurance Corporation Limited, a publicly listed reinsurance company, for 4 years, prior to which, he held a similar position at Diamond Trust Bank Kenya Limited (DTB).

Senior Management

4

Mr. Reuben K. Koech
Director, Corporate Banking

5

Mr. Cromwell Kedemi
Director, Retail Banking

6

Mr. Musa A. Adan
Director, Islamic Banking

Mr. Koech joined National Bank in August 2013. He holds a Bachelor of Arts (Economics Majors) and MBA, Strategic Management Option both from the University of Nairobi. He also has certification in credit assessment and analysis by Omega of UK and Culhanne of South Africa. Reuben is a career banker with more than 21 years of banking experience leading growth in the Corporate Banking and developing high performance teams at leading international as well as regional banks.

He has significant experience in corporate relationship management for public and private sectors, retail banking, credit analysis & assessment and management, complex loan syndications including PPP financing projects, renewable energy finance etc. Prior to joining National Bank, Reuben worked with Co-operative Bank of Kenya as a Senior Manager in charge of Energy and Manufacturing Sector within Corporate Banking & Trade Finance Unit.

He has also worked for Fina Bank (Now GT-Bank- Kenya , Uganda & Rwanda), Stanbic Bank (Kenya & South Africa) and Standard Chartered Bank in various leadership roles.

Mr. Kedemi joined National Bank in June 2013. He holds a Bachelor's degree in Economics and Sociology from the University of Nairobi and an MSC in Entrepreneurship from Jomo Kenyatta University of Agriculture and Technology (JKUAT) and is currently pursuing an MBA at Strathmore University, Nairobi. Cromwell is a banker with more than 21 years experience leading growth and developing high performing teams and systems at leading international and in regional banks.

He has significant experience across a broad range of banking operations including, managing deliverychannels and sales team and a deep expertise in business strategy.

Prior to joining the Bank, Cromwell worked for Barclays Bank of Kenya as the acting Head of Small and Medium Enterprises Banking. Previously, he worked with KCB, where he was part of the team that pioneered the Retail Banking Sales.

Mr. Adan joined the Bank in March 2013 as Head of Business Development in the Islamic Banking Division. He rose to the current
position of Director Islamic Banking in 2014.

He is a career banker with a track record of over 20 years, having worked in various management capacities in differentBanks in Kenya. He has over 9 years' experience in senior management of Islamic Banking.

He formerly worked at Gulf African Bank Ltd as the Regional Manager in charge of Business Growth and Market Acquisition. He is a pioneer in Shari'ah banking in different capacities. He holds B.com (Hons) and MBA from the University of Nairobi and ACIB - UK.

Senior Management

7

Ms. Bernadette Ngara
Director, Marketing, Corporate Communications & Customer Experience

8

Mr. Rodgers Mungumi
Director, Human Resources

9

Mr. Paul Mureithi
Director, Operations

Ms. Ngara joined the Bank in 2014 as the Director, Marketing and Corporate Communications. She has in the past handled the Marketing and Corporate Communications and Corporate Citizenship as well as Sustainability Reporting in the banking industry.

Ms Ngara has experience in advertising handling brands in the FMCG, NGO and service industries. She has worked in the banking industry in different markets including Kenya, Uganda, Rwanda and Nigeria.

She has over 20 years working experience in the banking sector and is a dynamic, passionate and customer centric marketing-communications specialist. Working in diverse industries from Manufacturing to banking (both local and international), she has brought life to both new and existing brands. She has particular expertise in Strategic Marketing Management, PR, CSR, Customer Analytics and Digital Marketing.

Bernadette has attended several executive leadership courses through Raiser Resource Group for Crestcom International, Cambridge University and Strathmore Business School. She holds an MA in International Marketing from University of Central England and is a Chartered Marketer (CIM).

Mr. Mungumi joined the Bank in December 2016. He holds an MBA (Human Resource Management) from the University of Nairobi, a Bachelor of Education (Business Studies) degree from Kenyatta University and various certifications in Human Resource Management, Banking and Leadership including Corporate Governance.

Prior to joining National Bank, Mr. Mungumi was Chief Manager, Human Resource Development & Performance Management at Kenya Revenue Authority (KRA).

He previously served as Head Talent Management & Senior HR Business Partner at the Co-operative Bank of Kenya, Senior HR Services Manager at Equity Bank and HR Business Support Manager at Kenya Commercial Bank (KCB). He has had the opportunity to work in different markets including Tanzania, Uganda, Rwanda and South Sudan. He has over 17 years of working experience and exposure in Human Resource Management.

He is a member of the Institute of Human Resource Management of Kenya (IHRM) and Human Capital Institute (HCI) and a Governing Council Member of the Kenya Institute of Bankers.

Mr. Mureithi, joined the Bank in July 2017. Paul is a Bachelor of Science degree holder from Nairobi University, majoring in Urban & Regional Planning.

He also holds an Executive Masters of Business Administration majoring in Strategy & Business Systems from the Maastricht School of Management and Eastern Africa School of Management (ESAMI). He is currently pursuing a PhD in Business Systems Design in the Modern Banking Era.

Paul has various certifications in Project Management, Change Management and Lean Six Sigma. Prior to joining National Bank, Paul worked in various capacities in the region, having served at Barclays Bank and Kenya Commercial Bank (KCB) in Kenya, Uganda, Tanzania, Sudan and Rwanda. His career in banking spans over 28 years.

Senior Management

10

Mr. Stephen Gathongo
Director, Credit

11

Mr. Shadrack Kiamuko
Ag. Director, Information and Communications Technology

12

Mr. Zablon Jowi
Director, Internal Audit

13

Mr. Duncan M. Okun
Chief Risk Officer

Mr. Gathongo joined the Bank in November 2016. He holds an MBA (Finance) of from University of Leicester - UK and Bachelors of Commerce from the University of Nairobi.

He also holds professional qualifications in ACIB - London and CPA - Kenya. Stephen has 24 years working experience in the field of Credit Management. Prior to joining the Bank, he worked as a Senior Manager Credit at KCB.

Previously, he worked at Barclays Bank in various positions and also at KCB Uganda as Head of Corporate Banking and Head of Credit where he set up the Credit and Corporate Banking functions (for Uganda), centralized credit approvals, credit administration and securitisation process.

Mr. Kiamuko joined the Bank mid-2013 as Head of Infrastructure and Data Centre.

He holds a BSc (Physics & Electronics) and is an accomplished Information Technology professional with 23 years of experience. Prior to joining the Bank,

Shadrack was a Senior Manager at Co-operative Bank in charge of Business Systems and Regional Technical Support Manager at Standard Chartered Bank in charge of technical support East, Central and Southern Africa. While at Standard Chartered, undertook regional assignments in Dubai, Ghana, Nigeria, Botswana, South Africa, Zambia and Uganda.

Mr. Jowi joined the Bank in November 2016. He has over 15 years' working experience in Internal Audit, having served in various organizations including Commercial Bank of Africa, I&M Bank, and Gulf African Bank where he was Assistant General Manager in-charge of Internal Audit department before joining National Bank.

He holds a Master of Business Administration (Strategic Management) from the University of Nairobi and a Bachelor of Science in Business Administration (Accounting) degree from United States International University (USIU). He is also a Certified Public Accountant of Kenya and a member of the Institute of Certified Public Accountants of Kenya (ICPAK), Institute of Internal Auditors and ISACA.

Mr. Okun joined the Bank in November 2016. He holds an MBA (Finance) from the University of Nairobi, postgraduate diploma in Financial Management from Kenya School of Monetary Studies (KSMS) and a B.A in Economics and Management from Moi University. He is an associate of the Kenya Institute of Bankers (KIB).

He is currently pursuing a qualification in Certified Securities and Investment Analysts (Section 5 completed) and has a Risk Certification Level 1 and 2 from Kenya School of Monetary Studies (KSMS). Duncan has over 11 years' experience in senior management roles.

Prior to joining the Bank, he worked with KCB as the Group Head of Operations Risk, which provides support to subsidiaries in Uganda, Rwanda, Burundi, Tanzania and Sudan. He has previously worked at Standard Chartered Bank in various positions in Risk & Compliance and at KCB under different roles where he designed and rolled out the operational risk frameworks.

Corporate Governance Report

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. At National Bank of Kenya Limited, the Board of Directors is mandated to control and direct the activities, affairs, operations and property of the Bank with a view to maximizing shareholders value, increasing profitability and guaranteeing sustainable business.

Good corporate governance practices are essential to the delivery of sustainable Shareholder and Stakeholder value and the Board of Directors of the Bank is committed to upholding principles of Corporate Governance by ensuring full compliance with all relevant and applicable laws in the banking industry, including but not limited to following, the Banking Act and the Central Bank of Kenya (CBK) Prudential Guidelines, The Capital Markets Act, the Code of Corporate Governance Practices for Issuers of Securities to the Public (2015), The Companies Act (2015), internal policies and procedures as well as other best practices.

The overall control over the activities, affairs, operations, business and property of the Bank is vested in the Bank's Board of Directors.

Corporate governance continues to be a key priority of the Board in exercise of its mandate as it accounts and reports to all stakeholders of the Bank about the procedures, systems and controls they have put in place to safeguard their interests in line with the highest standards of corporate governance. In line with the requirements of the Code of Corporate Governance Practices for Issuers of Securities to the Public (2015), promulgated under the Capital Markets Act, the Bank has undertaken a Corporate Governance audit to ascertain the robustness and effectiveness of its governance structures.

The Bank has in place a Board Charter as well as all critical Policies including Conflict of Interest and Code of Ethics and Conduct that govern operations of the Board and Management in the stewardship of the Bank within the confines of the Memorandum and Articles of Association of the Bank. Copies of these documents are available on the Bank's website (*www.nationalbank.co.ke*).

During the year under review, the Bank continued to embrace and adhere to tenets of good Corporate Governance and the Board of Directors is committed to ensuring that the Bank's business and operations are conducted with integrity and in compliance with the law, internationally accepted principles and best practices of corporate governance and business ethics. Being a Publicly listed company on the Nairobi Securities Exchange, the Bank is and continues to be subject to the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, promulgated under the Capital Markets Act. In 2018, the Bank filed with the Capital Markets Authority its Self-Assessment Report, disclosing its extent of compliance with the prescriptions of the Code of Corporate Governance.

Structure and Functioning of the Board of Directors

At National Bank of Kenya, the Board of Directors is elected by the shareholders and is charged with the mandate to oversee the strategy, management and performance of the Bank. The Board aims to promote the Bank's long-term success, deliver sustainable value to shareholders and promote a culture of inclusivity.

The Board in fulfillment of its fiduciary obligations to the shareholders and stakeholders, sets the Bank's strategy, risk appetite and approves capital and operating plans for the achievement of strategic objectives; on the recommendation of management as governed by the Board Charter and other operating regulations. Whilst the Board provides direction and guidance on strategic and general policy matters and remains responsible for establishing and maintaining overall internal controls over financial, operational and compliance issues, the Managing Director & Chief Executive Officer leads the Management team in exercising delegated authority to conduct the day-today business of the Bank.

All Board members have committed themselves to act in a professional manner, thereby upholding the core values of integrity and enterprise with due regards to their fiduciary duties and responsibilities and in accordance with the Bank's Code of Ethics and Conduct.

Board Composition

The current Board comprises of eight (8) Non-Executive Directors (including the Chairman) and one Executive Director (being the Managing Director & Chief Executive Officer). Four (4) members of the Board are independent Non-Executive Directors. The independent Non-Executive and Non-Executive Directors are expected to be independent and free of any business relationship or other circumstances that could materially interfere with the exercise of objective or independent judgment of matters seized by

Corporate Governance Report

them relating to the bank's operations. The Board members possess extensive experience in a variety of disciplines, including; banking, labour relations, general business, law and financial management, all of which are applied in the overall stewardship of the Bank. All non-executive directors are subject to periodic retirement and re-election to the Board, in accordance with the Bank's Articles of Association.

Board Meetings

The Board meets once every quarter but may from time to organize for special meetings in response to business needs. The Bank has an Annual Work Plan to guide the Board on areas of focus during the year. The Directors are also given appropriate and timely notice of Board meetings and are supplied with complete and accurate information to enable them to maintain full and effective control over strategic, business, financial, operational and compliance issues.

The Chairman ensures Board meetings are structured to facilitate open discussion on issues placed before the Board. The Board recognizes the importance of independent judgement and constructive debate on all issues under consideration. Directors are expected to bring views and judgement to Board deliberations that are independent of management and free of any business relationship or circumstances that would materially interfere with the exercise of objective judgement, having regard to the best interest of the organization and its stakeholders as a whole.

In accordance with the Board Charter, the Board only considers directors to be independent where they are independent of management and free of any business or other relationship that could materially interfere with, or reasonably be perceived to materially interfere with, the directors capacity to bring an independent judgement to bear on issues before the Board and to act in the best interest of the Bank or the shareholders generally. All Directors of the Bank must avoid any situation which might give rise to a conflict between their personal interest and that of the Bank.

The Directors are expected to make a disclosure on an annual basis to the Company Secretary cases of actual or potential conflict of interest situations or as soon as such a situation arises. Any Director with a material personal interest in any matter being considered during a Board or Committee meeting is expected to disclose the same and will not vote on the matter or be present when the matter is being discussed and considered. The Company Secretary facilitates scheduling and the Agenda of Board meetings in conjunction with the Chairman and the Managing Director & Chief Executive Officer, and assists directors monitor implementation by Management of the Bank's strategic objectives. The Company Secretary is responsible for facilitating good information flows within the Board and its Committees and between the Directors and Management as well as the induction of new Directors and professional development of Directors. Each member of the Board has direct access to the Company Secretary who also plays a key liaison role between the Bank and its shareholders through the Bank's Share Registrars.

Board Committees

To facilitate the discharge of its obligations, the Board has established and delegated authority to various committees whose membership constitutes of directors with appropriate skill set and expertise in particular disciplines in order to deal with specific issues with a view to operating optimally, and giving appropriate attention and consideration to these matters. The Board Committees play a pivotal role in ensuring that high standards of corporate governance are maintained throughout the Bank. Board Committees are constituted and governed by specific terms of reference formulated and reviewed regularly by the Board.

Operations of Board Committees are aligned to the regular Board process, and all Committees are provided with sufficient resources to perform their functions adequately. Board Committees from time to time invite members of Executive Management, service providers or if need be, independent consultants at the Bank's expense to enable them execute their mandates effectively.

Corporate Governance Report

Other Committee Reports

Mr. Joseph Kering'
Chair. Board Credit Committee

Board Credit Committee

The Committee comprises six (6) non-executive directors and the Managing Director & Chief Executive Officer, out of which three (3) are independent non-executive directors. The Committee meets at least once every month.

The Credit Committee determines the Credit Policies of the Bank and is responsible for its periodic review and oversight on all credit matters. The Committee deliberates and considers loan proposals beyond the credit discretion limits extended to Executive Management, on an ongoing basis, reviews lending approved by the Executive Management within its discretionary limits, as well as ensure that the loan book / asset quality and portfolio is within the thresholds prescribed by the relevant regulations.

The Committee further reviews and considers all issues that may materially impact the present and future quality of the Bank's credit risk management and assists the Board in discharging its responsibility to review the quality of the loan portfolio and ensure adequate bad debts provisions are maintained in line with the CBK prudential guidelines. The Committee also provides oversight over all remedial measures being taken on non-performing loans.

Dr. Francis Atwoli
Chair. Board Nomination and Remuneration Committee

Board Nomination and Remuneration Committee

The Nomination and Remuneration Committee comprises seven (7) Non-Executive Directors and the Managing Director & Chief Executive Officer, out of which three (3) are independent Non-Executive Directors. The Committee meets at least once every quarter.

In discharging its responsibilities, the Committee regularly reviews the Board's structure, size and composition, including skills, knowledge, independence and diversity represented on the Board so as to ensure it is aligned with the Bank's strategic priorities. The Committee further determines the membership of Board committees based on the member's knowledge, capabilities, expertise and experience.

The Nomination Committee further assesses the performance and effectiveness of Directors and Staff and ensures that annual performance reviews are conducted and appropriate rewards and sanctions are extended to executive Directors and all Bank staff.

The Committee is also responsible for setting the overarching principles, parameters and governance framework of the Bank's remuneration policy, and the remuneration of the Board members, Senior Management staff as well as other employees.

Corporate Governance Report

Other Committee Reports (Continued)

Ms. Linnet Mirehane
Chair. Board Risk Committee

Board Risk Committee

This Committee comprises four (4) Non-Executive Directors and the Managing Director & Chief Executive Officer, out of which two (2) are independent Non-Executive Directors. The Committee meets at least once every quarter.

The Committee is mandated to provide oversight on overall bank-wide risk management and the compliance issues facing the Bank and ensuring quality, integrity, effectiveness and reliability of the Bank's risk management and compliance monitoring framework is effective and well maintained.

The Committee defines the scope of the risk management work, ensures that there are adequate policies and strategies in place to effectively identify, measure, monitor and appropriately mitigate the various risks which the Bank is exposed to from time to time, and ultimately, monitors the Bank's compliance with relevant legislation, regulations and guidelines issued by regulatory bodies, as well as the Bank's laid-down policies and procedures.

The Committee facilitated the implementation by the Board of the Whistleblowing Policy Framework introducing an independent and anonymous platform for reporting any kind of information or activity that is deemed illegal, unethical, or not correct within the Bank.

Through the Committee, the Board has also ensured there is an Insider Trading Policy that provides the guiding operating framework for Directors and Staff when dealing Bank's trading securities (shares), particularly in cases where one is in possession of material non-public information relating to the Bank.

Jones Nzomo
Chair. Board Audit Committee

Board Audit Committee

This Committee comprises six (6) Non-Executive Directors, out of which three (3) are independent Non-Executive Directors, and meets at least once every quarter. The Chairman of the Committee is an independent and non- executive director and a member of the Institute of Certified Public Accountants of Kenya in good standing.

The Committee assist the Board assesses the effectiveness of the Bank's internal control, risk management & compliance framework. The Committee is mandated to check the quality of financial reporting, reviewing and strengthening the control environment and the effectiveness of the internal and external audit functions, reviewing of the Bank's financial statements including correct application of accounting requirements, advising the Board on best practices, monitoring compliance with relevant local legislation, regulations and guidelines issued by regulatory bodies, as well as the Bank's laid-down policies and procedures, ensuring quality, integrity, effectiveness and reliability of the Bank's systems. The Committee is also mandated to review the implementation of the approved work plans for the Internal Audit function each year.

Corporate Governance Report

Board and Director Evaluation

In line with prescribed regulatory stipulations made under the Banking Act and the Capital Markets Act, the Board undertakes an annual evaluation of its own performance, the performance of the Chairperson, that of its individual members, the Managing Director & Chief Executive Officer and Company Secretary. A summary on the evaluation report is made to the Central Bank of Kenya by 31 of March every year, in line with the CBK Prudential Guidelines.

Board Remuneration

The quality and commitment of our Board is fundamental to our success and, accordingly, the Board aims to attract, retain and motivate the very best candidates. To this end, the Board has in place a Board Remuneration Policy framework that governs the remuneration and benefits of its Executive and Non-executive Directors. The details of each Director's Remuneration are captured on page 71 of this report.

Attendance of Board and Board Committee Meetings

The Board and Board Committees meet regularly and have a formal schedule of matters reserved for periodic deliberation. The directors receive appropriate and timely information to enable them exercise full and effective control over strategic, financial, operational, compliance and governance matters of the Bank in line with the approved Board work plan.

The summary of the attendance of meetings by directors is as follows:

a) Board

Name of Non-executive Director	No. of meetings in the year 2018	No. of meetings attended
Mr. Mohamed Hassan	13	13
Managing Trustee –NSSF	13	10
Cabinet Secretary – National Treasury	13	11
Dr. Francis Atwoli	13	10
Ms. Linnet Mirehane	13	12
Mr. Joseph Kering'	13	13
Mr. Jones Nzomo	13	12
Mr. Mark Obuya	13	12
Mr. Wilfred Musau	13	13

b) Board Credit Committee

Name of Non-executive Director	No. of meetings in the year 2018	No. of meetings attended
Mr. Joseph Kering'	11	11
Cabinet Secretary – National Treasury	11	9
Ms. Linnet Mirehane	11	8
Managing Trustee –NSSF	11	7
Mr. Jones Nzomo	11	10
Mr. Mark Obuya	11	9
Mr. Wilfred Musau	11	9

Corporate Governance Report

c) Board Risk Committee

Name of Non-executive Director	No. of meetings in the year 2018	No. of meetings attended
Ms. Linnet Mirehane	4	4
Managing Trustee –NSSF	4	1
Mr. Jones Nzomo	4	4
Mr. Mark Obuya	4	3
Mr. Wilfred Musau	4	4

d) Board Nomination and Remuneration Committee

Name of Non-executive Director	No. of meetings in the year 2018	No. of meetings attended
Dr. Francis Atwoli	6	3
Cabinet Secretary – National Treasury	6	6
Ms. Linnet Mirehane	6	6
Mr. Joseph Kering'	6	6
Mr. Jones Nzomo	6	6
Mr. Mark Obuya	6	6
Mr. Wilfred Musau	6	6

e) Board Audit Committee

Name of Non-executive Director	No. of meetings in the year 2018	No. of meetings attended
Mr. Jones Nzomo	8	8
Managing Trustee –NSSF	8	6
Cabinet Secretary – National Treasury	8	6
Ms. Linnet Mirehane	8	5
Mr. Joseph Kering'	8	7
Mr. Mark Obuya	8	8

Internal Control Systems

The Bank has well defined written policies and procedures to ensure that best practices are followed in conducting the day-to-day operations and financial reporting as well as in implementing strategic action plans approved by the Board.

A well-structured organization structure ensures that there is adequate segregation of duties and proper oversight. Structures and systems have been defined in the Bank's policies and procedures to facilitate complete, accurate and timely execution of transactions, operations and commitments and the safeguarding of assets. Financial information is prepared using appropriate accounting policies, which are applied consistently. The Board is committed to managing risk and to controlling its business and financial activities in a manner that enables it to maximise profitable business opportunities, manage and ensure compliance with applicable laws and regulations and enhance resilience to external events. The Internal Audit and independent External Audit functions of the Bank as well as the Risk Management functions, assist the Board through the Board Audit and Board Risk Committees to streamline areas of weakness as well as maintain proper oversight of all critical operations from a controls perspective.

Management Committees

To assist management in fulfilling its mandate in running the business operations of the Bank and to ensure compliance with the laid-down policies and procedures, various management level committees have been established. The roles, responsibilities and composition of some of the key management committees are given below:

Executive Management Committee ("EMC")

The EMC is chaired by the Managing Director and comprises other senior management staff. It meets regularly and ensures that all financial and operational plans of the Bank are monitored and implemented as per the Board approved strategy. The Committee tracks the implementation of Bank's business projects, financial and staff performance trends, forecasts and actual performance against budgets and prior periods and regularly reports the same to the Board.

Executive Credit Committee ("ECC")

In accordance with the Bank's Credit Policy, the ECC is chaired by the Managing Director and comprises other senior management staff including the Director, Credit. The Committee reports to the Board Credit Committee on credit risk, asset quality and credit approval matters every month. The ECC meets regularly to review and approve customer credit applications within limits delegated by the Board and from time to time to analyse the Bank's overall credit risk portfolio health and related credit risk management.

Assets and Liability Committee ("ALCO")

This Committee is chaired by the Managing Director and comprises the Head of Treasury and other members of senior management staff. The ALCO, which meets at least once each month, is mandated to optimise returns, whilst prudently managing and monitoring the assets and liabilities of the Bank. The ALCO is responsible for controlling and managing the Bank's interest rate risk (price), market risk, currency risk and liquidity risk, in addition to ensuring compliance with the Bank's Investment Policy, and statutory requirements relating to liquidity, foreign exchange exposure and cash ratios.

Executive Risk Committee ("ERC")

The ERC reports to the Board Risk Committee and is chaired by the Managing Director and comprises of the Chief Risk Officer and other senior management staff including the Head of Compliance. The ERC meets at least once every month and is responsible for identifying major areas of business operations prone to operational risks, implementing respective mitigations and implementing suitable policy guidelines for managing and mitigating operational risk and reviewing audit irregularities relating to operations. The ERC also reviews the overall Bank compliance status vis a vis the various prevailing regulatory frameworks and internal policies stipulations.

ICT Steering Committee

This Committee in chaired by the Director, Information and Communication Technology and comprises other senior management staff. The Committee meets at least once every quarter and is responsible for provision of oversight in the development and implementation of the ICT strategy, review of the Bank's ICT systems and environment, as well as ensuring the management and review of the organization's ICT Plans are consistent with the goals, objectives and strategy of the Bank, assist with resolving strategic level issues and risks and provide advice and guidance on business issues facing ICT.

The Board has put in place a robust ICT Policy framework which is aligned to the Central Bank of Kenya guidelines that dictates the manner in which the Bank's ICT environment and systems are governed. The Bank's external auditors conduct independent audits of the Bank's systems against this policy framework and render periodic reports to the regulator.

Sustainability

The Bank strives to be an institution of public trust and recognizes that addressing environmental, social and governance (ESG) matters is fundamental to how it conducts its business. The Bank has therefore developed as robust ESG framework that focuses on non-financial performance indicators that addresses the Bank's approach towards responsible investment, sustainability, its impact on society and the environment, as well as other ethical and corporate governance considerations. A detailed report of the Bank's ESG evaluation is contained on page 61 of this report.

Relations with Shareholders

The Board recognizes the importance of good communication with all shareholders. The Annual General Meeting (AGM) as well as published annual reports and financial statements are used as an opportunity to communicate with all shareholders. The Bank always gives its shareholders requisite notice of the AGM as defined in its Memorandum and Articles of Association and in compliance with the Companies Act and the Capital Markets Act.

Shareholders have direct access to the Bank, its Company Secretary and the Shares Registrar (Image Registrars Limited), who respond to queries and correspondence received from the shareholders on a wide range of issues in a timely manner.

The Bank through its Share Registrar (Image Registrars Limited) files returns regularly in line with the requirements of the Companies Act and the Capital Markets Act.

Governance and Accountability

The number of shareholders as at 31st December 2018 was 48,955 distributed as shown below:

A. Top 10 Shareholders as at 31st December 2018

No.	Names	Address	Number of Shares	% of shares
1	National Social Security Fund	P.O. Box 30664 - 00100 Nairobi, Kenya	162,802,746	48.1%
2	The Cabinet Secretary To The Treasury	P.O. Box 30007 - 00100 Nairobi, Kenya	76,230,000	22.5%
3	Kenya Reinsurance Corporation Limited	P.O. Box 40984 - 00100 Nairobi, Kenya	4,840,000	1.4%
4	Best Investment Decisions Limited	P.O. Box 40127 - 00100 Nairobi, Kenya	2,350,271	0.7%
5	Baywood Holdings Limited	P.O. Box 81862 - 00100 Nairobi, Kenya	1,945,706	0.6%
6	Stanbic Nominees Limited a/c NR5551514	P.O. Box 30550 - 00100 Nairobi, Kenya	1,864,863	0.6%
7	Equity Nominee Ltd a/c 00084	P.O Box 75104 - 00200 Nairobi, Kenya	1,256,343	0.4%
8	NBK Client a/c 1	P.O. Box 72866 - 00200 Nairobi, Kenya	1,143,450	0.3%
9	Eng. Ephraim Mwangi Maina	P.O Box 53208 - 00200 Nairobi, Kenya	1,105,003	0.3%
10	George Muhia Mwaura	P.O Box 1408 - 00100 Nairobi, Kenya	1,026,440	0.3%
11	Others		84,235,178	24.9%
			338,800,000	**100%**

B. Directors' shareholding as at 31st December 2018

	Name	Number of Shares	% Shareholding
1	Mr. Mohamed Abdirahman Hassan	Nil	0
2	Cabinet Secretary, National Treasury	76,230,000	22.50
3	National Social Security Fund	162,802,746	48.10
4	Dr. Francis Atwoli	Nil	0
5	Ms. Linnet Mirehane	Nil	0
6	Mr. Joseph Kering'	Nil	0
7	Mr. Jones Nzomo	Nil	0
8	Mr. Mark Obuya	Nil	0
9	Wilfred Musau	Nil	0

C. Investor Distribution Summary as at 31st December 2018

Range	Number of Shareholders	Number of Shares	Percentage of Shares
1 to 1000	30,762	15,334,251	4.53%
1001 to 10000	17,288	35,120,628	10.37%
10001 to 100000	839	20,205,698	5.96%
100001 to 1000000	56	13,574,601	4.01%
1000001 to 10000000	8	15,532,076	4.58%
10000001 to 100000000	1	76,230,000	22.50%
100000001 to 1000000000	1	162,802,746	48.05%
	48,955	**338,800,000**	**100%**

D. Investor Summary Shareholding as at 31st December 2018

Category	Count of Shareholders	Sum of Shares	% of Shares
Local Corporate	1,648	264,674,022	78.12%
Foreign Corporate	6	1,890,224	0.56%
Foreign Individual	160	1,446,291	0.43%
Local Individual	47,141	70,789,463	20.89%
	48,955	**338,800,000**	**100%**

Our Business Model & Capitals (Inputs and Ouputs)

The Bank's value creation model shows the key inputs we use: capital (financial capital), employees (human capital), intellectual (knowledge capital), manufactured capital, social capital. Our capital inputs inform our business model, along with our mission, vision, strategy, and our products and services.

As a further step towards integrated thinking, we have expanded on how we utilize our six forms of Capitals to create value for our stakeholders in our business models.

Input	Processes
Financial Capital – We are dependent on our Capital inputs to perform business activities and to create value over time. Capital providers include our shareholders, clients, retained earnings and reserves.	Our products and services include banking, lending, capital management, leasing, insurance and mortgage. As our shareholders work on a restructuring and capitalization process we are confident to inform our customers that the bank still remains rock solid with sizeable liquidity buffers, a sound asset quality and healthy earnings.
Human Capital – Our people are our most valuable asset	To ensure we carry out our strategy, NBK remains focused in investing in our employees' competencies and capabilities as they play a vital role in enhancing systems and procedures in order to constantly improve the value we add to our clients. The Bank has employed 1,356 employees and believes in diversity to improve performance and inventiveness within the bank.
Intellectual Capital – Our Brand promise in creating innovative products and services plays a vital role in ensuring we build a sustainable business	National Bank's intellectual capital input encompasses 50 years of banking knowledge and expertise in various sectors. We use our knowledge base to offer our customers innovative products and services in line with economic changes and social trends. The Bank offers knowledge, financial resources and its network capabilities to its customers. To provide its customers with digital services and at a consistent level, the bank simplified its systems and now offers high overall system availability.
Manufactured Capital – We value both the tangible and intangible structures and mechanisms that allow us run our business on a day to day basis. .	The Bank's buildings, equipment and infrastructure available to use as we perform our duties.
Social Capital – We value the relationships we have created with our customers, shareholders, regulators, government, both private and public institutions as well as the media.	National Bank of Kenya Limited takes its role as a socially responsible bank seriously. The Bank participates in many community initiatives by supporting both businesses and private customers as we actively support sustainability. The Bank allocated 43 Million of its net profit to local community initiatives on a not-for-profit basis.

The Bank is committed to investing its time and resources to strategic, constructive and proactive dialogue with all stakeholders: customers, shareholders fintechs and startups. We recognize that these are the most influential stakeholder groups related to our business. Engagement with them is through cus in sector initiatives etc.

At National Bank, we remain in a proactive stance to promote a culture of ethical behavior with a set of values, beliefs and behavior patterns that form continually built a customer-focused culture celebrating innovation, success and diversity while encouraging an honest dialogue and working together m

Outputs

Products
Banking Solutions
Borrowing
Investing & Savings

Channels
82 Branches
Mobile Banking
1,480 Agents
124 NBK ATMS
ebanking Platforms
Access to over 2,200 ATMs through Kenswitch & Interswitch

Retail Banking

Provides banking services such as proactive advice to customers through a network of branches in Kenya. The unit also makes day-to-day banking simple and efficient through innovative digital solutions.

No. of Employees - 846
Total income - Kes. 2.7 billion

Corporate & Institutional Banking

This unit serves our medium to large corporate and institutional customers. The unit provides strategic advice, financial solutions and products in Capital Markets, Fixed Income, Currencies & Commodities and Transactional Banking.

No. of Employees - 62
Total income - Kes. 6.3 billion

NBK Insurance Agency

This is one of the Bank's subsidiaries, offering all types of Insurance services in partnership with major Insurance companies in Kenya at competitive pricing with flexible payment terms.

No. of Employees - 10
Total income - Kes. 98 million

Islamic Banking

This unit fosters development and social progress by participating in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to the Muslim community.

No. of Employees - 15
Total income - Kes. 624 million

National Bank Trustees

This subsidiary deals with the analysis and investments in financial assets including wealth management, investment for segregated pension schemes, umbrella schemes and income draw down.

No. of Employees - 6
Total income - Kes. 11 million

Shareholders funds	Shs. 6.9 Billion
Borrowings	Shs. 6 Billion
Customer Deposits	Shs. 98 Billion
Net interest income	Shs. 7.9 Billion
Net Commission	Shs. 1.1 Billion
Forex and Others	Shs. 767 million

Happy Satisfied Customers
Exceptional Customer experience - placing the client at the centre of everything we do.

Employee engagement
Making National Bank a great place to work.
Staff 1,356
Permanent Employees 1,153
Contract Staff 203
Female 681
Male 675
Shs. 4.4 Billion spent on Staff representing 60% of value added

Access to Government
Earnings for Business partners
Shareholder Value

Investments in Assets Kes. 771 Million

Implementation of Credit Management and Insurance Systems.

Revamped Mobile Banking System

Community Development
Kes. 43 Million spent on CSR activities

s, employees, regulators, Government agencies, media, other banks,
stomer feedback platforms, customer and employee surveys, participation

our core identity and help in shaping our employees' behavior. We have
ore effectively.

WORD FROM THE CHAIRMAN

Welcome to our 3rd edition of our Integrated Annual Report!

This report combines our financial and sustainability reporting with the aim of showcasing the interactions between financial, societal and environmental factors and how they influence our company's long-term development. As a brand we exist to enable economic growth and societal progress by creating positive impact for our clients, our people, our investors and our communities. We also seek to assure that the market served by National Bank remains productive, meaningful and sustainable.

2018 was a remarkable year for National Bank, having celebrated 50 years of exceptional service to our customers. Born in 1968, the Bank was formed to help Kenyans get access to credit and control their economy having gained independence. Over the years we have and continue to experience growth, evolving into an important player in the banking industry and a major revenue earner for the ex-chequer whilst creating value for our stakeholders.

Overview of the Banking Industry

The country's economy in the year under review remained buoyant shaking off the shocks caused by the severe drought experienced in the previous year, the long electioneering period we went through and the constraints posed by the interest rate capping law. Despite the challenging operating environment the banking sector remained fairly stable in 2018, posting strong liquidity as a whole, boosted by the development of recovery and resolution plans as well as stable political environment post-elections.

Globally, the banking sector is considerably healthier now than it was 10 years ago, at the start of the global financial crisis. A number of uncertainties though have continued to blemish the industry with respect to the Brexit resolution, escalation of trade and geopolitical tensions, US trade policies and effects of normalisation of Monetary Policy in the advanced economies.

Back at home, the Monetary Policy during the year retained a stable price ensuring the financial services Industry increased its capacity to support the fiscal growth agenda. To further support this agenda, the Central Bank of Kenya continued to improve on its Monetary Policy Framework through sharpening of its forward-looking tools and indicators, particularly the macro-economic forecasting framework and the use of market perception surveys which effectively guided the implementation of the monetary policy.

Stakeholder Value

For National Bank of Kenya, conducting business responsibly means serving the interests and meeting the needs of all our stakeholders. To this end the Board has taken an active approach to address some of the issues that could have raised concerns among our shareholders and stakeholders. I have highlighted few of the issues but the full report will offer a more comprehensive look at how we conducted our business. Our capital provision philosophy remained unchanged as we continued to focus on the long term value improvement for our shareholders with the aim of attaining regular return on investment.

In our previous Annual Report, I had mentioned that in the beginning of the year 2018 the Bank's major shareholders – the Government of Kenya through the National Treasury and National Social Security Fund (NSSF) – had made commitments to address our capital requirements by committing to provide a comprehensive and long-term capital solution to bridge compliance, support business growth and meet ICAAP requirements.

The talks geared to this issue, although delayed beyond the committed dates continued in earnest, and I want to assure all our shareholders and stakeholders that the principals remain committed to help with our capital requirements should circumstances dictate so.

Equally in the year under review, data security remained a key deliverable to our business continuity. As a Board we take cognizance of today's customer expectations, technological capabilities, regulatory requirements, demographics and economics which together create a vital change. This new philosophy has led to us to work harder and smarter to get ahead of arising challenges by adopting a proactive approach to data security. As a Group, we have taken a continuous approach to invest our resources in putting up efficient controls complemented with an effective IT-governance structure and supported by relevant policies into our management framework. In addition to a system based approach we have leveraged on a continuous educational tactic to both our staff and customers on the business risks and threats related to our network and the macro ecosystem to ensure alertness and general protection.

As a Board we also take note that sustainability of our business is also pegged on the achievement of a Sound Risk Management structure. Defining our credit risk, market risk, liquidity risk as well as other certain unquantifiable risk cannot be isolated from the overall quality of corporate governance. It is undeniable that risks associated with the banking sector have increased in recent years, making the financial markets more volatile.

Our dear shareholders, to this end I am pleased to inform you that the Board and Management have taken an active involvement in defining the risk appetite for the Group and we continuously work on improving and approving policies that ensure this appetite is reflected in activities and decisions undertaken by the Group and the risks which we operate in. Our objective in management of risk is to ensure we align with regulation whilst taking care of customer expectations in the face of changing technology.

Further on Corporate Governance, let me conclude by addressing how the management team and the Board of Directors work together to advance the Bank. I want to assure all our shareholders that you are represented by a strong independent Board, which holds regular meetings with management, regulators and shareholders to review progress of your Bank. Throughout the year, the Board meets with management to oversee risk management and governance and carry out other important duties directly and through Board Committees that have strong and experienced chairs and members. Furthermore, the management team and the Board meet to review in detail ongoing results and issues towards deeper discussions. Indeed toward the end of the year, we held an extended session to review our strategic milestones and plan for 2019 based on the operating environment, market and other opportunities.

Looking Forward

2019 will be a year of heavy lifting for the whole banking sector as the market stabilises to recover from market shocks experienced in the previous years. In the last two years, we have seen banks take blow after blow due to the recognition of bad loans and increased provisions required to comply with new accounting standards. While this initial recognition part is over, we appreciate that now the resolution of long outstanding bad debts holds the key for realising benefit.

As a Bank, we will focus our resources on putting forth effective resolution plans backed by efficient co-ordination among different stakeholders. To back our recovery plans and truly have an impactful bottomline we will also endeavour to revamp our retail space by redefining and improving our physical foot print, digital maturity, share of voice and customer experience. As promised in 2018, we will continue to improve our business model to adopt one that puts the customer at the heart; based on traditional attributes such as prudence and a long-term view whilst making the most of emerging digital channels.

In conclusion and on behalf of the Board of Directors, I would like to thank our committed and hard-working staff for their dedication to serving customers. I would also like to appreciate our customers who have over the years stood by us and ensured our doors remain open.

As we settle into the New Year we pray for peace in our country to enable us run our businesses seamlessly.

MOHAMED HASSAN
Chairman, Non-Executive Director

UJUMBE KUTOKA KWA **MWENYEKITI**

Karibuni kwenye toleo la tatu la ripoti yetu ya mwaka iliyojumuishwa pamoja!

Ripoti hii inajumuisha pamoja hali yetu ya fedha na uendelezi wa utoaji ripoti ikiwa na lengo la kuonyesha ushirikiano wa kifedha, kijamii na maswala ya mazingira na jinsi yanavyoathiri maendeleo ya muda mrefu ya kampuni. Kama bidhaa, tunadumu kuwezesha ukuaji wa kiuchumi na ustawi wa jamii kupitia ubunifu wa athari nzuri kwa wateja wetu, watu wetu , wawekezaji wetu na jamii zetu. Pia, tunataka kuhakikishia soko kwamba biashara za National Bank of Kenya zinazalisha manufaa, zenye maana na zinazodumu.

2018 ulikuwa mwaka wa ajabu kwa Nationa Bank baada ya kutimiza miaka 50 ya utoaji huduma za kipekee kwa wateja wetu. Benki hii ilianzishwa mwaka 1968 ili kuwasaidia wakenya kupata huduma za mikopo na kuendesha uchumi wao baada ya kujipatia uhuru. Kwa muda wa miaka yote, tumekuwa na tunaendelea kushuhudia ukuaji wa kipekee, kutekeleza nafasi kubwa kwenye sekta ya benki na kuchangia pakubwa kwenye mfuko wa hazina ya serikali huku tukizalisha thamani kwa wanahisa wetu na washika dau wengine.

Mtazamo wa Sekta ya Benki

Uchumi wa taifa kwa kipindi cha mwaka unaongaziwa ulendelea kufurahisha na kukabiliana na misukosuko iliyotokana na hali ya kiangazi kilichoshuhudiwa mwaka uliotangulia, kipindi kirefu cha uchaguzi tulichopitia na athari zilizotokana na sheria iliyowekwa kuhusu viwango vya juu vyaa riba. Licha ya changamoto za mazingira ya utekelezaji, kidogo, sekta ya benki iliendelea kuwa imara mwaka 2018 na kusajili ukwasi thabiti wa viwango vya mtaji wa kutosha kwa jumla kutokana na kuchochewa na maendeleo ya ufufuzi na maazimio ya mipango pamoja na mazingira imara ya kisiasa baada ya uchaguzi.

Kiulimwengu, kwa sasa, sekta ya benki inaonekana kuwa imara ikilinganishwa na miaka kumi iliyopita ya mwanzo wa taharuki za kiuchumi. Hata hivyo maswala mengine ambayo hayakutarajiwa yanaendelea kuathiri sekta hasa azimio la serikali ya Uingereza kujiondoa kutoka mkataba wa umoja wa mataifa ya bara ulaya (Brexit) , utengwaji biashara na taharuki za kisiasa, sera za kibiashara za marekani na athari za usawazishaji wa sera za Kifedha katika chumi zilizoendelea.

Huku nyumbani, wakati wa kipindi hiki cha mwaka, sheria ya fedha ilihifadhi bei thabiti na kuhakikisha kwamba huduma za biashara za fedha zilipanua uwezo wake kusaidia ukuaji wa agenda hii. Kusaidia zaidi agenda hii, Benki kuu ya Kenya (CBK) iliendelea kuimarisha mfumo wa sheria yake ya fedha kwa kutia makali zana zake za maendeleo na viashirio hasa mfumo wa mtazamo wa chumi ndogo na matumizi ya dhana za utafiti wa masoko ambazo zilitoa mwongozo mwema wa kuzinduliwa kwa sera ya fedha.

Thamani Ya Mwanahisa

Kwa National Bank Of Kenya, utekelezaji vyema wa biashara una maana ya kuhudumia matakwa na kuafikia mahitaji ya washikadau wetu. Kufikia sasa, Halmashauri imechukua hatua kuangazia baadhi ya maswala yaliyokuwa yameibua mashaka miongoni mwa wanahisa na washika dau wetu. Nimeangazia kwa kifupi baadhi ya maswala haya lakini ripoti kamili itatoa taswira kamili kuhusu jinsi tulivyotekeleza biashara zetu.

Filosofia yetu muhimu ilisalia kama ilivyo huku tukiendelea kudumisha uimarishaji wa thamani wa muda mrefu kwa wanahisa wetu ambao wako katikati mwa juhudi zetu kupitia upatikanaji wa mapato wa kila mara kupitia uwekezaji.

Kupitia ripoti ya awali ya mwaka, nilikuwa nimetaja kwamba, mwanzo wa mwaka 2018, mwekezaji mkuu wa benki ambaye ni Serikali ya Kenya kupitia Wizara ya Fedha na

Ujumbe Kutoka Mwenyekiti

Hazina Kuu ya Kitaifa ya Uzeeni (NSSF) walikuwa wamejitolea kuangazia mahitaji yetu ya mtaji kwa kujitolea kutoa mpango mpana wa muda mrefu wa kifedha ili kufuata pengo la masharti, kusaidia ukuaji wa biashara na kuafikia mahitaji ya ICAAP.

Ingawa yalichelewa kuanza kulingana na tarehe zilizopangwa, mazungumzo kuhusu swala hili yanaendelea na mafanikio makubwa yameripotiwa. Ningependa kuwahakikishia wanahisa wetu wote na washika dau kwamba, wawekezaji wakuu bado wamejitolea kupata suluhu la mahitaji yetu ya fedha.

Wakati wa kipindi hiki cha mwaka unaongaziwa, usalama wa data ulisalia kuwa kiungo muhimu cha kuendeleza biashara yetu. Kama Halmashauri, tunatambua mahitaji ya sasa ya wateja wetu, uwezo wa kiteknolojia, mahitaji ya kisheria, idadi ya watu na chumi ambazo kwa pamoja zinaleta changamoto kubwa. Filosofia hii mpya ilitupelekea kufanya kazi kwa bidii na kwa weledi ili kukabiliana awali na changamoto zinazojitokeza kwa kutumia mbinu zinazofaa kuhusiana na usalama wa data. Kama kundi, tumechukua hatua endelevu kuwekeza raslimali zetu kwa kuweka uthibiti imara kupitia mfumo wa teknolojia ya habari na mawasiliano unaosaidiwa na sera zinazohitajika kwenye muundo wetu wa usimamizi. Mbali na matumizi ya mfumo, tunaendelea kutumia vyema mbinu ya masomo kwa maafisa wetu na wateja kuhusu hatari za kibiashara na vitisho vinavyohusiana na mtandao wetu ili kuhakikisha kuwa tumejihami na kujilinda. Kama Halmashauri, tunatambua pia kwamba udumishaji wa biashara yetu unategemea uafikiaji wa muundo thabiti wa kukabiliana na athari za kibiashara. Kutambua athari za mikopo yetu, athari za masoko, athari za mtaji pamoja na athari nyinginezo zisizoweza kutambulika haziwezi kutengwa kutokana na usimamizi wote wa shirika. Haiwezi kukanushwa kwamba, athari zinazoambatana na sekta ya benki zimeongezeka miaka ya hivi majuzi na kufanya soko la kifedha kuingia katika hatari kubwa.

Wasomaji wetu wapendwa, kufikia sasa nina fahari kuwaarifu kwamba, Halmashauri ya usimamizi imejihusisha kikamilifu kutambua athari zinazoweza kukabili kundi na kuendelea kuimarisha na kupitisha sera zitakazohakikisha hatari hizi zinajumuishwa ndani ya shughuli za maamuzi ambayo kundi linachukua. Lengo letu kukabiliana na athari ni kuhakikisha kuwa tunajifahamisha kufuata masharti huku tukizingatia matarajio ya wateja mbele ya uso wa mabadiliko ya teknolojia.

Zaidi ya hayo, kuhusu usimamizi wa shirika, acha nitamatishe kwa kuangazia jinsi timu ya usimamizi na Halmashauri ya wakurugenzi wanavyoshirikiana kuendeleza benki. Ningependa kuwahakikishia wasomaji wetu wote na wanahisa kuwa mnawakilishwa vyema na timu ya halmashauri iliyo imara na huru ambayo imekuwa ikifanya mikutano ya kila mara na usimamizi, washauri na wanahisa ili kutathmini maendeleo. Wakati wa kipindi kizima cha mwaka, Halmashauri hukutana na usimamizi kuangalia uthibiti wa hatari na usimamizi wa kutekeleza majukumu mengine muhimu ya moja kwa moja kupitia kamati za Halmashauri zilizo na wanachama wenye nguvu . Zaidi ya hayo, timu ya usimamizi na halmashauri hukutana kutathmini kwa kina matokeo yanayoendelea na masuala mengine yanayohitaji majadiliano ya ndani. Hakika, kufikia mwisho wa mwaka , tumefanya kikao cha ziada kutathmini ufanisi wa mkakati na mpango wa mwaka 2019 kwa kutegemea mazingira ya utekelezaji , soko na nafasi nyinginezo.

Kuangazia siku za usoni

2018 utakuwa mwaka wenye uzito kwa sekta nzima ya benki huku soko linapokuwa thabiti kukabiliana na misukosuko iliyoshuhudiwa miaka iliyopita. Kwa kipindi cha miaka miwili iliyopita, tumeshuhudia benki zikiathirika kutokana na mikopo isiyolipika na kuafikiana na viwango vya vipya vya ukaguzi. Huku hali hii ya awali ikiwa imeisha, tunatambua kwamba, kwa sasa azimio la mikopo ya muda mrefu isiyolipwa linachukua nafasi kubwa kwa upatikanaji wa manufaa.

Kama benki, tutaangazia kuwekeza raslimali zetu kwenye mipango ya maazimio ikisaidiwa na kuungwa mkono na mwongozo kutoka kwa wadau mbali mbali. Ili kuunga mkono mipango yetu ya ufufuzi na kuleta athari nzuri kwenye matokeo ya jumla, tutajitolea kikamilifu kuinua sehemu yetu ya wateja wa reja reja, kuboresha majumba ya biashara zetu, kuimarisha mfumo wa dijiteli, uvumishaji na huduma ya wateja. Kama nilivyoahidi mwaka 2018, tutaendelea kuimarisha muundo wa biashara yetu na kuanza kutumia unaojali mteja kwa kuegemea sifa za jadi kama vile busara na mtazamo wa muda mrefu huku tukitumia vyema mifumo mipya ya kidijiteli inayojitokeza.

Nikihitimisha, kwa niaba ya halmashauri ya wakurugenzi ningependa kuwashukuru wafanyakazi wetu wenye bidii kwa kujitolea kwao kuwahudumia wateja. Pia, ningependa kuwashukuru wateja wetu ambao kwa muda wa miaka iliyopita wamesimama na sisi na kuhakikisha kwamba biashara yetu ingali inaendelea.

Huku tunapotulia mwaka mpya, tunaombea amani taifa letu ili kutuwezesha kuendeleza biashara yetu bila kusitishwa.

MOHAMED HASSAN
Mwenyekiti

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the Fiftieth Annual General Meeting of the Shareholders of National Bank of Kenya Limited ("the Company") will be held at the ***Moi International Sports Centre Kasarani, Indoor Arena, off Thika Super Highway on 14th June 2019 at 10.00 a.m.***to transact the following business:-

1. To read the Notice convening the Meeting.
2. To receive, consider and adopt the Company's audited financial statements for the year ended 31st December 2018 together with the Directors' and Auditors' reports thereon.
3. To note that the Directors do not recommend payment of dividend to shareholders for the year ended 31st December 2018.
4. To elect Directors of the Company:-
   a) In accordance with Article 90 of the Company's Articles of Association, Ms. Linnet Mirehane, retires by rotation as a Director and being eligible offers herself for re-election.
   b) In accordance with Article 90 of the Company's Articles of Association, Mr. Jones M. Nzomo retires by rotation as Director and being eligible offers himself for re-election.
   c) In accordance with the provisions of Section 769 of the Companies Act 2015, the following Directors being members of the Company's Board Audit Committee be elected to continue to serve as members of the said Committee:-

   (i) Mr. Jones M. Nzomo
   (ii) Mr. Joseph K. Kering
   (iii) Ms. Linnet Mirehane
   (iv) The Cabinet Secretary, to the National Treasury
   (v) Mr. Mark J. Obuya
   (vi) The Managing Trustee, National Social Security Fund

5. To approve the Directors' Remuneration Report for the year ended 31st December 2018.
6. To re-appoint the Company's Auditors, M/s. PricewaterhouseCoopers, in accordance with Section 721 of the Companies Act (Act No.17 of 2015) and Section 24(1) of the Banking Act (Cap.488). M/s. PricewaterhouseCoopers have indicated their willingness to continue in office.
7. To note the Auditors' remuneration for the year 2018 and authorise the Directors to fix the Auditors' remuneration for the year 2019.
8. To transact any other business of the Annual General Meeting in respect of which notice has been given.

Special Business:

9. Approval of Conversion of Non-Cumulative Preference Shares to Ordinary Shares:- To consider and, if thought fit, to pass the following resolutions with or without modifications as Special resolutions:

   a) "THAT subject to receipt of requisite regulatory approvals and completion of the proposed take-over of the Company by KCB Group Plc or competing take-over offer (if any) and with effect from the completion date, each of the one billion two hundred million (1,200,000,000) Non-Cumulative Preference Shares of Kenya shillings five (Kshs 5.00) only each being part of the Company's share capital, be and are hereby re-designated as one (1) ordinary share of Kenya shillings five (Kshs 5.00) only each to rank pari passu, in all respects with the existing ordinary shares in the share capital of the Company. Consequently upon this resolution becoming effective, the rights attaching to the Non-Cumulative Preference Shares shall automatically be extinguished."

   b) "THAT it be noted that the Cabinet Secretary to the National Treasury and the National Social Security Fund currently hold nine hundred million (900,000,000) and two hundred and thirty five million (235,000,000) Non-Cumulative Preference Shares, respectively, and that upon completion of the proposed take-over of the Company by KCB Group Plc or competing take-over offer (if any) as envisaged in resolution 9(a) above the said Non-Cumulative Preference Shares shall be re-designated as ordinary shares to rank pari passu in all respects with the existing ordinary shares in the share capital of the Company."

c) "THAT the Directors of the Company be and are hereby authorized to sign all documents and to do all such things as may be necessary to give effect to the above resolutions."

10. Alteration of the Memorandum and Articles of Association of the Company: - To consider and, if thought fit, to pass with or without modification(s), the following resolutions as Special Resolutions:

a) "That subject to completion of the proposed take-over of the Company by KCB Group Plc occurring and with effect from the completion date, the Memorandum of and Articles of Association of the Company be amended by deleting in its entirety Section 36 of the Memorandum of Association, and Article 2 of the Articles of Association and substituting therefor with the following narration:

"The Share capital of the Company is Kenya Shillings thirteen billion (Kshs13,000,000,000.00) divided into two billion, six hundred million (2,600,000,000) ordinary shares of Kenya Shillings five (Kshs5.00) only each."

b) "THAT the Directors of the Company be and are hereby authorized to sign all documents and to do all such things as may be necessary to give effect to the above resolutions, subject to receipt of all the regulatory and shareholder approvals as set out in resolutions 9 and 10 above".

By Order of the Board,

Habil A. Waswani
Company Secretary
16 May 2019

Notes:

1. A member entitled to attend and vote at the above meeting may appoint a proxy to attend and vote instead of him/her. A proxy need not be a member of the Company.

2. In the case of a member being a limited liability company or corporate body, the form must be completed under its Common Seal or under the hand of an officer or attorney duly authorised in writing.

3. The Proxy Form shall be available at the Bank's website www.nationalbank.co.ke, or, the offices of the Company's Share Registrars – Image Registrars Limited, 5th Floor, Barclays Plaza, Loita Street, P.O. Box 9287-00100, Nairobi.

4. Shareholders who will not be able to attend the Annual General Meeting are requested to complete the proxy form and return:-

a) by hand or email to Image Registrars Limited, 5th Floor, Barclays Plaza, Loita Street, P.O. Box 9287-00100, Nairobi, email: info@image.co.ke, or,

b) by hand to the Registered Office of the Company.

5. Proxy Forms must be received not less than 48 hours before the meeting i.e. not later than 5.00 p.m. on Wednesday 12th June 2019.

6. In accordance with Article 125 of the Company's Articles of Association a copy of the Audited Financial Statements may be viewed on and obtained from the Company's website www.nationalbank.co.ke or from the Registered Office of the Company. An abridged set of the audited Balance Sheet, Income Statement, Statement of Changes in Equity and Cashflow Statements for year ended 31st December 2018 have been published in two daily newspapers with nationwide circulation.

7. Registration of Members and proxies attending the Annual General Meeting will commence at 7:00 a.m. and will close at 10:00 a.m. Production of a National Identification Card, Passport or other acceptable means of identification and the Member's share certificate or current Central Depository Statement of account for their shares in the Company will be required.

Notisi Kuhusu Mkutano Wa Pamoja Wa Mwaka

NOTISI INATOLEWA HAPA KWAMBA, Mkutano wa hamsini wa pamoja wa mwaka wa wanahisa wa benki ya National Bank of Kenya (''Kampuni'') utafanyika katika ***uwanja wa Kimataifa wa Michezo wa Moi Kasarani katika ukumbi wa Indoor Arena Ijumaa Juni 14, 2019*** kuanzia saa Nne Asubuhi ili kuangazia maswala yafuatayo ya kibiashara;-

1. Kusoma notisi ya kuitishwa kwa Mkutano
2. Kupokea, kuwazia na kupitisha taarifa za matumizi ya pesa za kampuni zilizofanyiwa ukaguzi kwa kipindi cha mwaka uliomalizika Desemba 31, 2018 pamoja na ripoti kutoka kwa wakurugenzi na wakaguzi wa pesa.
3. Kutambua kwamba wakurugenzi hawapendekezi kutolewa kwa mgawo wa faida kwa wanahisa kwa kipindi cha mwaka uliomalizika Desemba 31, 2018.
4. Kuwachagua wakurugenzi wa kampuni;-

a) Kwa mujibu wa kifungu nambari 90 cha sheria za makampuni, Bi. Linnet Mirehane anastaafu kwa zamu kama mkurugenzi na kwa kuwa hali inamruhusu, anajitokeza ili achaguliwe tena
b) Kwa mujibu wa kifungu nambari 90 cha sheria za makampuni, Bw. Jones M. Nzomo anastaafu kwa zamu kama mkurugenzi na kwa kuwa hali inamruhusu anajitokeza ili achaguliwe tena
c) Kwa mujibu wa vipengele vya sehemu ya 769 vya sheria za makampuni ya mwaka 2015, wakurugenzi wafuatao ambao ni wanachama wa kamati ya halmashauri kuhusu uhasibu wachaguliwe ili kuendelea mbele kuhudumu kwama wanachama wa kamati iliyotajwa;-

(i) Bw. Jones M. Nzomo
(ii) Bw. Joseph K. Kering
(iii) Bi. Linnet Mirehane
(iv) Katibu katika wizara ya fedha
(v) Bw. Mark J. Obuya
(vi) Meneja Msimamizi , National Social Security Fund

5. Kupitisha marupurupu ya wakurugenzi kwa kipindi cha mwaka uliomalizika Desemba 31, 2018
6. Kuteua tena wakaguzi wa pesa , M/s. PricewaterhouseCoopers kwa mujibu wa sehemu ya 721 ya sheria za makampuni (sheria nambari 17 ya Mwaka 2015) na sehemu ya 24 (1) ya sheria za benki (cap 488) M/s. PricewaterhouseCoopers wamedhihirisha nia yao kuendelea na jukumu lao.

7. Kutambua marupurupu ya wakaguzi wa pesa kwa kipindi cha mwaka 2018 na kuwaamuru wakurugebzi kuamua marupuruu yao ya Mwaka 2019.

8. Kutekeleza majukumu mengine ya kibiashara ya mkutano mkuu wa pamoja wa mwaka ambayo notisi yake ita kuwa imetolewa.

Shughuli maalumu:

9. Kupitisha kubadilishwa kwa hisa maalumu ambazo hazijajumuishwa pamoja kwenye hisa za kawaida – Kuzingatia na endapo itakubalika kupitisha azimio lifuatalo kama lilivyo au bila kufanyiwa marekebisho kama azimio maalumu.;

a) KWAMBA '' baada ya kupata idhini la kisheria na kukamilishwa kwa pendekezo la umiliki wa kampuni ya KCB Group Plc au kushinda ushindani (endapo utakuwepo) na kuanzia tarehe ya kukamilishwa, kila mojawapo wa hisa bilioni moja milioni mia mbili (1, 2000, 000,000) ambazo hazijajumuishwa pamoja za shilingi tano (Kshs.5) kila moja ambazo ni sehemu ya mtaji wa hisa za kampuni ziweze na zigeuzwe kuwa hisa moja (1) ya hisa za kawaida za shilingi tano(5) kwa kila moja ili ziwe sawa kwa hali zote na hisa za kawaida zilizoko kwenye mtaji wa hisa za kampuni. Papo hapo, baada ya azimio kuanza kutumika, haki zinazoshirikisha hisa maalumu zisizojumuishwa pamoja mara moja ziweze kuondolewa''

b) '' KWAMBA'' ifahamike kwamba, Waziri katika wizara ya fedha na hazina ya kitaifa ya uzeeni (National Security Fund) kwa sasa wanashikilia hisa milioni mia tisa (900,000,000),milioni mia mbili thelathini na tano (235,000,000) mtawalia wa hisa maalumu ambazo hazijamuishwa pamoja na baada ya kukamilika kwa pendekezo la umiliki wa kampuni ya KCB Group Plc au kushinda ushindani wa umiliki (endapo utakuwepo) kama ilivyotarajiwa kwenye azimio nambari 9 (a) hapo juu, hisa maalumu ambazo hazijamuishwa pamoja zitawekwa kama hisa za kawaida ili ziwe kiwango sawa kwa hali zote na hisa za kawaida zilizoko sasa kwenye mtaji wa hisa wa kampuni.''

c)'' KWAMBA wakurugenzi wa kampuni waamrishwe kutia sahihi stakabadhi zote na kufanya mambo yote yatakayokuwa muhimu ili kuanza kutumika kwa azimio lililotajwa hapo juu''

10.Kufanyia mabadiliko mkataba na vipengele vya sheria za kampuni;- Kuwazia na endapo itakubalika, kupitisha au bila kufanyia mabadiliko maazimio yafuatayo kama maazimio maalumu;

a) Kwamba baada ya kukamilika kwa pendekezo la kampuni kumiliki KCB Group Plc na mara moja baada ya tarehe ya umiliki, memoranda na vipengele vya sheria za kampuni zifanyiwe marekebisho kwa kuondoa kabisa sehemu ya 36 ya memoranda ya ushirika na sehemu ya 2 ya sheria za kampuni na badala yake kubatilishwa na maneno yafuatayo:
b) ''bilioni 13 (Kshs. 13,000,000,000.00) zilizogawanywa kwa bilioni mbili, milioni mia sita (2,6000,000,000) ya hisa za kawaida za shilingi tano (Kshs.5.00) kila moja''
c)''KWAMBA wakurugenzi wa kampuni waweze na wapewe uhuru kutia sahihi stakabadhi zote na kufanya mambo yote yatakayoonekana kuwa sawa ili kufanya azimio lililotajwa kuweza kutekelezwa baada ya kupokea idhini zote za kisheria na za mwanahisa kama ilivyotajwa kupitia azimio la 9 na 10 hapo juu''.

Kwa Amri ya Halmashauri

Habil A. Waswani
Katibu wa kampuni
Mei 16, 2019

1) Mwanachama aliye na ruhusa kuhudhuria mkutano na kupiga kura anaweza kumteua wakala kufika na kupiga kura kwa niaba yake. Si lazima kwa wakala kuwa mwanachama wa Kampuni

2) Katika hali ambapo mwanachama ni kampuni maalumu au shirika, ni lazima fomu ya wakala iwe imepigwa muhuri wa kawaida au chini ya afisa au wakili aliyeidhinishwa kwa njia ya kuandika.

3) Fomu ya uwakilishi inapatikana kupitia wavuti wa benki www.nationalbank.co.ke au ofisi ya msajili wa hisa za kampuni, image registrars Limited orofa ya tano , jumba la Barclays Plaza, barabara ya Loita Slp 9287-00100 Nairobi.

4) Wanahisa ambao hawataweza kuhudhuria mkutano wa pamoja wa mwaka wanaombwa kujaza fomu ya wakala na kuirudisha kwa:-

a) Kwa njia ya mkono au barua pepe kwa; image registrars Limited orofa ya tano , jumba la Barclays Plaza, barabara ya Loita Slp 9287-00100 Nairobi, barua pepe: info@image.co.ke au

b) njia ya mkono kupitia ofisi ya kampuni iliyosajiliwa

5) mawakala wawe wamepokelewa na kampuni saa 48 kabla ya kuanza kwa mkutano yaani kabla ya saa kumi na moja jumatano Juni 12,2019.

6) Kwa mujibu wa kifungu nambari 125 cha sheria za kampuni , nakala nzima ya ripoti ya mwaka na kaguzi za pesa zinaweza kupatikana kupitia wavuti wa kampuni www.nationalbank.co.ke au ofisi ya kampuni iliyosajiliwa. Muhtasari wa mizania , taarifa kuhusu mapato, taarifa kuhusu mabadiliko ya umiliki wa hisa na mtiririko wa pesa kwa kipindi cha mwaka uliomalizika Desemba 31, 2018 zimechapishwa kupitia magazeti mawili ya kila siku yanayosambazwa kote nchini.

7) Usajili wa wanachama na wakala watakaohudhuria mkutano utaanza saa moja asubuhi na kufungwa saa nne asubuhi. Utoaji wa kitambulisho cha kitaifa, hati ya kusafiria au stakabadhi nyingine za kujitambulisha zinazokubalika na cheti cha hisa cha uanachama au taarifa ya hivi punde ya akaunti ya CDS kuhusu hisa zao katika kampuni zitahitajika.


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LONG VEHIC

WORD FROM THE MANAGING DIRECTOR & CEO

Dear readers, thank you for choosing National Bank of Kenya as your preferred financial partner. Our resolve to stay true to a sustainable growth and a Bank that values the power of every connection continued in the year 2018. Despite our capital constraints, a challenging market environment, low interest rates and further investments in technology and controls our organic growth initiatives still delivered tangible results. As a solid Group, we believe we are firmly positioned on the path to producing growth and higher returns with sustained discipline on costs and risks.

In line with our solid commitment driven by the market design, our customer deposits grew 5% from Shs 94 billion to Shs 99 billion on account of stable growth on customer confidence in the Bank and new products such as the revamped mortgage offering as well as the supplier financing solutions, enhanced Natmobile and extensive investment in client service.

As a result of continued stability, the Bank improved its liquidity with the ratio closing at 43% compared to 36% in the previous year.

Business Growth

I am proud of the different ways our 1,500 staff plugged into the business, engaged and delivered in 2018, indeed this was proved through a Staff Survey conducted towards the end of the financial year, which exhibited an improvement of staff engagement to 74% from 60% in December 2017.

With a re-energized team, we bravely continued to invest in our workforce, our communities and

Word from the Managing Director & CEO

improving our Bank through operational excellence to achieve responsible growth. To ensure sustainability of our business we aligned with the market design, our customer and risk frameworks for both short-term and long-term gains.

During the year under review, we outlined a multi-year strategy aligned with our motivation to build on the core strengths of our business model and client base. We adopted 10 strategic themes geared to make our business more efficient, less risky, better capitalized and with disciplined execution.

Nandi Branch re-launch

Our dear readers, I am humbled to announce to you that in 2018 we made significant improvements in our corporate communication, ensuring better strategy alignment within the organisation. To support alignment of business strategy execution, we introduced departmental morning meetings dubbed *'Strategy Cascade'* where together with management we met staff and took them

Business Club Seminar

through the Bank's objectives whilst also creating an opportunity to receive direct feedback to ensure no one was left behind.

To keep this line of communication open and active we further introduced a cascade tool to assist staff in planning, managing and tracking KPI's across board.

Other material progress towards our goals announced at the start of the year encompassed growth in our focus segments in Medium Small Micro Enterprises (MSME) in both Retail and Islamic Banking. To boost the sector we managed to secure strategic partnerships with both the public and the private sector such as the KRA/NBK supplier financing targeting the MSME.

Simultaneously and in line with the market design, we also made a realignment of our business divisions and formed the Strategy, Research and Innovation Unit (SRI) under the CEO's office whose focus is driving strategy alignment and execution, identifying competitive and relevant products based on research.

Kitale Branch re-launch

We also consolidated non-funded income activities across divisions in a bank-wide perspective by moving the transactional banking unit to report to the MD through the SRI unit.

Dear readers, the Bank takes its commitment to its values, business principles, ethical and legal behavior seriously. For this reason we launched a Whistle Blowing Program to facilitate the reporting of unethical and illegal behaviors, breaches of values and business principles.

Outlook

A few years after the introduction of the interest capping law and a decade after the global banking crisis, 2019 looks like it could be the year of tipping points in the evolution of the industry.

Already some banks have announced mergers such as CBA & NIC Bank and some acquisitions have already taken place in the industry while Fintechs are growing daily eating into huge part of our market. As a Bank we still remain positive of the alerts having now been

Word from the Managing Director & CEO

accustomed to the fast pace of change through innovation, the usage of data and analytics more extensively and the digitization of processes. Due to the changing environment we are gearing up by becoming more strategically focused and technologically advanced to respond to consumer expectations while trying to defend our market share against both existing and new competition.

Real Estate Excellence Awards

At the beginning of 2018, we set out the next phase (2018 - 2022) of our strategy, highlighting our key priorities for the next five years and how we intend to deliver value and high quality experiences for customers, alongside strong and sustainable financial performance for our shareholders within a prudent risk and conduct framework.

Our guiding principles for this new cycle as mentioned in our previous report will be anchored on:

1. Business growth driven by new products, value chain optimization and innovation
2. Diversification of revenue by growing our subsidiaries
3. Investing in exceptional client service
4. Prudent cost management and well controlled business
5. Risk management and governance
6. Investing in growing our people skills and capabilities.

National Tree Planting Launch

Dear readers, in 2016 we set out on the path towards reorganisation and stabilisation of our Bank. Our report over the years since then has clearly demonstrated a strong foundation for realizing the Bank's full potential.

All our energies can now be effusively deployed with the assurance that we have a good thing going on, hence my optimism about the future and look forward to what lies ahead.

WILFRED MUSAU
Managing Director & CEO

UJUMBE KUTOKA KWA MENEJA MSIMAMIZI NA AFISA MKUU MTENDAJI

Wasomaji wapendwa, asanteni kwa kuchagua National Bank of Kenya kama mshirika anayefaa kifedha. Uamuzi wetu kusalia kuwa kweli kudumisha ukuaji thabiti wa benki inayothamini uwezo wa kila kituo uliendelea mwaka 2018.

Licha ya changamoto zetu za kifedha, changamoto za mazingira ya kibiashara, viwango hafifu vya riba na uwekezaji zaidi kwenye teknolojia na uthibiti mikakati ya ukuaji wetu, tuliweza kufanikisha matokeo ya kuvutia. Kama kundi lililo imara, tunaamini kwamba tumejiweka kwenye mkondo wa ukuaji na matokeo ya hali ya juu huku tukidumisha nidhamu kukabiliana na gharama na athari.

Kufungamana na kujitolea kwetu kunakoendeshwa na mfumo wa soko, akiba ya wateja wetu ilikua kwa asilimia 5 kutoka Shillingi bilioni 94 na kufikia Shillingi bilioni 99 kutokana na ukuaji thabiti wa imani ya wateja kwa benki na uwepo wa biadhaa mpya kama vile mikopo ya rehani pamoja na suluhu la ufadhili kwa watoaji huduma, huduma za benki kupitia simu tamba na uwekezaji zaidi kwa huduma za wateja. Kutokana na kuendelea kuwepo kwa uthabiti, benki iliimarisha ukwasi wake huku uwiano ukiwa baina ya asilimia 43 ikilinganishwa asilimia 36 mwaka uliotangulia.

Ukuaji wa biashara

Nina furaha kwa mbinu mbali mbali ambazo wafanyakazi wetu 1,500 walizotumia kwa biashara yetu na kuzalisha mwaka 2018. Hakika hili lilitambuliwa kufuatia utafiti wa wafanyakazi uliofanyika mwishoni mwa kipindi cha matumizi ya pesa ambao ulidhihirisha kuimarika kwa uhusishaji wa wafanyakazi kwa asilimia 74 kutoka asilimia 60 mwezi Desemba mwaka 2017.

Huku tukiwa na timu yenye nguvu mpya, tuliendelea kuwekeza kwa wafanyakazi, kwenye jamii zetu na kuimarisha benki yetu kupitia utendaji bora wa kazi ili kufanikisha ukuaji unaowajibika. Kuhakikisha uthabiti wa biashara yetu, tulijiweka sawa na muundo wa soko, wateja wetu na mfumo wa kukabiliana na hatari kwa manufaa ya muda mfupi na mrefu.

Ujumbe Kutoka kwa Meneja Msimamizi na Afisa Mkuu Mtendaji

Wakati wa kipindi cha mwaka unaoangaziwa, tuliweka mikakati mbali mbali iliyoenda sambamba na hamasisho letu la kujenga kwenye msingi imara wa muundo wa biashara yetu na msingi wa wateja. Tulianza matumizi ya maeneo kumi ya mkakati ambao lengo lake ni kuifanya biashara kuhudumu vyema zaidi, kupungukiwa na hatari, kuwa na mtaji bora na kuwa na taratibu bora za utekelezaji.

Wasomaji wetu, nina fahari kuwatangazia kwamba, mwaka 2018 tulipata mafanikio muhimu kwenye mawasiliano ya kimashirika na kuhakikisha mkakati ulio sawa katika shirika. Kwa kusaidia uzinduzi wa mkakati sawa wa biashara, tulianzisha mikutano ya asubuhi ya idara kwa jina " Strategy Cascade" ambao pamoja na usimamizi tulikutana na wafanyakazi na kuwaonyesha malengo ya benki huku tukipata nafasi kupokea majibu ili kuhakikisha kwamba hakuna mtu aliyeachwa nyuma. Ili kuweka wazi laini hii ya mawasiliano, tulianzisha chombo cha kuwasaidia wafanyakazi kupanga, kusimamia na kufuatilia vigezo muhimu vya utendakazi kote.

Vifaa vingine vya ufuatiliaji malengo vilivyotangazwa mwanzo wa mwaka vilihusisha ukuaji kwenye vitengo vyetu vya chumi ndogo na vya kadri (MSME) vya reja reja na uwekezaji wa benki wa kiislamu. Ili kuinua biashara, tuliweza kupata ushirikiano muhimu wa umma na sekta za kibnafsi kama vile KRA/ NBK kufadhili wafanyabiashara kwa kulenga chumi ndogo na za kadri (MSME).

Wakati huo huo na kwa kufungamana na muundo wa soko, tulibadili vitengo vya biashara zetu na kubuni kitengo cha mkakati, utafiti na ubunifu (SRI) chini ya Ofisi ya Afisa Mkuu Mtendaji (CEO) ambacho mtazamo wake ni kusimamia uwekaji sawa mkakati na uzinduzi, kutambua bidhaa zilizo na ushindani na zinazofaa kwa kutegemea utafiti. Pia, tuliweka pamoja shughuli za mapato yasiyofadhiliwa katika vitengo vyote kwa mtazamo mpana wa benki kwa kuhamasisha kitengo cha utekelezaji shughuli za benki ili kuripoti kwa Meneja Mkurugenzi kupitia kitengo cha SRI.

Wasomaji wapenzi, benki inawajibikia vikali thamani yake, maadili ya kibiashara, nidhamu na utiifu wa sheria. Ni kutokana na sababu hii ambapo tulianzisha mpango wa utoaji habari ili kuandaa utoaji wa ripoti zinazohusu ukiukaji wa maadili na taratibu za kibiashara.

Mtazamo

Miaka michache baada ya kuzinduliwa kwa sheria inayothibiti kiwango cha juu cha riba na mwongo mmoja baada ya taharuki katika sekta ya benki ulimwenguni, 2019 unaonekana kama mwaka utakaoleta mabadiliko kwenye sekta hii.

Tayari, baadhi ya benki zimetangaza kuungana kama vile CBA na NIC. Kwa upande mwingine, umiliki umeanza kutekelezwa kwenye sekta hii ya kifedha huku biashara inayolenga kutoa huduma za kifedha kwa kutumia teknolojia ya kisasa (fintechs) ikiendelea kukua kila siku na kutwaa sehemu ya nafasi kubwa ya soko letu. Kama benki, tungali na matumaini kuhusiana na tahadhari na kwa sasa tumezoea mabadiliko na kasi kupitia ubunifu, matumizi ya data,uchambuzi zaidi na dijiteli.

Kutokana na mabadliko ya mazingira tunajiandaa kuwa kwenye nafasi nzuri ya kujihami na kujiendeleza kiteknolojia ili kukabiliana na matarajio ya wateja wetu huku tukilinda nafasi ya soko letu dhidi ya washindani walioko sasa na wanaoibuka.

Mwanzoni mwa mwaka 2018, tulianza sehemu ya awamu nyingine (2018-2022) ya mkakati wetu unaoangazia maeneo yetu muhimu ya miaka 5 ijayo na jinsi tunavyotarajia kuzalisha thamani na huduma za hali ya juu kwa wateja pamoja na matokeo ya juu ya kifedha kwa wanahisa wetu chini ya mfumo salama kutokana na hatari.

Vipengele muhimu vya mwongozo wetu kwenye mfumo huu mpya kama ilivyotajwa kupitia ripoti yetu ya hapo awali zitaongozwa na:

1) Ukuaji wa biashara kupitia bidhaa mpya, uboreshaji wa thamani na ubunifu
2) Upanuzi wa mapato na kuinua biashara zetu tanzu
3) Kuwekeza kwenye huduma za kipekee kwa wateja
4) Kuboresha usimamizi wa gharama na usimamizi bora wa biashara
5) Usimamizi wa hatari na utawala
6) Kuwekeza kwenye uboreshaji wa taaluma za watu wetu na uwezo

Wasomaji wapendwa, mwaka 2016 tuliandaa mkondo wa kupanga upya uthabiti wa benki yetu. Kuanzia wakati huo, ripoti yetu imeonyesha dhahiri msingi imara kuafikia manufaa kamili ya benki. Kwa sasa, nguvu zetu zote kutumika kikamilifu tukiwa na hakikisho kwamba kuna kitu kizuri kinachoendelea. Nina matumaini kuhusu siku za usoni na natarajia kuhusu yaliyo mbele.

WILFRED MUSAU
Meneja Msimamizi na Afisa Mkuu Mtendaji

Financial Performance
Chief Finance Officer

The operating environment progressively improved in 2018 after the electioneering period in 2017 with GDP growing by 6.3% compared to 4.7% in the previous year mainly attributable to growth in agriculture, manufacturing and transport sectors. During half one of the year we recorded reduced customer flows in our key business segments which combined with a 50 basis points reduction in lending rate impacted top line growth and increased the non-performing loan book.

Profit for the year decreased by 98% from Kshs 410 million to Kshs 7 million caused by a one-off restructuring cost of Kshs 541 million and decrease in operating revenues.

Total operating income declined from Kshs 10 billion to kshs 9 Billion as a result of decrease of 10% in customer loans and advances. Operating expenses declined by 2% year on year benefiting from successful implementation of various efficiency programs.

Balance sheet recorded growth of 5% to close at Kshs 114 billion buoyed by growth of 5% in customer deposits with gains in Retail and Corporate business.

The group continued to record good performance in asset quality for new to Bank lending as a result of enhanced lending policies and procedures with non-performing loan ratio of the new book below 2%. Overall gross non-performing loans increased by Kshs 3 billion compared to previous year. The Bank has put in place measures to accelerate recovery of bad loans, this will ensure that our asset quality improves in coming years.

With the macro environment is expected to improve, we are well positioned to deliver enhanced customer satisfaction and new innovations with increasing focus towards micro, small & medium enterprises leveraging new products and strategic partnerships.

Internally, we will continue to implement efficiency programs through process automation and re-engineering, capacity building and re-investing this gains in new products and digitization programs. We are optimistic that this programs combined with a comprehensive and long term capital solution will drive our balance sheet growth and increase profitability.

Business Review and Achievements

2018 Highlights

PBT & Exceptional Item - Kes millions

2018	2017
456	785

Total Assets - Kes billions

2018	2017
114	109

Deposits - Kes millions

2018	2017
98,866	94,276

Net loans - Kes millions

2018	2017
47,779	52,361

NPL Ratio

2018	2017
48%	41%

Gross NPLs - Kes millions

2018	2017
31,461	27,658

Cost to Income Ratio

2018	2017
74%	67%

ATM Transactions - Volume Kes millions

2018	2017
27,876	28,004

Mobile Transactions - Volume Kes millions

2018	2017
13,688	12,437

5 Year Financial Performance - Kes Millions

	2014	2015	2016	2017	2018
Consolidated statement of financial position					
Assets					
Government securities	30,091	27,083	34,546	35,718	46,342
Net loans & advances to customers	65,641	62,531	55,020	52,361	47,779
Fixed & intangible assets	5,518	5,588	5,464	4,871	5,313
Other assets	21,842	26,165	17,057	16,923	15,416
Total assets	123,092	121,367	112,086	109,873	114,850
Liabilities					
Customer deposits	104,734	108,439	93,870	94,276	98,866
Other deposits	5,078	4,526	7,312	5,620	6,021
Other liabilities	1,056	1,399	3,994	2,743	2,990
Shareholder's funds	12,224	7,003	6,910	7,234	6,973
Total liabilities & equity	123,092	121,367	112,086	109,873	114,850
Consolidated statement of profit or loss					
Total operating income	9,933	9,192	10,649	11,006	9,887
Total operating expenses	8,105	7,588	8,154	7,418	7,792
Impairment losses	525	8,628	2,415	2,803	2,180
Profit before tax	1,303	(7,025)	80	785	(85)

Risk Management Statement

Effective risk management is fundamental to the continued existence of any organization. This precept is particularly true for financial institutions. National Bank of Kenya Limited prides itself in embedding risk management in all its strategic business decisions and has a formally documented Risk Management Framework (RMF) that details the risk management processes within the Bank.

The Bank has several committees that are charged with management and oversight of risk both at the senior management (executive level) and at the Board level. The Bank has a functioning Executive Risk Committee (ERC) with clearly documented Terms of Reference. The committee meets every month to discuss the top risks facing the Bank and comes up with strategies on how to manage them.

The key risk mitigation and management deliverables endorsed by the ERC are presented to the Board Risk Committee (BRC) on a quarterly basis and on need basis. The BRC during the quarterly meetings considers the top risks facing the Bank and the adequacy of the strategies put in place by the senior management to mitigate the risks. The Bank has aligned its business strategies to risk management strategy through a clearly documented risk appetite statement.

Bank's Risk Profile

1. Credit

Potential loss due to failure of counter party to meet its obligations to pay the bank according to the agreed terms

Risk Drivers

This risk arises majorly out of the Bank's core business of lending to its customers or to support its customers to meet its obligations to other third parties through guarantees, letters of credit etc.

How we manage the risk

We have a clearly documented credit risk policy and credit underwriting standards that markedly outline the credit risk management processes, acceptable exposures and authorities to grant loans.

The Bank has separated loan origination which basically lies with the businesses from credit underwriting which lies with Credit Division. These are supported by a clearly documented Credit delegated authorities for individuals and committees approved by the Board.

2. Market

Potential loss of earnings arising from movements in market prices.

Risk Drivers

Foreign currency trading, interest rate margins, fixed income trading, holding of foreign currency deposits and assets, revenues and expenses in foreign currency and movement in commodity prices.

How we manage the risk

The Bank has in place approved Market Risk Framework. All market risk exposures are monitored, managed and reported to the Assets and Liabilities Committee (ALCO), Executive Risk Committee and the Board Risk committee. Any potential damage to the Bank's financial position is quickly remedied as directed by Senior Management and the Board.

3. Liquidity

The risk that a bank, though solvent, either does not have sufficient financial resources available to meet all its obligations and commitments as they fall due or can secure them only at excessive costs. It is the inability to meet the banks liabilities when they fall due.

Risk Management Statement

Risk Drivers
The risk emanates from the Bank's banking activities of deposit taking from customers and onward lending to other customers who require funding in the form of loans which could be short-term, medium-term or long-term e.g. mort-gages. The Risk occurs due to mismatches in assets and liabilities.

How we manage the risk
The Bank has in place a robust Liquidity Risk Management Policy that is overseen by Senior Management through the ALCO. This committee meets monthly to review the balance sheet structure and take required remedial actions to ensure that the Bank is not exposed to liquidity risk.

Achievements
The Bank has maintained a liquidity ratio of above 30% in the last 2 years highlighting the effectiveness of the liq-uid-ity risk management strategies.

4. Operational

This is the potential loss resulting from inadequate or failed internal processes, people, and systems or from external events such as terrorist attacks, flooding etc. These potential losses include losses from legal risks but excludes repu-tational risks and strategic risks.

Risk Drivers
These risks emanate from the day to day banking activities and cannot be eliminated. The risks are inherent in the ICT systems used by the bank; people relied on to perform certain activities, processes being used and exposure to threats from the external environments where the Bank operates.

How we manage the risk
The Bank has documented an Operational Risk Management Framework, policies and procedures for effective man-agement of operational risks. In addition, all the top operational risks facing the Bank are presented to the ERC and BRC where the mitigation plans are interrogated for their effectiveness and adequacy to control the identified risks.

Achievement
The Bank has seen a reduction in operational losses by over 25% due to effectiveness of processing controls and im-proved risk culture. In addition, there has been improved turnaround time attributable to stable transaction pro-cessing system. This is as a result of an effective business continuity management framework.

5. Reputational

Possible damage to the Bank's image resulting in loss of earnings or inability to raise capital, liquidity from the market due to investors and customers taking negative view of the bank.

Risk Drivers
The key driver for reputational risk is negative media publicity (both mainstream media and social media). The negative publicity normally results from inappropriate conduct of business e.g. failure to comply with the expected environmental and social standards while conducting our business. The negative perceptions may also be as a result of poor stakeholder management, including vendors, employees, regulators and shareholders.

How we manage the risk
The Bank is committed to ethical conduct of business and strives to treat all our stakeholders fairly. The Bank has clearly documented reputational risk management policy, policy on code of conduct, anti-bribery & corruption policy, commu-nication policy and corporate governance standards. All these policies are strictly implemented and all stake-holders are expected to abide by them.

Risk Management Statement

Achievement
In the last two years, the Bank has seen an increase in positive reporting both in the main media and on social media thereby boosting customer confidence. This has attributed to an increase in customer deposits from Kshs.94B in 2017 to Kshs.99B in 2018.

6. Compliance

This is the risk of legal or regulatory sanctions, material financial loss, or loss to reputation the bank may suffer as a result of its failure to comply with laws and regulations.

Risk Drivers
The risk emanates from the external environment especially with respect to the many laws and regulations that the Bank is expected to comply with in the conduct of its business.

Compliance control environment

Policies and Procedures	The Bank is guided in its operations by the Board approved policies, which incorporate the changes and or additions made in the regulatory space.
Training and Education	The Bank has provided for training in the Bank to raise awareness and enhance compliance with policies, procedures and regulations.
Continuous Monitoring	The management reports to the Board on a quarterly basis on any non-compliance that was noted, for mitigation and guidance.
Compliance Governance	The compliance function reports directly to the Board Risk Committee on a quarterly basis through the Chief Risk Officer.
Complaints Management	The Bank, together with the regulatory bodies, ensures that all complaints with respect to the Bank are amicably and conclusively resolved.

How we manage the risk
The Bank has a dedicated and independent compliance function that monitors all the Bank's activities to ensure that it operates within the stipulated laws, rules and regulations of the land. Compliance Function reports to the Board through the Chief Risk Officer hence assuring its independence.

The Bank proactively manages compliance risk and considers the risk to be an essential part of the business decision making process, cutting across all levels of business within the institution. We have established a robust compliance

Risk Management Statement

program, which ensures that compliance risks are timely identified, assessed and managed within the defined risk appetite levels, to enable the Bank achieve its objectives. The Board Risk Committee provides an oversight on the effective implementation of the program. The Bank strives to ensure compliance is achieved at all times in its operations. The compliance exposure is minimised by ensuring that all bank activities are conducted in accordance to the operating governing laws, regulations, codes of ethics and conduct, standards of best practices, internal policies and procedures.

The Bank is equally committed to the fight against money laundering and combating terrorist financing. While onboarding customers, the Bank ensures that adequate Know Your Customer (KYC) procedures are conducted and only establish relationship with customers who meet the minimum KYC thresholds.

Continuous monitoring of customers transactions are also conducted to ensure that all transactions are done within the confines of the law. To ensure full awareness on money laundering and terrorism financing, the Bank has developed an e-learning program, which must be undertaken by every member of staff, on an annual basis.

Ethics and code of Conduct

The Bank has put in place a framework to ensure ethical business practices. Every member of staff is expected to embrace the key values of transparency, integrity, accountability, zero tolerance on corruption, honesty and any other unethical business practices in all their business dealings with the customers.

The Bank has put in place policies and procedures which are accessible to all staff, to support ethical behavior at work. These policies include but are not limited to, anti-bribery and corruption, conflict of interest, whistleblowing, code of conduct, and sexual harassment, amongst others.

Every member of staff is expected to fully adhere to these policies and under-takes annual conflict of interest and secrecy declaration at the beginning of every year.

Conflict of Interest Policy

The Bank's employees are required to full disclose, any real or potential conflict of interest, whether direct or indirect, on an annual basis. The directors of the Bank are expected to fully disclose any real or potential conflict of interest, whether direct or indirect in order to ensure that no board decision is influenced or biased.

Code of Conduct

The Bank has a code of conduct in place. This code of conduct is availed to every staff for sign-off at the point of employment, as an extension of the employment contract, in order to ensure that every employee has read and un-derstood the contents of the code.

Whistleblowing Policy

The Bank has a Whistle blowing platform which is guided by the Whistle blowing Policy. A whistleblowing platform was established in 2018 and approved by the Board to facilitate anonymous reporting on unethical business practices. The access is currently available to every member of staff, through an email, toll-free hot-line and website. This platform consists of a toll free number, an email address and a website.

The platform is hosted by an independent and external institution to guarantee anonymity and encourage an ethical culture in the Bank.

The Bank's employees have all been trained and are encouraged to report anonymously on unethical behavior in the Bank without any fear of retaliation.

Risk Management Statement

The whistle blowing reports are reported to the Board Risk Committee and to the main Board on a quarterly basis.

Insider trading Policy
In compliance with the Companies Act [2015], the Bank has an insider trading policy which guides the Directors and all employees on when they are not allowed to trade in the Bank's shares as listed in the Nairobi Stock Exchange.

Sexual Harassment Policy
In compliance with the Employment Act [2012], the Bank has a sexual harassment policy which establishes a safe work environment for all NBK employees. Sexual harassment is condemned and prohibited in the Bank.

Governance Structure
Compliance Risk is managed on a day to day basis by the Compliance and Ethics department, which is part of the Risk Division. The Compliance Function reports to the Board through the Board Risk Committee.

Achievement
As a result of effective compliance policies, the Bank recorded nil reulatory penalties on AML and other non-compliance matters. In addition, six staff were dismissed from the Bank for failing to comply with key Bank policies. This highlights the Bank's committtment to strong ethical standards and zero tolerance approach to compliance.

7. Cyber/Fraud

Fraud is the potential financial loss resulting from an act, falsification of information or misrepresentation by a person (internal or external fraudsters). Cyber-crime fraud is committed using a computer and/or the Internet.

Risk Drivers
The risk derives from both the internal and external environment as a result of weak internal controls, collusion, lack of segregation of duties, process failures, lack of documented processes, bribery and corruption, dishonesty and money laundering, among others.

How we manage the risk
The Bank has in place cyber risk and fraud risk management policies for effective integration of fraud risk manage-ment within a combined assurance environment and fraud awareness. The Bank's operations are also subjected to cyber security assessments through dedicated forensic personnel. The Bank's staff also have access to an anonymous whis-tle blowing reporting facility managed by the Compliance Department. All frauds are reported at ERC and BRC.

Achievement
The Bank has near real time detection of cyber-attacks thereby making tremendous improvement in the actual losses recorded against total cyber fraud attempts. In 2018, the actual loss is 14% of the potential loss as compared against an actual loss of 44% of the potential loss recorded in 2017.

The 17 Sustainable Development Goals

To ensure long-term stability and economic development, National Bank of Kenya has over the last few years transformed its attitudes and actions to promote more responsible and sustainable business practices. The Bank takes cognizance of the challenges posed by the current and potential impact of climate change and the growing resource scarcity arising from economic development carried out in an unsustainable manner.

The Bank therefore aims to empower its customers and strengthen its communities by providing financial services in conjunction with access to the knowledge it has acquired over the last 50 years.

Our sustainability policy framework provides a benchmark for how we:

As a socially engaged institution, the Bank takes responsibility to make a meaningful contribution to achieving the 17 SDGs, which is why we have embedded our contribution to the SDGs which are also aligned to the Big Four Agenda in our strategic ambitions. Our commitment to the SDGs fits with the Bank's mission:

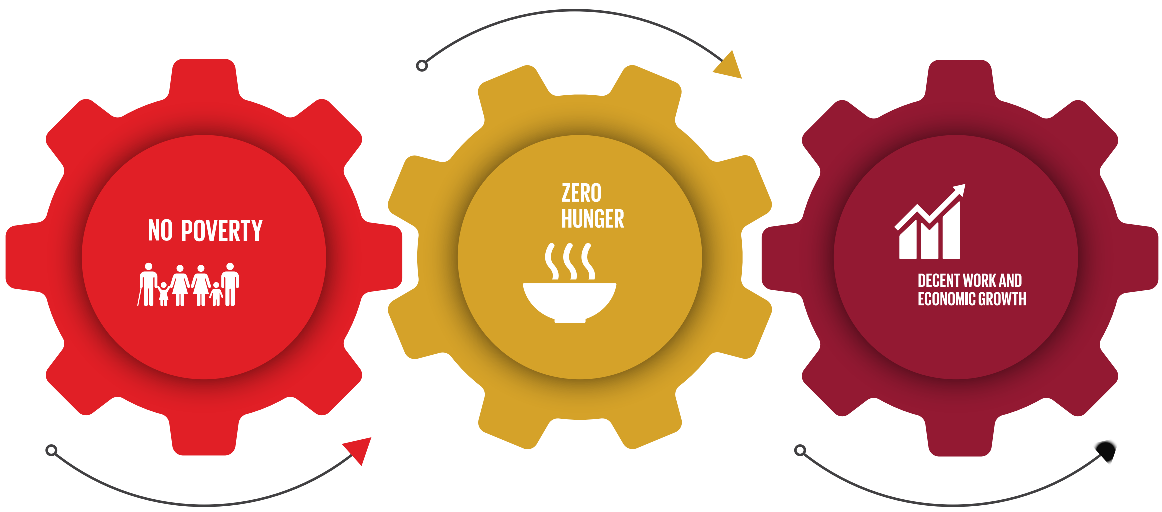
To be dedicated to excellence in providing competitive financial solutions, meeting the changing needs of our customers whilst being a responsible Corporate Citizen providing attractive opportunities to our employees and improving shareholders Value.

To this end the Bank measures its sustainability ambitions using 14 key performance indicators, divided into three pillars as guided by the Sustainable Development Goals (SGDs). Our contribution to these KPIs is through the provision of financial support, sharing knowledge and connecting people.

1. Economic Pillar

The Bank is committed to helping clients and their communities in achieving sustainability by providing tailored financial services and access to knowledge and networks through the following KPIs aligned to the SDGs

a. End poverty in all forms everywhere the Bank is represented
b. End hunger, achieve food security and improve nutrition and promote sustainable agriculture
c. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all



1. Economic Pillar (Continued)

The Bank and its clients are aware through experience that sustainable development and economic development are closely intertwined. A proper example to further illustrate this is that people who invest in energy conservation both save costs and help protect the climate.

Sustainable energy production is another excellent illustration. This initiative needs investment, but also generates financial returns in the longer run whilst conserving natural resources. This pillar therefore calls us to serve the following KPI' derived from the Sustainable Development goals and as such investing in vital communities is a significant part of our economic pillar. We did this not only through monetary means, but also through our knowledge and networks.

Some of the initiatives supported under the economic pillar include:

i) Sustainable agriculture and food supply

Businesses in food and agriculture and other sectors that look at raw material, production methods and recycling from a fresh angle can both achieve new earning models and help conserve raw materials and natural resources.

The Bank is committed to making agricultural value chains sustainable on a national scale. To this end we engaged with innovative customers and public-sector partners to realise ambitious sustainability projects in agricultural value chains that also served to inspire players throughout the chain to become more sustainable.

• We revamped our agricultural financing product to address financial needs and general provide solutions to all the players in the agricultural sector aimed at promoting food security and economic growth. To further enhance our value offer we actively participated in several farmers shows.

• The Chai Bonus Advance a short term financing to tea out growers

• Kilimo Advance a short term financing to agribusiness enterprises like farmers, agro dealers, suppliers etc

• Agribusiness working capital a credit product specifically designed to cater for day to day operations general activities like purchase of inputs, farming activities, Labor, payments of services like Veterinarian, agronomical and technical services, agricultural plant set up, Stocking of Agro shops, purchase of modern agricultural tools and equipment, irrigation structures, Post-handling services, Value Addition and warehousing

• Dairy Herd Improvement a facility available to individual clients engaged in the production level of the whole dairy value chain, to enhance efficiency in production of dairy products

• Livestock fattening and financing targeted for rearing cattle, sheep, goats, horses, camel and poultry

ii) Retail and Premium Banking Customers

The Bank helped retail and private banking customers achieve their ambitions with professional advice and we also managed to do our best to guarantee access to suitable financial services to our clients.

To cater for our vulnerable groups , in 2018 we were able to enter into a strategic partnership with Grant Thornton (a reputable professional services and consulting firm) to conduct financial advisory and trainings for members of our Business Club.

The Bank also actively managed to conduct various seminars under its Business Club initiatives in Nairobi, Nakuru, Nyeri, Molo, Mombasa, Kisumu and Eldoret where they recruited more than 300 members to the Business Club. The existing and new recruits were also given the opportunity to attend the Canton Fair in China by the Bank.

Under our sustainability program we assisted vulnerable customers gain access to banking services. Through a strategic partnership agreement with Kenya Revenue Authority, the Bank was able to offer unsecured LPO financing facilities to suppliers of KRA registered under the AGPO program to assist them deliver on the tenders they had won.

AGPO Partnership

KPO Walk

Other initiatives targeting the vulnerable groups included participation in the Kenya Paraplegic Organisation Wheel and Walk Fun to raise funds to support the organisation achieve its objectives of transforming the public towards an inclusive society especially to persons living with disabilities.

2. Social Pillar

Caring for people, the climate and the environment often goes hand in hand with the creation of new income and opportunities. To achieve this, the Bank is aligned to:

a. Ensure healthy lives and promote well-being for all at all ages
b. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
c. Achieve gender equality and empower all women and girls
d. Ensure availability and sustainable management of water and sanitation for all
e. Ensure access to affordable, reliable, sustainable and modern energy for all
f. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
g. Take urgent action to combat climate change and its impacts
h. Conserve and ensure sustainable use of oceans, seas and marine resources for sustainable development
i. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, To be considered a corporate citizen by promoting a just and cohesive society enjoying equitable social development in a clean and secure environment, the Bank invested in various social initiatives on a not-for-profit basis.

National Bank Donates to Angelica Medical Supplies

i) Health Partnership with Angelica

• To ensure healthy lives and promote well-being for all at all ages the Bank entered into strategic partnership with Angelica Medical Supplies and Roche for the distribution of glucometer kits and training of health workers in renal centres in public hospitals in Kenya under the medical Equipment (MES) a project by the Ministry of Health.

Under this initiative the Bank will invest in the purchase of glucometres and strips for use in the testing of blood sugar in patients in Renal Centres in public hospitals. The role of AMS is to implement the project through distribution of the consumables and training of the health workers in the utilisation of the kits.

ii) Strategic Partnership with Kenyatta National Hospital

• In the year under review the Bank also embarked in refurbishing the patients Kenyatta National Hospital kitchen. The project on completion will see the facility enjoying a new floor, an enhanced plumbing and drainage works, steam piping, mechanical ventilation and a general ambience up-lift. This was one of our key deliveries in the year and the project hand-over should happen sometime in this New Year.

iii) Educational Support

• To ensure inclusive and equitable quality education and promote lifelong learning opportunities for all, the Bank under a campaign dubbed Directors' CSR sort to identify schools that are in need of IT equipment to support technology and innovation learning. The Bank refurbished used computers and other accessories and donated to the schools identified in the whole country.

iv) Book Bunk Partnership

• To aid the building of resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation, the Bank decided to go back to its roots and identified a strategic partnership with Book Bunk and the Nairobi County to restore some of the country's most iconic libraries and social halls for inclusive public use. Through this initiative the Bank will also have an

Book Bunk Partnership

opportunity to use the spaces to advance its gender quality and empowerment of women and girls as well as provide quality learning.

iv) Ministry of Environment Partnership

• Under the UN development goal number 15 to protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification and halt and reverse land degradation and halt biodiversity loss; National Bank of Kenya partnered with the Ministry of Environment to launch the National tree planting day.

The Bank committed to support the initiative through sponsoring the purchase of tree seedlings.

National Tree Planting Launch

Employment Practices

With regard to Employment practices, we continue to be guided by the Constitution and Labour Laws of Kenya, ILO Conventions and best practices. In the year under review, we reviewed our Employment Policy with an aim of bringing clarity as an Equal Opportunity Employer, giving emphasis on development of internal talent to fill vacancies with ratio of 70% internal and 30% external.

We also came up with a stand-alone Policy on Sexual Harassment as required by the Employment Act Section 6. Previously, this policy was housed within the Employee Relations Policy.

Labour/Management Relations

We have continued to have close working relationship with key stake holders such as Ministry of Labour, FKE, COTU and BIFU. In addition, internally management has continued to have close working relationship with the Union through monthly meetings between the Union Representatives and HR team; and quarterly meetings between Union representatives, HR and the MD to address union issues and ensure positive labour relations.

In 2018 a draft paper was done aimed at forming Management Council to address management issues. Town Hall meetings have also continued to be conducted between Senior Management and rest of staff to listen, get feedback and address staff issues.

Occupational Health and Safety

In year 2018, an OSHA survey /audit was carried out and we are currently addressing the gaps identified. Training for First Aid and Fire Marshals were also organized.

The Bank has also continued to address the gaps that were identified in the year 2017 Ergonomic Survey including provision of Orthopaedic chairs to staff that require them, improvement of lighting in some offices, refurbishment of some work places and restocking of First Aid Boxes.

The Bank also has a mother's lactation room which is being refurbished to make it more modern and fit for purpose.

Training and education of staff

As a learning organization, a number of Learning and Development programs were implemented in year 2018 targeting all staff. Key highlights included the introduction of learning time where biweekly; all staff in their respective Divisions/Branches meet to learn on topical issues e.g. bank's products, our values, compliance issues etc.

In Partnership with the Strathmore Business School we also introduced Women in Leadership training program and so far we have trained thirty (30) female staff. A number of line managers were also trained as coaches and currently we have 34 internal certified coaches. The Executive Management staff also underwent Executive Coaching aimed at enhancing their leadership skills.

Diversity and equal opportunity

The Bank continues to be a strong adherent to diversity principles. For example, in terms of gender distribution in the Bank, 50.7% are female and 49.3% are men and out of the top 150 top management staff 30% are ladies. Deliberate efforts are being made for example through women in leadership development program and equal employment opportunity to have more ladies in leadership.

The Bank has also not shied away from employing people with disabilities. Currently the Bank has ten (10) staff with various disabilities. The Bank work force also reflects the face of Kenya in terms of regional balance.

Equal remuneration for women and men

The Compensation and Benefit Policy of the Bank is very clear. All jobs are evaluated and paid as per the grade within the Bank's grade and salary structure and the same does not discriminate on gender.

Non- discrimination

This is anchored in our Employment Policy as an Equal Opportunity Employer which clearly states the Bank will not discriminate on any grounds and will work towards ensuring there are no discrimination practices.

Freedom of association and collective bargaining

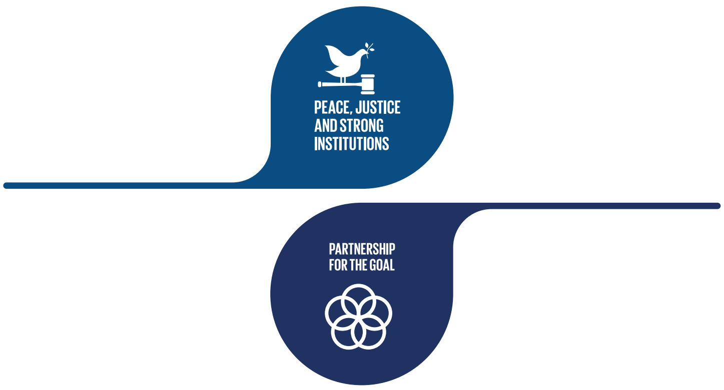
The Bank continues to respect and encourage freedom of association. 40% of the Bank's workforce is currently made up of Union staff.

Anti-corruption

In year 2018, the Bank rolled out a Whistle blowing channel in partnership with Deloitte Kenya and awareness campaigns were carried out. The channel is now up and running.

All staff are guided by our core values and any deviations are addressed. We also have an anti-bribery policy in place and the Bank has zero tolerance to any corrupt malpractices. The Bank also has a conflict of interest declaration policy where each is expected to abide and it is a requirement that every year, each staff has to sign the anti-bribery and conflict of interest form.

3. Administrative Pillar



NBK for Peace Initiative

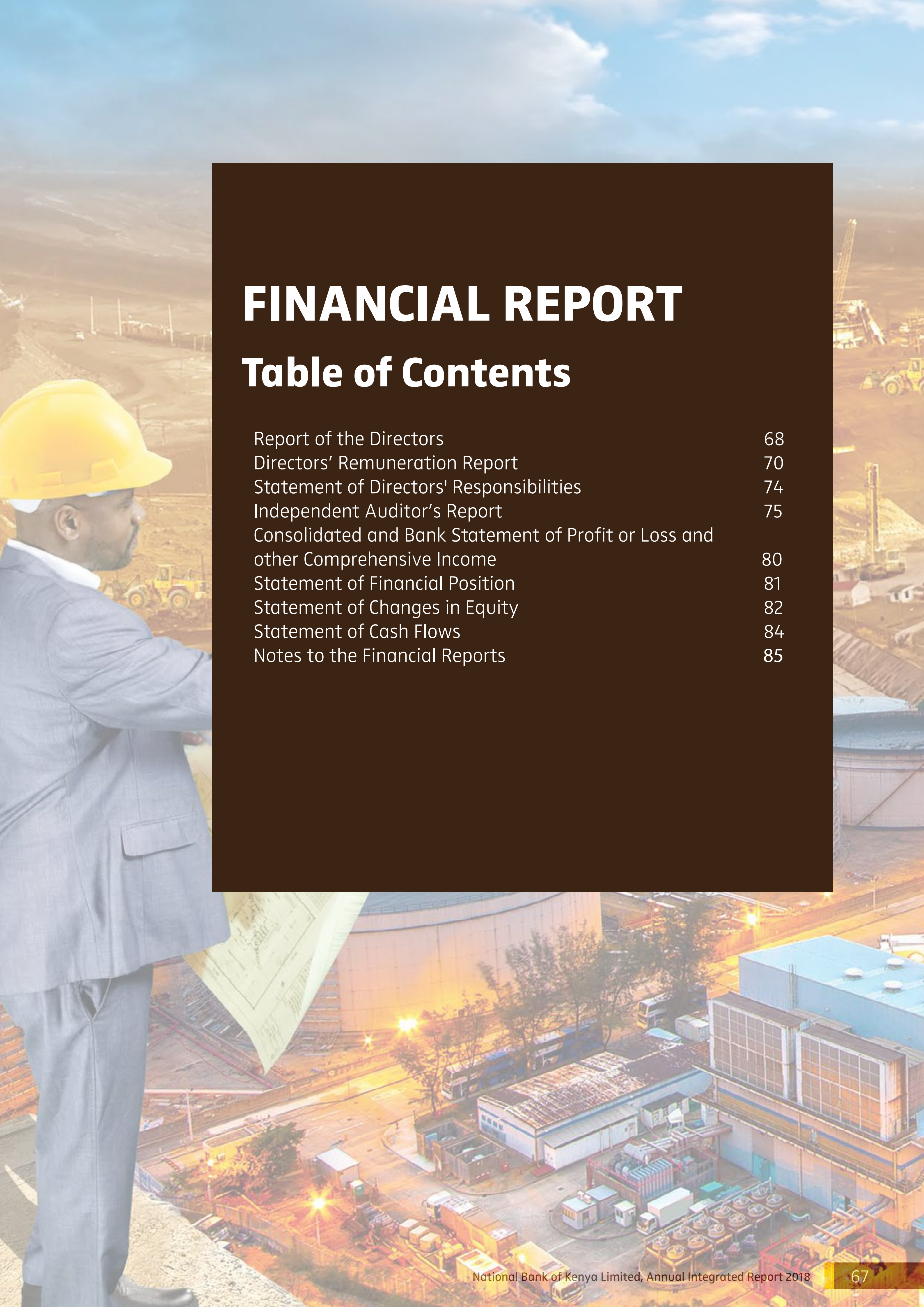
This pillar gives the Bank an opportunity to focus on issues based, people centred, result-oriented and an accountable governance system to provide employees with opportunities to interact and provide support while getting inspired by the community initiatives identified in the year.

• To promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and an inclusive institution, the Bank participated in a campaign dubbed NBK for Peace campaign during the post-election period of 2017 to 2018.

a. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.

b. Strengthen the means of implementation and revitalize the global partnership for sustainable development.

Our efforts are designed to maximize our positive impact on the SDGs. We believe that the United Nations' goals can only be achieved through cooperation between companies, NGOs, non-profit organisations and Government.



FINANCIAL REPORT

Table of Contents

The directors present their report together with the audited financial statements of National Bank of Kenya Limited (the "Bank") and its subsidiaries (together, the "Group") for the year ended 31 December 2018, which disclose its state of financial affairs.

Principal activities

The principal activity of the Group is the provision of banking, bancassurance, custody and related financial services.

Dividend

i) The directors do not recommend the payment of a dividend to the holders of the preference shares in respect of the financial year ended 31 December 2018 (2017 – Nil).

ii) The directors do not recommend the payment of a dividend to the holders of the ordinary shares in respect of the financial year ended 31 December 2018 (2017 – Nil).

Business review

The Group financial statements include results of National Bank of Kenya Ltd and its wholly owned subsidiaries; NBK Insurance Agency Limited and Natbank Trustee and Investment Services Limited.

During the year under review, the operating economic environment improved due to increased spending, improved weather, recovery in agriculture and continued stability. The industry continues to face competition from FinTech and other firms offering financial services.

As a Bank, we have enhanced our mobile banking platform offering, built a strong pipeline of digital innovations and entered into various strategic partnerships to provide financing to suppliers in medium, small and micro enterprises. The key challenge for the Bank remains capital inadequacy and high stock of non-performing loans. Our main shareholders have renewed their commitment to recapitalise the Bank and this process is ongoing. On non-performing loans, management has enhanced credit policy and implemented remediation and recovery strategies to accelerate recovery in 2019.

The Group's total assets grew by 5% in year 2018 due to enhanced product offering and client service resulting in increased deposits by Shs 4 billion. However, operating income decreased by 4% to Shs 7.7 billion from Shs 8.2 billion last year due to the decline in interest income due to reduced lending due to capital constraints.

To drive efficiency and increase productivity, the Group implemented voluntary early retirement which led to a one off restructuring cost of Shs 541 million. Total operating expenses (excluding impairment losses) declined by 3% year on year due to improved cost management.

The Group's profit for the year decreased to Shs 7 million from Shs 411 million in 2017 due to decline in loans and advances resulting in reduced interest income, increased loan impairment and voluntary early retirement costs.

Results for the Year	**Group**		**Bank**	
	2018	**2017**	**2018**	**2017**
	Sh'000	**Sh'000**	**Sh'000**	**Sh'000**
Profit before taxation	(84,901)	785,082	50,915	740,373
Taxation expense	91,909	(374,298)	105,224	(360,376)
Profit for the year	7,008	410,784	156,139	379,997

Directors

The directors who held office during the year and to the date of this report are as shown on page 15.

Pursuant to article 90 of the Bank's Articles of Association, Mr. Mohamed A. Hassan and Mr. Joseph K. Kering were re-elected as directors at the Bank's last Annual General Meeting held on 28 May 2018.

In accordance with article 90 of the Bank's Articles of Association, Ms. Linnet Mirehane and Mr. Jones M. Nzomo will retire by rotation as directors, at the Annual General Meeting to be held on 24 May 2019 and being eligible, have offered themselves for re-election.

Statement as to disclosure to the Company's auditor

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

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

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

Terms of appointment of the auditor

PricewaterhouseCoopers continues in office in accordance with the company's Articles of Association and Section 719 of the Companies Act, 2018.

The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees.

Events after the reporting period

There have been no events after the reporting date that require adjustment to these financial statements.

By Order of the Board

H A Waswani
Company Secretary
Nairobi

28th March 2019

Information not subject to audit

Directors' remuneration report has been prepared in accordance with the requirements of The Companies (General) (Amendment) (No.2) Regulations, 2017 promulgated under The Companies Act, (Act No. 17 of 2015), and, The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, Regulations, promulgated under The Capital Markets Act (Cap.485A).

National Bank of Kenya Limited's ('The Company') board of directors has a functional Board Nomination and Remuneration Committee (the ''Committee'') made up of six non-executive directors and the Managing Director as indicated in page 1. The Committee's responsibilities have been set by the board and are outlined in the Board Charter and the Committee's terms of reference.

The committee is responsible for assessing the organizational structure, performance and effectiveness of staff and that of the board of directors, proposing and vetting new nominees to the board, and ensuring, through annual reviews, that the board composition reflects an appropriate mix of skills and expertise required by the Company. The Committee is also mandated to periodically review and recommend to the full board, the remuneration of executive directors and senior management staff as well as the bank wide structure of compensation.

Remuneration policy for non-executive directors

The Company has a policy that sets out the general rules and principles that govern the remuneration of non-executive directors. The policy is designed to provide guidance on the remuneration and privileges of non-executive directors of the Company as they execute their roles and responsibilities for the time required to be spent in discharging meaningful and effective contribution to the oversight, leadership and guidance for the Company.

Non-executive directors are issued with appointment letters after their respective elections at the annual general meeting and are subject to retirement by rotation as provided for by the Company's Memorandum and Articles of Association.

In November 2016, the board revised the compensation policy for the non-executive directors, the last review having been done in February 2011. The key elements of the revised compensation include:

i) Monthly fees (honoraria);
ii) Sitting allowance for board and board committee meetings;
iii) Expense allowances covering airtime and club membership fees / subscriptions; and
iv) Medical cover for inpatient, outpatient within prescribed limits.

In arriving at the remuneration care was taken to ensure that the remuneration review process was above board and comparable to market practice amongst market peers in the industry. The remuneration is subject to approval by the shareholders at annual general meetings.

Remuneration policy for executive directors

The terms of employment for the executive directors (currently only the Managing Director and CEO) are within the Company's human resource policies for employees, and have requirements for a formal employment contract. The terms of service and remuneration for the Managing Director and CEO are reviewed by the board and are detailed in the specific contract of employment and agreed performance objectives and other parameters.

Directors' Remuneration Report (Continued)

The highlights of the board remuneration policy are as follows:

Item	Non-Executive Directors	Executive Director
Fees, allowances and salaries	• Monthly allowance is paid in arrears. • A standard sitting allowance is paid to members attending the board and various board committees' sessions.	• A monthly salary is paid based on contractual terms approved by the board. • Periodic reviews are based on performance and industry salary benchmarking. • No sitting allowances paid for board and board committee meeting attendance.
Pension and gratuity	None	• No pension is payable by the Company for staff on contract as per HR policy • Gratuity is payable after 2 years as per HR policy
Benefits	• Medical cover within prescribed limits • Expense allowances for airtime • Social club membership	• Medical cover within prescribed limits • Expense allowances for airtime and utilities • Car allowance • Social club membership
Bonus or share based rewards	The policy does not include a performance based incentive for non-executive directors nor any share options	The Company has no share based rewards for staff or directors.
Performance measures	The board sets / reviews the Company's strategic objectives annually and reviews implementation status semi-annually.	Targets are set beginning of each year and reviewed semi-annually.

Statement of voting at annual general meeting

During the Company's annual general meeting held on 28 May 2018, the shareholders unanimously approved the directors' remuneration for the financial reporting year ended 31 December 2017.

Information subject to audit

For the financial years ended 31 December 2018 and 31 December 2017, the Company's directors' remuneration was as shown below. The aggregate directors' emoluments are shown in Note 31 (d) & (e).

For the year ended 31 December 2018	Salary	Director's Fees	Sitting Allowance	Expense allowance	Estimated value for non-cash benefits	Total
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Executive Directors						
Mr. W Musau	41,492	-	-	8,760	-	50,252
Non-Executive Directors						
Mr. M A Hassan - Chairman	-	2,400	1,014	200	1,542	5,155
Cabinet Secretary - National Treasury	-	1,080	1,872	171	128	3,251
Managing Trustee - NSSF	-	1,080	1,545	200	128	2,953
Mr. M J Obuya	-	1,080	1,924	171	141	3,316
Dr. F L Atwoli	-	1,080	611	200	211	2,102
Ms. L Mirehane	-	1,080	2,186	200	696	4,162
Mr. J K Kering'	-	1,080	2,336	171	257	3,845
Mr. J M Nzomo	-	1,080	2,345	200	128	3,752
Total	**41,492**	**9,960**	**13,832**	**10,274**	**3,229**	**78,787**

For the year ended 31 December 2017	Salary	Director's Fees	Sitting Allowance	Expense allowance	Estimated value for non-cash benefits	Total
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Executive Directors						
Mr. W Musau	39,300	-	-	8,760	-	48,060
Non-Executive Directors						
Mr. M A Hassan - Chairman	-	2,400	1,331	120	128	3,979
Cabinet Secretary - National Treasury	-	1,080	2,774	117	128	4,099
MT - NSSF	-	1,080	1,721	106	1,119	4,026
Mr. M J Obuya	-	720	770	93	73	1,656
Dr. F L Atwoli	-	1,080	1,134	120	128	2,462
Ms. L Mirehane	-	1,080	2,377	106	128	3,691
Mr. J K Kering'	-	1,080	2,724	140	1,043	4,987
Mr. J M Nzomo	-	1,080	2,736	96	124	4,036
Eng. E K Mwongera	-	450	1,390	20	55	1,915
Total	**39,300**	**10,050**	**16,957**	**9,678**	**2,926**	**78,911**

Compensation for past directors

There was no payment of directors' fees to past directors during the year.

Directors’ Remuneration Report (Continued)

Sums paid to third parties in respect of a director’s services

The following directors are considered third party and served the Company in capacity as directors during the year. Included in the directors remuneration balances on page 72 is remuneration paid to representatives of institutions for the services as directors.

		2018	2017
		Sh’000	**Sh’000**
1.	B Gathirwa - Represents CS - National Treasury	3,251	4,099
2.	A Omerikwa - Represents MT - NSSF	2,953	4,026

ON BEHALF OF THE BOARD

Dr. F L Atwoli
Chairman, Board Nomination & Remuneration Committee
Nairobi
28 March 2018

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 the Bank as at the end of the financial year and of their profit or loss for that year. The directors are responsible for ensuring that the Group and the Bank keep proper accounting records that are sufficient to show and explain the transactions of the Group and the Bank; disclose with reasonable accuracy at any time the financial position of the Group and the Bank; and that enables them to prepare financial statements of the Group and the Bank 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 the Bank, 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 apply them consistently; and
iii. Making judgements and accounting estimates that are reasonable in the circumstances

Having made an assessment of the Group's ability to continue as a going concern, the directors have disclosed in Note 3 (i) of the financial statements matters relating to the use of going concern basis of preparation of the financial statements.

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

Approved by the board of directors on 28th March 2019 and signed on its behalf by:

....
Mr. M A Hassan
Chairman

....
Mr. W Musau
Managing Director & CEO

Independent auditor's report to the shareholders of National Bank of Kenya Limited

Report on the audit of the financial statements

Our opinion

We have audited the accompanying financial statements of National Bank of Kenya Limited (the Bank) and its subsidiaries (together, the Group) set out on pages 80 to 185, which comprise the Consolidated and Bank statement of financial position at 31 December 2018 and the Consolidated and Bank statement of comprehensive income, Consolidated statement of changes in equity, Bank statement of changes in equity and Consolidated and Bank statement of 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 National Bank of Kenya Limited give a true and fair view of the financial position of the Group and the Bank 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 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.

Material uncertainty relating to going concern

We draw attention to Note 3 (i) in the financial statements which indicates that the Bank was significantly in breach of the regulatory capital ratios at 31 December 2018. This condition indicates that a material uncertainty exists that may cast significant doubt on the Bank's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described under the ''material uncertainty relating to going concern'' paragraph above, the matters described below were of most significance in our audit of the consolidated financial statements of the current period.

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Key audit matters (continued)

Key audit matter	How our audit addressed the matter
Credit risk and provision for expected credit losses (ECL) on financial assets The Group implemented IFRS 9, Financial instruments, on 1 January 2018, which requires the recognition of expected credit losses on the Group's on-balance sheet and off-balance sheet financial assets. Previously, under IAS 39, impairment losses on financial assets were recognised on incurred basis only if there was objective evidence of impairment. As disclosed in note 3 (ii) and 4(i) of the financial statements, the determination of expected credit losses on financial assets involves significant judgments, assumptions and estimates by the management, and the use of complex mathematical models. Our audit procedures focused on the following areas in the calculation of the expected credit losses whose outcomes have a significant impact on the financial performance and position of the Group: • the asset risk classifications at the reporting date, including identification of financial assets that have experienced significant increase in credit risk (SICR) or default; • the determination of key inputs in calculating the expected credit losses such as the Probabilities of Default (PDs), the Loss Given Default (LGDs), Exposures at Default (EADs), and the forward looking information overlays. These inputs are based on the analysis of the historical credit behavioral patterns of the Group's portfolio of financial assets, and, in some instances, use of external proxy data. • the conceptual logic and accuracy of the expected credit losses calculation models used by the Group.	We obtained an understanding of the Group's IFRS 9 implementation process including the governance processes thereof through discussions with management and review of related documentation. We obtained an understanding of Group's controls over origination, performance monitoring and identification of delinquent loans or counterparties that may have experienced SICR. We selected a sample of loans and advances accounts and tested consistent application of asset risk classification in accordance with IFRS 9 requirements and the Group policy. We reviewed and assessed management's accounting policies over key IFRS 9 concepts especially significant increase in credit risk (SICR), default definition, forecasting of forward looking macro-economic factors, and weighting of expected loss scenarios. For non-performing loans and advances, where the expected credit losses are calculated individually, we selected a sample of accounts and examined the reasonableness of management judgement and assumptions over the critical data inputs. Where impairment was calculated on a collective basis using a expected credit loss models (for performing accounts and accounts experiencing a significant increase in credit risk) , we tested the basis and operation of those models and the data and assumptions used. We also tested the historical data trends and how they were applied to compute key expected credit losses parameters such as the probability of default, Loss Given Default and Exposures at Default. We assessed the consistency of application of the principles, judgments and assumptions on transition opening balances and the closing balances at the year end. We reviewed management's ECL related financial statement disclosures especially sensitivities on areas of estimation.

Independent auditor's report to the shareholders of National Bank of Kenya Limited (continued)

Key audit matters (continued)

Dependency on information technology (IT) systems and applications for accounting and financial reporting The Group's financial accounting and reporting processes are dependent on complex information systems and applications. Specifically, the calculation, recording and financial reporting of transactions and balances related to interest and fees and commissions revenues, loans and advances and customers' deposits are significantly dependent on IT automated systems and applications. Weaknesses in the design and operating effectiveness of the automated system dependent processes could result in material errors in the Group's financial information. Our dependence on the IT systems was mainly on the following aspects: • Management of logical access to critical systems including privileged access and developer access to the production environment; • Controls over changes to programs and system developments; • Automated application controls relating to accounting calculation and financial reporting; and • Interfaces between core banking systems to financial reporting modules, including any manual adjustments to financial information.	We assessed and tested the design and operating effectiveness of the controls over the continued integrity of the IT systems that are relevant to financial accounting and reporting. We tested controls over program development and changes, access to programs and data and IT operations including compensating controls where required. We also carried out direct tests of certain aspects of the security of the Group's IT systems including logical access management and segregation of duties. Where controls deficiencies either in design or operating effectiveness were identified, we altered our audit approach and identified compensating controls and increased substantive procedures to mitigate the deficiencies found. These additional procedures mitigated the deficiencies found and provided the additional audit evidence required. We validated any manual adjustments to information generated by the IT systems and applications and ensured such adjustments are appropriate.

Other information

The other information comprises the Corporate information, Chairman's Statement, Managing Director's Statement, Report of the directors, Statement of directors' responsibilities and the Directors' remuneration report which we obtained prior to the date of this auditor's report, and the rest of the other information in the Integrated 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.

Independent auditor's report to the shareholders of National Bank of Kenya Limited (continued)

When we read the rest of the other information in the Integrated 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.

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.

Independent auditor's report to the shareholders of National Bank of Kenya Limited (continued)

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

- 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.

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

Report of the directors

In our opinion the information given in the Report of the directors' report on pages 68 to 69 is consistent with the financial statements.

Directors' remuneration report

In our opinion the auditable part of the Directors' remuneration report on pages 70 to 73 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

Certified Public Accountants
Nairobi 29th March 2019

FCPA Michael Mugasa Practicing certificate No. 1478
Signing partner responsible for the independent audit

Consolidated and Bank statement of comprehensive income

		Group		Bank	
		2018	2017	2018	2017
			Restated		Restated
	Notes	Sh'000	Sh'000	Sh'000	Sh'000
Interest income	5	10,870,018	12,008,522	10,869,514	12,008,341
Interest expense	5	(2,884,962)	(3,237,573)	(2,909,683)	(3,254,365)
Net interest income		7,985,056	8,770,949	7,959,831	8,753,976
Fee and commission income	6	1,229,165	1,435,462	1,186,503	1,378,397
Fee and commission expense	6	(127,158)	(193,505)	(127,158)	(193,367)
Net commission income		1,102,007	1,241,957	1,059,345	1,185,030
Net income from financial instruments at fair value through profit or loss	7	(5,312)	97,127	(5,312)	97,127
Credit impairment losses	16	(2,142,224)	(2,802,767)	(2,142,224)	(2,802,767)
Gains on foreign exchange dealings	7	601,114	526,963	601,114	526,963
Other operating income	8	165,976	369,127	336,780	369,439
Net other operating income		(1,380,446)	(1,809,550)	(1,209,642)	(1,809,238)
Operating expenses	9	(7,791,518)	(7,418,274)	(7,758,619)	(7,389,395)
(Loss) / profit before tax		(84,901)	785,082	50,915	740,373
Income tax credit / (expense)	11	91,909	(374,298)	105,224	(360,376)
Profit for the year		7,008	410,784	156,139	379,997
Other comprehensive income					
Items that may be subsequently reclassified to profit or loss					
Revaluation surplus on Property, plant and equipment		695,867	-	695,867	-
Fair value loss on revaluation of available for sale financial assets		-	(124,755)	-	(124,755)
Fair value loss on financial instruments at FVOCI	19	(8,383)	-	(8,235)	-
Tax effect on above items		(89,063)	37,427	(89,107)	37,427
Total other comprehensive income		598,421	-(87,328)	598,525	(87,328)
Total comprehensive income for the year		605,429	323,456	754,664	292,669
Earnings per share	12				
- Basic and diluted (Sh)		0.02	1.26	0.46	1.17

Consolidated and Bank statement of financial position

		Group		Bank	
		2018	2017	2018	2017
	Notes	Sh'000	Sh'000	Sh'000	Sh'000
Assets					
Cash and balances with Central Bank of Kenya	13	6,117,711	7,500,172	6,117,711	7,500,172
Deposits and balances due from financial institutions	14	2,068,220	2,460,142	2,068,220	2,460,142
Financial investments	15	46,341,772	35,718,032	46,310,604	35,707,852
Loans and advances to customers	16	47,778,777	52,361,043	47,778,777	52,361,043
Other assets	17	3,674,536	3,689,398	3,670,182	3,685,782
Non-current assets held for sale	22	438,569	590,944	438,569	590,944
Other investments	18	366,822	334,134	366,822	334,134
Due from subsidiaries	31	-	-	321,266	69,959
Investment in subsidiaries	20	-	-	19,963	19,963
Property and equipment	21	3,998,833	3,710,949	3,998,390	3,710,328
Intangible assets	23	1,314,221	1,159,618	1,300,050	1,159,618
Current income tax		459,476	486,345	463,362	479,924
Deferred income tax	19	2,290,168	1,862,363	2,289,527	1,862,181
Total assets		114,849,105	109,873,140	115,143,443	109,942,042
Liabilities					
Deposits and balances due to financial institutions	25	6,020,730	5,620,120	6,020,730	5,620,120
Customer deposits	24	98,865,959	94,275,768	99,223,459	94,544,397
Provisions for liabilities	27	59,183	8,747	59,184	8,747
Other liabilities	26	2,930,379	2,734,597	2,904,352	2,721,241
Total liabilities		107,876,251	102,639,232	108,207,725	102,894,505
Equity					
Share capital	28	7,368,906	7,368,906	7,368,906	7,368,906
Statutory credit reserve		3,333,324	2,852,654	3,333,324	2,852,654
Revaluation reserve		1,261,906	670,678	1,261,907	670,678
Other reserves		(136,506)	(132,828)	(136,403)	(132,828)
Accumulated losses		(4,854,776)	(3,525,502)	(4,892,016)	(3,711,873)
Total equity		6,972,854	7,233,908	6,935,718	7,047,537
Total liabilities and equity		114,849,105	109,873,140	115,143,443	109,942,042

The financial statements on pages 80 to 185 were approved and authorised for issue by the board of directors on 28th March 2019 and were signed on its behalf by:

Mr. M A Hassan –Chairman

Mr. W Musau – Managing Director & CEO

Mr. J Nzomo –Director

Mr. H Waswani –Secretary

Consolidated statement of changes in equity

Year ended 31 December 2018	Notes	Share capital Sh'000	Revaluation reserve Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Other reserves Sh'000	Total Sh'000
At start of year		7,214,976	680,430	(1,367,738)	428,282	(45,500)	6,910,450
Comprehensive income for the year							-
Profit for the year		-	-	410,784	-	-	410,784
Other comprehensive income:							
- Fair value loss on revaluation of available for sale financial assets		-	-	-	-	(87,328)	(87,328)
Transfer of excess depreciation		-	(13,931)	13,931	-	-	-
Deferred tax on excess depreciation		-	4,179	(4,179)	-	-	-
Transfer to statutory credit reserve		-	-	(2,424,372)	2,424,372	-	-
Transaction with owners recorded in equity							
Bonus shares issued		153,930	-	(153,930)	-	-	-
At end of year		7,368,906	670,678	(3,525,502)	2,852,654	(132,828)	7,233,908
Year ended 31 December 2017							
At start of year		7,368,906	670,678	(3,525,502)	2,852,654	(132,828)	7,233,908
Impact of initial application of IFRS 9:							
- Additional impairment loss	2.2(c)	-	-	(866,482)	-	-	(866,482)
- Transfer from statutory credit reserve		-	-	1,143,541	(1,143,541)	-	-
		7,368,906	670,678	(3,248,443)	1,709,113	(132,828)	6,367,426
Comprehensive income for the year							
Profit for the year		-	-	7,008	-	-	7,008
Other comprehensive income:							
- Fair value loss on financial instruments at FVOCI		-	-	-	-	(3,678)	(3,678)
- Revaluation surplus, net of tax		-	602,098	-	-	-	602,098
Transfer of excess depreciation		-	(15,528)	15,528	-	-	-
Deferred tax on excess depreciation		-	4,658	(4,658)	-	-	-
Transfer to statutory credit reserve		-	-	(1,624,211)	1,624,211	-	-
At end of year		7,368,906	1,261,906	(4,854,776)	3,333,324	(136,506)	6,972,854

Bank statement of changes in equity

Year ended 31 December 2018	Notes	Share capital Sh'000	Revaluation reserve Sh'000	Retained earnings Sh'000	Statutory reserve Sh'000	Other reserves Sh'000	Total Sh'000
At start of year		7,214,976	680,430	(1,523,321)	428,282	(45,500)	6,754,867
Comprehensive income for the year							
Profit for the year		-	-	379,998	-	-	379,998
Other comprehensive income:							
- Fair value loss on revaluation of available for sale financial assets		-	-	-	-	(87,328)	(87,328)
Transfer of excess depreciation		-	(13,931)	13,931	-	-	-
Deferred tax on excess depreciation		-	4,179	(4,179)	-	-	-
Transfer to statutory reserve		-	-	(2,424,372)	2,424,372	-	-
Transaction with owners recorded in equity							
Bonus shares issued		153,930	-	(153,930)	-	-	-
At end of year		7,368,906	670,678	(3,711,873)	2,852,654	(132,828)	7,047,537
Year ended 31 December 2017							
At start of year		7,368,906	670,678	(3,711,873)	2,852,654	(132,828)	7,047,537
Impact of initial application of IFRS 9:							
- Additional impairment loss	2.2(c)	-	-	(866,482)	-	-	(866,482)
- Transfer from statutory credit reserve		-	-	1,143,541	(1,143,541)	-	-
		7,368,906	670,678	(3,434,814)	1,709,113	(132,828)	6,181,055
Comprehensive income for the year							
Profit for the year		-	-	156,139	-	-	156,139
Other comprehensive income:							
- Fair value loss on financial instruments at FVOCI		-	-	-	-	(3,575)	(3,575)
- Revaluation surplus, net of tax		-	602,099	-	-	-	602,098
Transfer of excess depreciation		-	(15,528)	15,528	-	-	-
Deferred tax on excess depreciation		-	4,658	(4,658)	-	-	-
Transfer to statutory credit reserve		-	-	(1,624,211)	1,624,211	-	-
At end of year		7,368,906	1,261,906	(4,892,016)	3,333,324	(136,403)	6,935,718

Consolidated and Bank statement of cash flows

	Notes	Group 2018 Sh'000	Group 2017 Sh'000	Bank 2018 Sh'000	Bank 2017 Sh'000
Cash flows from operating activities					
Cash generated from operating activities	29	(1,439,852)	735,528	(1,455,070)	860,456
Income tax paid		(3,115)	(42,072)	(2,075)	(24,825)
Net cash generated from operating activities		(1,442,967)	693,456	(1,457,145)	835,631
Cash flows from investing activities					
Purchase of property and equipment	21	(141,631)	(232,825)	(141,623)	(232,825)
Purchase of intangible assets	23	(630,108)	(279,493)	(615,938)	(279,493)
Proceeds from disposal of property		73,134	-	73,134	-
Net cash used in investing activities		(698,605)	(512,318)	(684,427)	(512,318)
(Decrease)/increase in cash and cash equivalents		(2,141,572)	181,138	(2,141,572	323,313
Cash and cash equivalents at 1 January		(2,079,772)	(2,260,910)	(2,079,772)	(2,403,085)
Cash and cash equivalents at 31 December	29	(4,221,344)	(2,079,772)	(4,221,344)	(2,079,772)

Notes

1. Reporting entity

National Bank of Kenya Limited ("the Bank") and its subsidiaries consolidated (together, the "Group") provide banking, bancassurance, financial and related services. The Bank is incorporated in Kenya under the Companies Act as a public limited liability company and is domiciled in Kenya. The Bank's shares are listed on the Nairobi Securities Exchange.

The address of the Bank's registered office is as follows:

National Bank Building
18 Harambee Avenue
P.O. Box 72866 City Square
00200 Nairobi.

2. Summary of significant accounting policies

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

2.0. Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Kenyan Companies Act, 2015.

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

2.1. Basis of preparation

The annual financial statements have been prepared under the historical cost basis except for the following material item in the statement of financial position:-

i) Financial assets measured at fair value through profit or loss or other comprehensive income
ii) Certain classes of property and equipment, measured at fair value
iii) Non-current assets held for sale, measured at the lower of carrying value and the fair value less costs to sell
iv) Loan notes measured at fair value.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures

Application of new and revised International Financial Reporting Standards (IFRSs) and interpretations (IFRIC)

Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following accounting standards and interpretations have been published but were not effective as at 31 December 2018, and have not been early adopted by the Group. The Group's assessment of the impact of the new standards and interpretations is set out below.

IFRS 16 'Leases'

The standard was issued in January 2016 and replaces the existing standard on leases i.e. IAS 17 and other related interpretations. Upon implementation, the standard will will result in almost all leases being recognised on the statement of financial position, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases. The accounting for lessors will not significantly change.

The standard will affect primarily the accounting for Group's operating leases. As at the reporting date, the Group has non-cancellable operating lease commitments of Shs 1,002 million (2017: Shs 1,209 million) (see Note 30 (c)). The Group is still in the process of performing a comprehensive review of its leases, from which exercise, it will determine right of use asset and related liability for future payments, to be recognised.

Some of the commitments may be covered by the exception for short-term and low-value leases and some commitments may relate to arrangements that will not qualify as leases under IFRS 16. The standard is effective for annual periods beginning on or after 1 January 2019. The Group is currently assessing the impact of the standard on its financial statements. The actual impact of applying IFRS 16 on the financial statements for the financial year ending 31 December 2019 will depend on: (a) the final reconciliation of the of the Group's leases' portfolio; (b) the Group's assessment of whether it will exercise any lease renewal options; and (c) the extent to which the Group chooses to utilise practical expedients and recognition exemptions available under the standard especially on the low value and short term leased assets.

On transition, IFRS 16 allows entities not to restate its comparatives. The Group will therefore adopt IFRS 16 on 1 January 2019 using a modified retrospective approach. As such, 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.

IFRIC 23 'Uncertainty over Income Tax Treatments'

This interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. In such circumstances, an entity shall recognise and measure its current or deferred tax asset or liability applying the requirements in IAS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Interpretation. This interpretation addresses: whether an entity considers uncertain tax treatments separately; the assumptions an entity makes about the examination of tax treatments by taxation authorities; how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and how an entity considers changes in facts and circumstances. The IFRIC will be applied retrospectively. The impact on the annual financial statements has not yet been fully determined. The new interpretation is effective on 1 January 2019 and earlier application is permitted. The Group is currently assessing the impact of this IFRIC.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Application of new and revised International Financial Reporting Standards (IFRSs) and interpretations (IFRIC) (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group

IFRS 15 'Revenue from Contracts with Customers'

In May 2015, IFRS 15 was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. Effective 2018, IFRS 15 supersedes the current revenue recognition guidance including IAS 18 Revenue, IAS 11 Construction Contracts and the related interpretations when it becomes effective. The standard is applicable to customer contracts, except for contracts within the scope of the standards on financial instruments, leases and insurance contracts .

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

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

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 reviewed the contracts with customers that are within the scope of this standard and concluded that the adoption of IFRS 15 did not materially impact the Group's revenue recognition criteria and there were therefore no transition adjustments required.

IFRS 9 'Financial instruments'

The Group adopted IFRS 9 on 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements.

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 liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also been applied only to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in the 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 such as IFRS 7, ''Financial Instruments: Disclosures''.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Group. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in note 2.20.

Notes (continued)

2 Summary of significant accounting policies (continued)
2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

(a) Classification and measurement of financial instruments

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

Group

	IAS 39			IFRS 9		
	Category	Measurement	Carrying amount	Category	Measurement	Carrying amount
Financial assets			Sh'000			Sh'000
Cash and balances with Central Bank of Kenya	Loans and receivables	Amortised cost	7,500,172	Financial assets at amortized cost	Amortised cost	7,500,172
Deposits and balances due from financial institutions			2,460,142			2,453,497
Debt securities (Government bonds and bills)			20,813,253			20,813,253
Loans and advances to customers (Excluding loan notes at fair value through profit or loss)			49,935,707			48,792,165
Other assets			1,884,769			1,851,137
Equity investment securities	Financial assets at fair value through profit or loss (FVPL)	FVPL	334,134	Financial assets at fair value through profit or loss (FVPL)	FVPL	334,134
Loans and advances to customers - Loan notes at fair value through profit or loss			2,425,336			2,425,336
Debt securities (Government bonds and bills)	Available for sale	Fair value through other comprehensive income (FVOCI)	14,904,779	Financial assets at fair value through other comprehensive income	FVOCI	14,904,779

Notes (continued)

2. Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

Bank	IAS 39			IFRS 9		
	Category	Measurement	Carrying amount	Category	Measurement	Carrying amount
Financial assets			Sh'000			Sh'000
Cash and balances with Central Bank of Kenya	Loans and Receivables	Amortised Cost	7,500,172	Financial assets at amortised cost	Amortised cost	7,500,172
Deposits and balances due from financial institutions			2,460,142			2,460,142
Debt securities (Government bonds and bills)			20,813,253			20,813,253
Loans and advances to customers (Excluding loan notes at fair value through profit or loss)			49,935,707			49,935,707
Due from subsidiary			69,959			69,959
Other assets			1,884,769			1,884,769
Loans and advances to customers - Loan notes at fair value through profit or loss	Financial assets at fair value through profit or loss (FVPL)	FVPL	2,425,336	Financial assets at fair value through profit or loss (FVPL)	FVPL	2,425,336
Equity investment securities			334,134			334,134
Debt securities (Government bonds and bills)	Available for sale	Fair value through other comprehensive income (FVOCI)	14,894,599	Fair value through other comprehensive income (FVOCI)	FVOCI	14,894,599

There were no changes to the principles of classification and measurement for financial liabilities, other than to changes in the fair value of financial liabilities designated at fair value through profit or loss that are attributable to changes in the instrument's credit risk, which are now presented in other comprehensive income. The Group does not hold any financial liabilities at fair value through profit or loss at present.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 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 performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics. The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

Group

	IAS 39 carrying amount 31 Dec 2017	Reclassifications	Remeasuments	IFRS 9 carrying amount 01 Jan 2018
	Sh'000	Sh'000	Sh'000	Sh'000
Amortised cost				
Cash and balances with Central Bank of Kenya				
Opening balance under IAS 39 and closing balance under IFRS 9	7,500,172	-	-	7,500,172
Deposits & balances due from financial institutions				
Opening balance under IAS 39	2,460,142	-	-	-
Remeasurement: ECL allowance	-	-	(6,645)	-
Closing balance under IFRS 9	-	-	-	2,453,497
Financial assets - Held to maturity (at amortised cost)				
Opening balance under IAS 39 and closing balance under IFRS 9	20 813,253	-	-	20,813,253
Loans and advances to customers				
Opening balance under IAS 39	49,935,707	-	-	-
Remeasurement: ECL allowance	-	-	(1,143,542)	-
Closing balance under IFRS 9	-	-	-	48,792,165
Other assets				
Opening balance under IAS 39	1,884,769	-	-	-
Remeasurement: ECL allowance	-	-	(33,632)	-
Closing balance under IFRS 9	-	-	-	1,851,137
Total financial assets measured at amortised cost	82,594,043	-	(1,183,819)	81,410,224

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

Group

	IAS 39 carrying amount 31 Dec 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 01 Jan 2018
	Sh'000	Sh'000	Sh'000	Sh'000
Fair value through profit or loss (FVPL)				
Loans and advances to customers				
Opening balance under IAS 39 and closing balance under IFRS 9	2,425,336	-	-	2,425,336
Equity securities				
Opening balance under IAS 39	307,130	-	-	-
Addition: From held at cost	-	27,004	-	-
Closing balance under IFRS 9	-	-	-	334,134
Total financial assets measured at FVPL	2,732,466	27,004	-	2,759,470
Fair value through other comprehensive income (FVOCI)				
Financial assets - FVOCI				
Opening balance under IAS 39	-	-	-	-
Addition: From available for sale	-	14,904,779	-	-
Closing balance under IFRS 9	-	-	-	14,904,779
Financial assets - Available for sale				
Opening balance under IAS 39	14,904,779	-	-	-
Subtraction: To FVOCI	-	(14,904,779)	-	-
Closing balance under IFRS 9	-	-	-	-
Total financial assets measured at FVOCI	14,904,779	-	-	14,904,779
Equity instruments at cost				
Equity securities				
Opening balance under IAS 39	27,004	-	-	-
Subtraction: To FVPL	-	(27,004)	-	-
Closing balance under IFRS 9	-	-	-	-
Total equity securities at cost	27,004	(27,004)	-	-

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

Bank

	IAS 39 carrying amount 31 Dec 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 01 Jan 2018
	Sh'000	Sh'000	Sh'000	Sh'000
Amortised cost				
Cash and balances with Central Bank of Kenya				
Opening balance under IAS 39 and closing balance under IFRS 9	7,500,172	-	-	7,500,172
Deposits & balances due from financial institutions				
Opening balance under IAS 39	2,460,142	-	-	-
Remeasurement: ECL allowance	-	-	(6,645)	-
Closing balance under IFRS 9	-	-	-	2,453,497
Financial assets - Held to maturity				
Opening balance under IAS 39 and closing balance under IFRS 9	20 813,253	-	-	20,813,253
Loans and advances to customers				
Opening balance under IAS 39	49,935,707	-	-	-
Remeasurement: ECL allowance	-	-	(1,143,542)	-
Closing balance under IFRS 9	-	-	-	48,792,165
Due from subsidiary				
Opening balance under IAS 39 and closing balance under IFRS 9	69,959			69,959
Other assets				
Opening balance under IAS 39	1,881,153	-	-	
Remeasurement: ECL allowance	-	-	(33,632)	-
Closing balance under IFRS 9	-	-	-	1,847,521
Total financial assets measured at amortised cost	**82,660,386**	**-**	**(1,183,819)**	**81,597,448**
Fair value through profit or loss (FVPL)				
Loans and advances to customers				
Opening balance under IAS 39 and closing balance under IFRS 9	2,425,336		-	2,425,336
Equity securities		-		
Opening balance under IAS 39 and closing balance under IFRS 9	307,130	-	-	-
Addition: From held at cost	-	27,004	-	-
Closing balance under IFRS 9	-	-	-	334,134
Total financial assets measured at FVPL	2,732,466	27,004	-	2,759,470

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

Bank

	IAS 39 carrying amount 31 Dec 2017	Re classifications	Re measuri-ments	IFRS 9 carrying amount 01 Jan 2018
	Sh'000	Sh'000	Sh'000	Sh'000
Fair value through other comprehensive income (FVOCI)				
Financial assets - FVOCI				
Opening balance under IAS 39	-	-	-	-
Addition: From available for sale	-	14,894,599		-
Closing balance under IFRS 9	-	-	-	14,894,599
Financial assets - Available for sale			-	
Opening balance under IAS 39	14,894,599	-	-	-
Subtraction: To FVOCI	-	(14,894,599)		-
Closing balance under IFRS 9	-	-	-	-
Total financial assets measured at FVOCI	14,894,599	-		14,894,599
Equity instruments at cost			-	
Equity securities			-	
Opening balance under IAS 39	27,004	-	-	-
Subtraction: To FVPL	-	(27,004)	-	-
Closing balance under IFRS 9	-	-	-	-
Total equity securities at cost	27,004	(27,004)	-	-

Designation of equity instruments at FVPL

The Group has designated investments of Shs 27,004,000 of non-trading equity securities at FVPL as permitted under IFRS 9. These securities were previously held at cost.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

The following table reconciles the prior period's impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

Group and Bank

Measurement category	IAS 39 carrying amount 31 Dec 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 01 Jan 2018
	Sh'000	Sh'000	Sh'000	Sh'000
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Cash and balances with Central Bank of Kenya	-	-	-	-
Deposits & balances due from financial institutions	-	-	6,645	6,645
Loans and advances to Customers	283,034	-	1,061,865	1,344,899
Other assets	-	-	33,632	33,632
Total	283,034	-	1,102,142	1,385,176
Loan commitments and guarantee contracts				
Loan commitments	-	-	75,402	77,327
Guarantees and letters of credit	-	-	54,014	54,014
Unutilised lines of credit	-	-	6,274	4,349
Total	-	-	135,690	135,690
Total loan loss allowance	283,034	-	1,237,832	1,520,866

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

The total Group and Bank remeasurement adjustment of Shs 1,237,832,000 was recognised in opening reserves at 1 January 2018, affecting various financial statement line items as follows;

Group

	IAS 39 at 31 December 2017	IFRS9 remeasurement adjustment	IFRS 9 at 1 January 2018
	Sh'000	Sh'000	Sh'000
Assets			
Financial investments	35,718,032	-	35,718,032
Loans and advances to customers	52,361,043	(1,143,541)	51,217,502
Deposits and balances due from financial institutions	2,460,142	(6,645)	2,453,497
Other assets	1,884,769	(33,632)	1,851,137
Other non-financial assets	15,586,791	-	15,586,791
Deferred tax	1,862,363	371,348	2,233,711
Total assets	109,873,140	(812,468)	109,060,672
Equity			
Ordinary shares	7,368,906	-	7,368,906
Statutory reserve	2,852,654	(1,143,541)	1,235,936
Other reserves	537,850	-	537,850
Accumulated losses	(3,525,502)	277,059	(3,248,443)
Total equity	7,233,908	(866,482)	6,367,426
Liabilities			
Provisions	8,747	54,014	62,761
All other liabilities	102,630,485	-	102,630,485
Total liabilities	102,639,232	54,014	102,693,246
Total equity and liabilities	109,873,140	(812,468)	109,060,672

Notes (continued)

2 Summary of significant accounting policies (continued)

2.2 Changes in accounting policies and disclosures (continued)

Standards, amendments and interpretations to existing standards that have been adopted as from 1 January 2018 by the Group (Continued)

IFRS 9 Financial Instruments (continued)

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

Bank

	IAS 39 at 31 December 2017	IFRS 9 remeasurement adjustment	IFRS 9 at 1 January 2018
	Sh'000	Sh'000	Sh'000
Assets			
Financial investments	35,718,032	-	35,718,032
Loans and advances to customers	52,361,043	(1,143,541)	51,217,502
Deposits and balances due from financial institutions	2,460,142	(6,645)	2,453,499
Other assets	1,881,153	(33,632)	1,847,521
Other financial and non-financial assets	15,659,309	-	15,659,309
Deferred tax	1,862,363	371,348	2,233,711
Total assets	109,942,042	(812,468)	109,129,574
Equity			
Odinary shares	7,368,906	-	7,368,906
Statutory reserve	2,852,654	(1,143,541)	1,709,113
Other reserves	537,850	-	537,850
Accumulated losses	(3,711,873)	277,0599	(3,434,814)
Total equity	7,047,537	(866,482)	6,181,055
Liabilities			
Provisions	8,747	54,014	62,761
All other liabilities	102,885,758	-	102,885,758
Total liabilities	102,894,505	54,014	102,948,519
Total equity and liabilities	109,942,042	(812,468)	109,129,574

For non-loan financial assets measured at amortised cost and FVOCI such as investments securities, interbank balances and other financial assets, expected credit loss (ECL) was computed using external default data as proxy due to limited historical default statistics relating to the specific instruments internally. The ECL computed at 1 January 2018 and 31 December 2018 was immaterial and as such no ECL has been recognised on these instruments. The Group will continuously evaluate this in future.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.3 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and its subsidiaries National Bank Insurance Agency Limited and Natbank Trustee & Investments Services Limited for the year ended 31 December 2018. All inter-company transactions, balances and gains or losses on transactions between group companies are eliminated in full on consolidation.

(i) Investment in subsidiaries

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 Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date carrying of the acquirer's previously held equity interest in the acquiree is re-measured to its fair value at the acquisition date; any gains or losses arising from such re-measurement are recognised in profit or loss.

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IFRS 9 either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not re-measured, and its subsequent settlement is accounted for within equity.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the-acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill.If the total of consideration transferred, non-controlling interest recognised and previously held interest measured is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the profit or loss.

Inter-company transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated. When necessary, amounts reported by subsidiaries have been adjusted to conform to the Group's accounting policies.

(ii) Changes in ownership interests 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 subsidiaries is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

Notes (continued)

2 Summary of significant accounting policies (continued)

2.3 Basis of consolidation (continued

(iii) Disposal of subsidiaries

When the Group ceases to have control any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

2.4 Interest income and expense

Interest income and expense for all interest earning/ bearing financial instruments, are recognised within interest income or interest expense in profit or loss using the effective interest method except for;

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

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

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Once a financial asset or group of similar 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 the purpose of measuring the impairment loss.

2.5 Fees and commissions

Fees and commissions summarily include account ledger fees, transaction charges, advances commitment and appraisal fees and service commissions. Fees relating to services provided or received by the Group are recognised as the services are provided, say on completion of an underlying transaction. Other fee and commission expenses relate mainly to transaction and service fees, which are expensed as the services are received.

2.6 Foreign currency trading income

This arises from the margins which are achieved through market-making and customer business and from changes in market value caused by movements in exchange rates. It comprises gains and losses related to trading assets and liabilities, and includes all realised and unrealised foreign exchange differences.

2.7 Investments in subsidiary companies

Investments in subsidiary companies are stated at cost less impairment loss where applicable.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.8 Other Income

The Group receives revenues streams that are not directly attributable to banking activity; this is generally recognised as other income and includes items like profit on disposal of assets, rental income from leased property, debt collection from written-off advances and securities trading.

2.9 Property and equipment

Land and buildings are recognised at fair value, based on periodic valuation that are conducted at least every five years by independent external valuers, less subsequent depreciation for buildings. A revaluation surplus is credited to other reserves in shareholders' equity. All other property and equipment are recognised at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of these assets.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits will flow to the Group and the cost of the item can be measured reliably. Maintenance and repairs, which do not meet these criteria, are recognised in profit or loss as incurred.

Depreciation

Freehold land is not depreciated. Depreciation on other property and equipment is calculated to write off their cost or valuation in equal annual instalments over their estimated useful lives. Depreciation, impairment losses and gains or losses on disposal of assets are included in profit or loss.

The estimated useful lives of tangible assets for the current financial year are as follows:

Buildings on long leasehold and freehold land	2%
Buildings on short leasehold land	over the unexpired period of the lease
Computers	20%
Motor vehicles	20%
Equipment, furniture and fittings	12.5%

Short leasehold land refers to leases whose lease period does not exceed 50 years.

Depreciation methods, useful lives and residual values are reviewed each financial year end and adjusted, if necessary.

Impairment

Property and equipment are reviewed for impairment on an annual basis. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is immediately written down to its recoverable amount. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed through profit or loss only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes (continued)

2. Summary of significant accounting policies (continued)

Impairment (continued)

Gains or losses on disposal of property and equipment are determined by comparing proceeds with carrying amount and are taken into account in determining operating profit.

Long and short leasehold land

Payments to acquire leasehold interest in land are treated as operating lease prepayments and amortised over the period of the lease.

2.10 Non-current assets held for sale

Non-current assets, comprising assets that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale and are measured at the lower of carrying amount and fair value less costs to sell.

2.11 Intangible assets

Costs that are clearly associated with an identifiable and unique product which will be controlled by the Group and has a probable benefit exceeding the cost beyond one year, are recognised as an intangible asset. Expenditure which enhances and extends computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original costs of the software.

Computer software development costs recognised as assets are stated at cost less amortisation. Amortisation is calculated on a straight line basis over the estimated useful lives not exceeding a period of 5 years. Amortisation methods, useful lives and residual values are reviewed each financial year end and adjusted, if necessary.

Work in progress

Work in progress relates to the acquisition of banking software and related hardware; and the construction of the Banking halls for the branches under the branch expansion program. Costs include materials, direct labour and any other direct expenses incurred in respect of the project. Depreciation of these assets commences when the assets are ready for their intended use.

2.12 Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

(i) Current income tax

The current income tax payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(ii) Deferred income tax

Deferred income tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and

Notes (continued)

2. Summary of significant accounting policies (continued)

(ii) Deferred income tax (continued)

liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

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

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

(iii) Current and deferred tax for the year

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.

2.13 Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Kenya shillings, which is the group's presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except for differences arising on translation of non-monetary financial assets carried at fair value through other comprehensive income, which are recognised in other comprehensive income.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within ''finance income or costs''. All other foreign exchange gains and losses are presented in the statement of profit or loss for the year within ''other gains/losses-net''.

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

The Group does not have any foreign operations.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.14 Statutory reserve

Central Bank of Kenya prudential guidelines require the Group to set aside certain prescribed amounts for impairment losses on loans and advances. Where impairment losses required by Central Bank regulations exceed those computed under IFRS, the excess is recognised as a statutory loan loss reserve and is accounted for as an appropriation of retained earnings. The statutory loan loss reserve is non-distributable.

2.15 Property revaluation surplus

This arises on revaluation of land and buildings and is not distributable. When revalued land or buildings are sold, the portion of the properties revaluation reserve that relates to that asset is transferred directly to retain earnings. Items of other comprehensive income included in the properties revaluation reserve will not be reclassified subsequently to profit or loss.

2.16 Investments revaluation reserve

This represents the unrealised increase or decrease in the value of investments at fair value through other comprehensive income, excluding impairment losses. The reserve is not distributable to the shareholders.

2.17 Employee benefits

(i) Retirement benefit obligations

a. The Group's defined contribution pension scheme

The Group operates a defined contribution scheme for its employees. The assets of this scheme are held in a separate trustee administered fund. The scheme is funded by contributions from both the employees and employer. Benefits are paid to retiring staff in accordance with the scheme rules. The Group's contribution is charged to profit or loss.

b. Statutory defined contribution pension scheme

The Group also contributes to the statutory National Social Security Fund (NSSF). This is a defined contribution scheme registered under the National Social Security Act. The Group's obligations under the scheme are limited to specific contributions legislated from time to time. The Group's obligations to staff retirement benefit schemes are charged to the profit or loss in the year to which they relate.

(ii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. An accrual is made for the estimated liability for annual leave accrued at the end of the reporting period.

Certain employees of the Group are entitled to service gratuity on resignation or termination of employment based on the salary at the time of such resignation or termination of services. The service gratuity is provided for in the financial statements as it accrues to each employee.

2.18 Other investments

Other investments comprise quoted and unquoted equity instruments. Unquoted investments are classified as available for sale and are stated at cost less impairment loss where applicable. Quoted investments are classified as fair value through profit or loss and are stated at their fair value determined by the published price in the stock exchange markets they are traded in.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.19 Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the company by the weighted average number of ordinary shares in issue during the year. Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary share shareholders and the weighted average number of ordinary shared outstanding for the effects of all dilutive potential shareholders if any.

2.20 Provisions and contingent liabilities

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. Provisions are measured at the present value of the expenditure expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

Letters of credit, acceptances, guarantees and performance bonds are generally written by the Group to support performance by a customer to third parties. The Group is only required to meet these obligations in the event of the customer's default. These obligations are accounted for as off-balance sheet transactions and disclosed as contingent liabilities. Undisbursed commitments provided by the Group are approved loans, overdrafts or lines of credit that have not been disbursed.

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.

2.21 Financial instruments

2.21.1 Current year accounting policies for financial assets and liabilities

(i) Recognition

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

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21 Financial instruments (continued)

2.21.1 Current year accounting policies for financial assets and liabilities (continued)

(i) Recognition

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

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

- When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss.
- In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

(ii) Classification and measurement

Financial liabilities

The Group measures all financial liabilities including customer deposits and borrowings at amortised cost, except for:

1. 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;
2. Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition or when the continuing involvement approach applies. When the transfer of financial asset did not qualify for derecognition, 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
3. Financial guarantee contracts and loan commitments

Derecognition of financial liabilities

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires) and the consideration paid and payable is recognised in profit or loss.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.20 Financial instruments (continued)

2.20.1 Current year accounting policies for financial assets and liabilities (continued)

(ii) Classification and measurement (continued)

Financial assets

The Group classifies its financial assets into the following categories: Financial assets at fair value through profit or loss (FVPL); Financial assets at fair value through other comprehensive income (FVOCI); Financial assets at amortised cost. Management determines the appropriate classification of its investments at initial recognition. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

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

a) Debt instruments

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

(i) the Group's business model for managing the asset; and
(ii) the cash flow characteristics of the asset.

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

<u>Amortised cost:</u> 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 measured and recognised. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

<u>Fair value through other comprehensive income (FVOCI):</u> 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 'Other operating income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

<u>Fair value through profit or loss (FVPL):</u> 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 'Other operating income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'other operating income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.20 Financial instruments (continued)

2.20.1 Current year accounting policies for financial assets and liabilities (continued)

(ii) Classification and measurement (continued)

Financial assets (continued)

a) Debt instruments (continued)

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, 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 how the cash flows for these assets will be collected, how the asset's performance is evaluated and reported to Asset Liabilities Committee (ALCO) and how risks are assessed and managed. 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 FVPL.

Solely payments of principal and interest

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.

b) Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. The Group measures all equity investments at fair value through profit or loss. Gains and losses on equity investments at FVPL are included in the 'Other operating income' line in the statement of profit or loss.

(iii) Impairment of financial assets

At the end of each reporting period, all financial assets are subject to review for 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:

Notes (continued)

2. Summary of significant accounting policies (continued)

(ii) Classification and measurement (continued)

2.21 Financial instruments (continued)

2.21.1 Current year accounting policies for financial assets and liabilities (continued)

a) Debt instruments (Continued)

(iii) Impairment of financial assets

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

(iv) Restructure 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 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.
- Significant extension of the loan term when the borrower is not in financial difficulty.

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).

(vi) Derecognition

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.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21 Financial instruments (continued)

2.21.1 Current year accounting policies for financial assets and liabilities (continued)

(vi) Derecognition

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:

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

Collateral 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.

Offsetting financial assets and financial liabilities

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

Financial guarantee contracts and loan commitments

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 provision.

Derivative financial instruments

The Group enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign currency exchange rate risks, including currency forward exchange contracts, interest rate swaps and cross currency swaps.

Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value at the end of each reporting period. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21 Financial instruments (continued)

2.21.1 Current year accounting policies for financial assets and liabilities (continued)

Derivative financial instruments (continued)

instrument, in which event the timing of recognition of gains or losses in the profit or loss will depend on the nature of the hedge relationship. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Derivatives embedded in the non-derivative host contracts are treated as separate derivatives when:

- their risks and economic characteristics are not closely related to those of the host contract;
- a separate instrument with the same terms would meet the definition of a derivative; and
- the hybrid contract is not measured at fair value through profit or loss.

2.21.2 Comparative accounting policies for financial assets and liabilities

The IAS 39 related accounting policies below are provided because financial instruments comparative balances were recognised and measured under this standard.

(i) Classification and measurement

Financial liabilities

Debt and equity instruments are classified, as either financial liabilities or as equity in accordance with the substance of the contractual agreement.

After initial recognition, the Group measures all financial liabilities including customer deposits and borrowings other than liabilities held for trading at amortised cost. Liabilities held for trading (financial liabilities acquired principally for the purpose of generating a profit from short-term fluctuations in price or dealer's margin) are subsequently measured at their fair values.

Interest-bearing borrowings are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings.

Derecognition of financial liabilities

Financial liabilities are derecognised and the consideration paid and payable is recognised in profit or loss.

Financial assets

The Group classifies its financial assets into the following categories: Financial assets at fair value through profit or loss; loans and receivables; held- to- maturity investments; and available-for-sale assets. Management determines the appropriate classification of its investments at initial recognition. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21.2 Comparative accounting policies for financial assets and liabilities (continued)

(i) Classification and measurement (continued)

Financial assets (continued)

Financial assets at fair value through profit or loss

This category has two sub-categories: Financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading. 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 of financial assets at fair value through profit or loss are included in the profit or loss in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

a) Those classified as held-for-trading and those that the Group on initial recognition designates as at fair value through profit or loss;
b) Those that the Group upon initial recognition designates as available-for-sale; or
c) Those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

Held to maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value including direct and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method. Were the Group to sell more than an insignificant amount of held-to-maturity assets, the entire category would be tainted and would have to be reclassified as available-for-sale.

Available-for-sale financial assets

Financial assets that are not (a) financial assets at fair value through profit or loss, (b) loans and receivables, or (c) financial assets held to maturity are classified under this category

Available-for-sale financial assets are subsequently carried at fair value. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income and accumulated in the revaluation reserve, with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognised in profit or loss. Where the investment is disposed off or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21 Financial instruments (continued)

2.21.2 Comparative accounting policies for financial assets and liabilities (continued)

Financial assets (continued)

Available-for-sale financial assets (continued)

Where fair value cannot be reliably measured, the unquoted investment is carried at cost. Dividends on available-for-sale equity instruments are recognised in the profit or loss when the Group's right to receive payment is established.

Fair values of quoted investments in active markets are based on quoted bid prices. Equity securities for which fair values cannot be measured reliably are measured at cost less impairment.

(ii) Subsequent measurement of financial assets

Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Available-for-sale financial assets and financial assets at fair value through profit or loss are carried at fair value. Gains and losses arising from changes in the fair value of 'financial assets at fair value through profit or loss' are included in profit or loss in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income and cumulated in a separate reserve in equity until the financial asset is de-recognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in the profit or loss when the Company's right to receive payment is established.

(iii) Impairment and uncollectability of financial assets

At the end of each reporting period, all financial assets are subject to review for impairment. If it is probable that the Group will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans, receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The carrying amount of the asset is reduced to its estimated recoverable amount through use of an allowance account. The amount of the loss incurred is included in profit or loss for the period.

If a loss on a financial asset carried at fair value (recoverable amount is below original acquisition cost) has been recognised directly in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative net loss that had been recognised directly in other comprehensive income is removed from equity and recognised in profit or loss for the period even though the financial asset has not been derecognised.

Objective evidence that financial assets are impaired can include observable data that comes to the attention of the Group about the following loss events:

- Significant financial difficulty of the borrower,
- default or delinquency by a borrower,
- restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider,
- indications that a borrower or issuer will enter bankruptcy,
- 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.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.21 Financial instruments (continued)

2.21.2 Comparative accounting policies for financial assets and liabilities (continued)

Financial assets (continued)

(iii) Impairment and uncollectability of financial assets (continued)

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that is, on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral types, past due status and other relevant factors. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

a) Assets carried at amortised cost

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

b) Assets carried at fair value

Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of equity to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in equity. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(v) Offsetting financial instruments

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

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

2.22 Repurchase agreement transactions

Securities purchased from the Central Bank of Kenya under agreements to resell (''reverse repos''), are disclosed as balances with the Central Bank of Kenya as they are held until their maturity after which they are repurchased and are not negotiable/discounted during the tenure. The difference between the sale and repurchase price is treated as interest and accrued over the life of the repurchase agreement using the effective yield method.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.23 Leases

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

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

The Group as lessee

Operating lease payments are recognised as an expense in profit or loss on a straight-line basis over the lease term. Contingent rent payable is recognised as an expense in the period in which it is incurred. Prepaid operating leases are accounted for as an asset using the straight-line method of amortisation over the period of the lease.

Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

2.24 Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from these financial statements where the Group acts in a fiduciary capacity such as nominee, trustee or agent.

2.25 Cash and cash equivalents

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

2.26 Dividends

Dividends are charged to equity in the period in which they are declared. Proposed dividends are not accrued until they have been ratified at the Annual General Meeting.

2.27 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.

The chief operating decision maker is the person or Group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Executive Management Committee as its chief operating decision maker. All transactions between business segments are conducted on commercial terms basis with intra-segment revenue and costs being eliminated at Group level.

Notes (continued)

2. Summary of significant accounting policies (continued)

2.28 Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.29 Comparatives

Where necessary, comparative figures have been restated to conform with changes in presentation and/or measurement in the current year.

3 Critical accounting estimates and judgements in applying the Group's accounting policies

In the process of applying the Group's accounting policies, Directors and management have made estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. These are dealt with below:

i. Going concern

The financial statements have been prepared on a going concern basis which assumes the entity will remain in operation and continue to meet its obligations as they fall due for the foreseeable future.

At year end, the liquidity ratio was at 43% against the minimum statutory ratio of 20%. However, as shown under Note 4, the Bank is significantly in breach of the regulatory capital ratios due to historical credit losses on loans and advances. This could affect the Group's ability to continue in operation without restrictions.

The principal shareholders have provided confirmation to the board of directors of their continued efforts to execute a comprehensive and long term capital solution for the Bank.

The Board and management continue to implement other internal initiatives to restore capital involving disposal of non-core assets, investment in new products and platforms to boost profitability, cost reduction initiatives and accelerated recovery of the non performing book.

The directors believe that the capital restoration plan will be achieved and accordingly, have prepared the financial statements on a going concern basis.

ii. Impairment losses on financial assets

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

3 Critical accounting estimates and judgements in applying the Group's accounting policies (continued)

ii. Impairment losses on financial assets (continued)

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

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL;
- Establishing groups of similar financial assets for the purposes of measuring ECL;
- Determining period of exposure for revolving credit facilities i.e credit cards and overdrafts; and
- Determining business models and assessing the ''SPPI'' requirements for financial assets.

As at 31 December 2018, certain key judgements and estimations were made regarding the above items, as they relate to the determination of expected credit losses on financial assets. Out of those, the highest sources of uncertainty and their sensitivities are as follows;

For non-performing (stage 3) loans and advances:

i) Recoverable amounts of collateral for stage 3 (non-performing) loans: Were the net present value of estimated cash flows on the non performing portfolio to differ by +/-1%, the impairment loss would vary by Shs 165 million (2017: Shs 158 million).

For performing (stage 1 & 2) loans and advances:

ii) Probabilities of default (PDs): Were the PDs determined using historical trends to vary by +/-5%, the expected credit loss on this portfolio of assets would vary by Shs 16 million (2017: Shs 30 million).

iii) Secured loss given defaults (LGDs) – Were the LGDs determined using collateral values, adjusted for time and cost to recovery, to vary by +/-5%, the expected credit loss would vary by Shs 39 million (2017: Shs 71 million).

iv) Forward looking information (FLI) adjustment factor. Refer to note 4.1.3 (d) for further details.

iii. Investments at amortised cost

The Group follows the guidance of IFRS 9 on classifying non-derivative financial assets held to collect and whose cash flows meet SPPI, as amortised cost. This classification requires significant judgement including evaluation of the Group's business model and the cash flow characteristics of the instrument. If the Group sells a significant portion of the assets or disposes frequently from the portfolio – it will be required to reclassify the entire class as FVOCI, and to measure them at fair value.

If all investments at amortised cost were to be so reclassified, the carrying value would decrease by Shs 609 million (2017: Shs 1,675 million), with a corresponding entry in the fair value reserve in shareholders' equity.

iv. Valuation of loan notes held 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.

3 Critical accounting estimates and judgements in applying the Group's accounting policies (continued)

iv. Valuation of loan notes held at fair value (continued)

The Group holds loan notes that are measured at fair value through profit or loss. For these, fair value is composed of two key cash flow components, being the interest receivable on the loan notes and valuation of the shares upon whose sale the principal debt amount will be realised. Any shortfall from the above cash flow streams is covered, albeit partially, by government guarantees.

To determine the value of the shares, the Group utilises valuation models that incorporate both observable and unobservable inputs such as quoted prices and/or suitable proxies. These prices are then subjected to valuation adjustments which include, but are not limited to liquidity adjustments. The selection and application of these models and the related inputs is judgmental.

Changes in assumptions about these factors could affect the reported fair value of loan notes. At 31 December 2018, the fair value of the loan notes would have been an estimated Shs 65 million higher (2017: Shs 241 million) and Shs 65 million lower (2017:Shs 175 million), if the discount applied on the day's quoted share price was assumed to be 5% lower/higher respectively.

v. Income taxes

The Group is subject to Kenyan taxation laws and regulations. In the normal course of business, there may be transactions and calculations, 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.

For financial reporting purposes, estimates are required in determining the provision for income taxes, especially relating to matters under dispute. 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. 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.

4 Financial risk management

Introduction and overview

The Group's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the Group's business, and operational risks are an inevitable consequence of being in business.

The Group's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on its financial performance.

The most important types of risk include:
- Credit risk
- Liquidity risk

Notes (continued)

- Market risk- includes currency, interest rate and price risk

4 Financial risk management (continued)

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework.

The Board has established a Board Audit and Risk Committee and a risk department to assist in the discharge of this responsibility. The board has also established the Credit, Finance, Information & Technology Committee, the Tender Committee and Operations and Marketing Committees which are responsible for developing and monitoring risk management in their respective areas. These committees comprise of non-executive members and report regularly to the Board of Directors.

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

The Group's Audit and Risk Committee is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group.

The Audit and Risk Committee is assisted in these functions by internal audit and the risk departments. Internal audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The risk department is responsible for the development of detailed risk management policies and for the day to day implementation of those policies.

4.1 Credit risk

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

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities ('trading exposures') including non-equity trading portfolio assets and derivatives as well as settlement balances with market counterparties and reverse repurchase agreements.

Credit risk is the single largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. The credit risk management and control are centralised in a credit risk management team which reports regularly to the Board of Directors and head of each business unit.

For risk management reporting purposes, the Group considers and consolidates all elements of credit risk exposure.

The Board of Directors has delegated responsibility for the management of credit risk to its Credit Committee and Risk Committee. Board Credit Committee has delegated this responsibility to the Management Credit Committee which is responsible for oversight of the Group's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit credit officers. Larger facilities require approval by the Management Credit Committee or the Board Credit Committee as appropriate.

  Reviewing and assessing credit risk.

  The Credit department assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.

- **Limiting concentrations of exposure** to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

- **Developing and maintaining the Group's risk gradings** in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of eight grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by the Board Credit Committee.

- **Reviewing compliance** of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the credit department on the credit quality of local portfolios and appropriate corrective action is taken.

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

4.1.1 Credit risk grading

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9.

The Group uses internal credit risk grading that reflect its assessment of the credit worthiness of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application is fed into this rating model. In addition, the models enable expert judgement from the Director, Credit to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The following are additional considerations for each type of portfolio held by the Group:

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

Notes (continued)

4. Financial risk management (continued)

4.1 Credit risk (continued)

4.1.1 Credit risk grading (continued)

The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9.

The Group uses internal credit risk grading that reflect its assessment of the credit worthiness of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application is fed into this rating model. In addition, the models enable expert judgement from the Director, Credit to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The following are additional considerations for each type of portfolio held by the Group:

Retail

After the date of initial recognition, for retail business, the borrowers are grouped into a pre-determined cluster with similar loan characteristics. The payment behaviour of the different clusters are monitored on a periodic basis to ascertain the probability of default.

Corporate & Business

For wholesale business, the probability of default is determined at the borrower level. Any new information or credit assessment of the borrower is incorporated into the credit. Where it is difficult to ascertain the PD at a borrower level, the PD is determined at a segment or product level.

Treasury

Banks overnight lending are ascribed the risk rate attached to counterparties by the Central Bank in the money Market.

4.1.2 Relationship between the bank's internal credit ratings and external ratings

The Group's rating method comprises 2 rating levels for instruments not in default (Stage 1 & 2) and one default class (stage 3). The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of observed default trends. The Group's quantitative credit quality grading as compared to Central Bank of Kenya's prudential guidelines grading is summarised in the table below;

Rating	CBK grading	Days past due	Credit quality
Stage 1	Normal	Up to date within contractual terms or has less than 30 days arrears	Performing
Stage2	Watch	31 to 90 days	Performing-SICR
Stage 3	Substandard	91 to 180 days	In Default
	Doubtful	181 to 360 days	
	Loss	above 360 days	

In addition to the standard credit ratings above, the Group also utilises other qualitative information relating to counterparties to determine their internal credit grading.

Notes (continued)

4. Financial risk management (continued)

4.1.3 Expected credit loss measurement

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

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

The key judgements and assumptions adopted by the Group in computing expected loss in line with IFRS 9 are as follows:

(a) Significant increase in credit risk (SICR)

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

- Significant dip in operating results of the borrowers
- Credit distress necessitated extension to the terms granted
- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates
- Significant change in collateral value which is expected to increase risk of default
- Early signs of cashflow/liquidity problems such as delay in servicing of trade creditors/loans

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

(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:

Quantitative criteria :The borrower is more than 90 days past due on the contractual payments.

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
- The borrower is in breach of financial covenant(s)
- 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
- Increase in probability that the borrower will enter bankruptcy
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.3 Expected credit loss measurement (continued)

(b) Definition of default and credit-impaired assets (continued)

The criteria above has 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 is aligned to Central Bank of Kenya's prudential guidelines.

The criteria above has 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 is aligned to Central Bank of Kenya's prudential guidelines.

(c) Measuring ECL – Inputs, assumptions and estimation techniques

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

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months, or over the remaining lifetime 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 or over the remaining lifetime (Lifetime EAD). For a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur, using a determined credit conversion factor.
- Loss Given Default (LGD) represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure or collective segment and multiplied together which effectively calculates an ECL.

The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis. Where sufficient data is not available to estimate the 12M PD transition into lifetime PDs, the Group interpolates its internal 12-month PD to external rating agencies long term proxies to estimate the lifetime PDs.

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.3 Expected credit loss measurement (continued)

(c) Measuring ECL – Inputs, assumptions and estimation techniques (continued)

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

- For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12month or lifetime basis.
- For revolving products, the exposure at default is predicted by taking current drawn 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 recoveries made post default. These vary by product type.

- For secured products, this is primarily based on expected recovery from collateral force sale values, adjusted for time to repossession and recovery costs observed.
- For unsecured products, LGD's are typically derived from past recoveries from past defaults of unsecured products or the residual unsecured portions of partly secured exposures.

(d) Forward looking information factor

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 are adjusted to the ECL. The forward looking economic variables have been adjusted by a management multiplier.

Sensitivity analysis

The most significant assumption affecting the ECL allowance is interest rates given its impact on borrowers' ability to meet their contractual repayments. Other forward looking consideration not otherwise incorporated within the calculation of ECL, such as inflation, GDP and exchange rates, have been considered but do not have a material impact therefore no adjustment has been to ECL for such factors. This is reviewed and monitored periodically.

Set out below are the changes to the ECL as at 31 December 2018 that would result from reasonably possible changes in this parameter from actual assumptions used in the Group's economic variable assumptions;

	Interest rates	
	-5%	+5%
	Shs 000	Shs 000
Corporate portfolio	741	(741)
Retail portfolio	1,167	(1,167)
Project finance portfolio	124	(124)

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.3 Expected credit loss measurement (continued)

(e) Impaired financial assets

Impaired financial assets are those which the Group determines it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s). These loans are classified under stage 3 in the Group's internal credit risk grading system and graded as grade 3 to 5 as required by the regulator. According to the Central Bank of Kenya prudential guidelines, loans and advances overdue by over 90 days are considered non performing.

(f) Past due but not impaired financial assets

Financial assets where contractual interest or principal payments are past due but the Group believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Group. Loans under this category are no more than 90 days overdue.

(g) Loans and advances that are neither past due nor impaired

The Group classifies loans and advances under this category for those exposures that are up to date and in line with contractual agreements. Such loans would have demonstrated financial conditions, risk factors and capacity to repay that are acceptable. These exposures will normally be maintained largely within approved product programs and with no signs of impairment or distress.

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.4 Credit risk exposure

The table below represents the maximum credit risk exposure to the Group and Bank at 31 December 2018 and 2017, for financial instruments where an ECL allowance has been recognised. The gross carrying amount also represents maximum exposure to credit risk on these assets.

		2018			2017
Group	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Total**
	12 - Month ECL	**Lifetime ECL**	**Lifetime ECL**		
	Shs 000	**Shs 000**	**Shs 000**	**Shs 000**	**Shs 000**
Gross balances					
Cash and balances with Central Bank of Kenya	6,117,711	-	-	6,117,711	7,500,172
Deposits and balances due from Banking institutions	975,024	-	1,462,481	2,437,505	2,813,393
Government securities	46,341,772	-	-	46,341,772	9,960,314
Loans and advances to customers:					
- Corporate loans	6,002,682	4,193,301	27,123,597	36,964,840	37,429,539
- Retail loans	13,581,229	1,422,459	2,915,114	17,918,802	18,844,081
- Project finance loans	1,196,528	1,690,874	2,671,976	5,559,378	5,545,859
Other assets	1,827,178	-	-	1,827,178	1,906,366
	76,042,124	7,306,634	33,818,428	117,167,186	83,999,724
Credit loss allowance					
Loans and advances to customers	426,448	504,293	14,091,091	15,021,832	11,883,772
Deposits and balances due from Banking institutions	9,025	-	360,260	369,285	353,251
Other assets	60,932	-	-	60,932	21,597
	496,405	504,293	14,451,351	15,452,049	12,258,620
Carrying amount	75,545,719	6,802,341	19,367,077	101,715,137	71,741,104

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

Bank	Stage 1	Stage 2	Stage 3	Total	Total
	2018				2017
	12 - Month ECL	Lifetime ECL	Lifetime ECL		
	Shs 000	Shs 000	Shs 000	Shs 000	Shs 000
Gross balances					
Cash and balances with Central Bank of Kenya	6,117,711	-	-	6,117,711	7,500,172
Deposits and balances due from Banking institutions	975,024	-	1,462,481	2,437,505	2,813,393
Government securities	46,310,604	-	-	46,310,604	9,960,314
Loans and advances to customers:				-	
- Corporate loans	6,002,682	4,193,301	26,768,857	36,964,840	37,429,539
- Retail loans	13,581,229	1,422,459	2,915,114	17,918,802	18,844,081
- Project finance loans	1,196,528	1,690,874	2,671,976	5,559,378	5,545,859
Other assets	1,822,864	-	-	1,822,864	1,902,750
	76,006,642	7,306,634	33,818,428	117,131,704	83,996,108
Credit loss allowance					
Loans and advances to customers	426,448	504,293	14,091,091	15,021,832	11,883,772
Deposits and balances due from Banking institutions	9,025	-	360,260	369,285	353,251
Other assets	60,932	-	-	60,932	21,597
	496,405	504,293	14,451,351	15,452,049	12,258,620
Carrying amount	75,510,237	6,802,341	19,367,077	101,679,655	71,737,488

The table below represents the maximum credit risk exposure to the Group from financial assets not subject to impairment;

	Group and Bank 2018	2017
	Sh '000	Sh '000
Loans and advances to customers at fair value		
	2,395,589	2,425,336

Other facilities that may expose the Group to credit risk are included in Note 30 (a) of these financial statements.

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.5 Write-off policy

The Group writes off a loan / security balance (and any related allowances for impairment losses) when the Credit department determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

4.1.6 Restructure of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery. Such restructuring activities include extended repayment period, payment moratorium and writing off part of the debt.

Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original.

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 upgraded from Stage 3 or Stage 2 to Stage 1. This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more.

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

4.1.7 Impairment assessment for non-loan financial assets

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

- uses external credit ratings as proxies to infer approximate PDs;
- assumes 100% LGDs; and
- EADs are estimated based on the expected maturities of the instruments, most of which are less than 12 months.

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.8 Collateral and other credit enhancements

(a) Collateral

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

Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2018 or 2017.

The table below shows the collateral coverage on the Bank's maximum exposure to credit risk. The table includes collateral that management takes into consideration in the management of the bank's exposures to credit risk. All on- and off- balance sheet exposures that are exposed to credit risk, including non-performing loans, have been included.

Collateral includes:

- Physical items, such as property, plant and equipment
- Debentures over obligors' assets
- Financial guarantees and intangible assets
- Other

	Group and Bank			
	2018		2017	
	Sh'000	Security coverage	Sh'000	Security coverage
Overdrafts	4,676,718	70%	5,553,786	93%
Mortgages	18,030,487	100%	17,991,648	100%
Secured term loans	30,619,714	80%	29,738,364	80%
Credit Cards	256,380	0%	218,755	0%
Unsecured loans	9,217,310	0%	10,742,262	0%
Total on-balance sheet items	62,800,609	82%	64,244,815	82%
Off- balance sheet items	5,285,441	100%	7,237,833	100%

(b) Lending limits

The Bank maintains strict control limits on net open derivative positions (that is, the difference between purchase and sale contracts) by both amount and term. The amount subject to credit risk is limited to expected future net cash inflows of instruments, which in relation to derivatives are only a fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not always obtained for credit risk exposures on these instruments, except where the Bank requires margin deposits from counterparties.

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Bank's market transactions on any single day.

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.8 Collateral and other credit enhancements (continued)

(c) Master netting arrangements

The Bank further restricts its exposure to credit losses by entering into master netting arrangements with counterparties with which it undertakes a significant volume of transactions. Master netting arrangements do not generally result in an offset of assets and liabilities of the statement of financial position, as transactions are either usually settled on a gross basis or under most netting agreements the right of set off is triggered only on default. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if a default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as it is affected by each transaction subject to the arrangement.

(d) Financial covenants (for credit related commitments and loan books)

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan.

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

The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

4.1.9 Impairment and provisioning policies

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

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

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.9 Impairment and provisioning policies (continued)

The following tables explain the changes in the credit loss allowance in the year due to these factors;

Group and Bank	Stage 1 12 - Month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	Sh' 000	Sh' 000	Sh' 000	Sh' 000
Corporate loans				
At start of year	77,094	634,272	9,397,824	10,109,190
Net staging transfers	(279,098)	(114,504)	393,602	-
Changes in PDs/LGDs/EADs	275,958	(290,654)	1,547,372	1,532,676
Changes in model assumptions	-	-	(156,177)	(156,177)
Modification of contractual cash flows	-	46,934	(368,616)	(321,682)
Net charge to profit or loss in the year	(3,140)	(276,048)	10,814,005	11,164,007
Other movements with no profit or loss impact				
Write offs	-	-	(27,232)	(27,232)
At year end	73,954	276,048	10,786,773	11,136,775
Retail loans				
At start of year	541,875	72,062	1,864,325	2,478,262
Net staging transfers	(452,466)	(45,597)	498,064	-
Changes in PDs/LGDs/EADs	227,122	151,344	598,577	977,042
Changes in model assumptions	-	-	(9,001)	(9,001)
Net charge to profit or loss in the year	316,531	177,809	2,951,964	3,446,304
Other movements with no profit or loss impact				
Write offs	-	-	(120,474)	(120,474)
At year end	316,531	177,809	2,831,490	3,325,830
Project finance loans				
At start of year	62,194	39,079	338,589	439,862
Net staging transfers	(89,448)	(112,077)	201,525	-
Changes in PDs/LGDs/EADs	63,217	123,434	(54,247)	132,404
Changes in model assumptions	-	-	(13,039)	(13,039)
Net charge to profit or loss in the year	35,963	50,436	472,828	559,227
Other movements with no profit or loss impact				
Write offs	-	-	-	-
At year end	35,963	50,436	472,828	559,227

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.9 Impairment and provisioning policies (continued)

Significant changes in the gross carrying amounts of loans and advances to customers that contributed to movements in loss allowances were new loans advanced in the year, as well as write off of impaired loans. The following tables explains changes in the gross carrying amount loans and advances to help explain the changes in the loss allowance;

Group and Bank	Stage 1 12 - Month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	Sh' 000	Sh' 000	Sh' 000	Sh' 000
Corporate loans				
Gross carrying amount at 1 January 2018	7,876,628	11,406,825	18,146,087	37,429,540
Net staging transfers	(737,962)	(816,579)	1,554,541	-
Net new financial assets originated or purchased	(287,671)	(151,461)	60,098	(379,034)
Modification of contractual cash flows of financial assets	-	763,551	(3,518,146)	(2,754,595)
Changes in interest accrual	83,234	25,679	2,730,038	2,838,951
Write-offs	-	-	(27,232)	(27,232)
FX and other movements	(35,131)	(34,714)	(72,944)	(142,789)
Gross carrying amount	6,899,098	11,193,301	18,872,442	36,964,841
Retail loans				
Gross carrying amount as at 1 January 2018	16,071,307	966,900	1,805,874	18,844,081
Net staging transfers	(1,060,743)	554,106	506,637	-
Net new financial assets originated or purchased	(188,107)	(103,761)	(783,750)	(1,075,618)
Modification of contractual cash flows of financial assets	-	-	-	-
Changes in interest accrual	10,017	5,350	255,405	270,772
Write-offs	-	-	(120,474)	(120,474)
FX and other movements	-	-	41	41
Gross carrying amount	14,832,474	1,422,595	1,663,733	17,918,802
Project finance loans				
Gross carrying amount at 1 January 2018	2,527,152	1,461,289	1,557,418	5,545,859
Net staging transfers	(62,559)	41,344	21,215	-
Net new financial assets originated or purchased	(1,277,266)	177,020	918,442	(181,804)
Modification of contractual cash flows of financial assets	-	-	-	-
Changes in interest accrual	9,216	12,316	179,679	201,211
Write-offs	-	-	-	-
FX and other movements	(15)	(1,096)	(4,777)	(5,888)
Gross carrying amount	1,196,528	1,690,873	2,671,977	5,559,378

Notes (continued)

4 Financial risk management (continued)

4.1 Credit risk (continued)

4.1.10 Concentrations of risk

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

Advances to customers- gross	Group and Bank 2018		2017	
	Sh'000	%	Sh' 000	%
Agriculture	1,394,853	2	1,511,227	3
Manufacturing	4,236,089	7	3,101,714	5
Wholesale and retail trade	12,447,577	20	15,587,311	26
Transport and communications	4,572,942	7	8,756,540	10
Mining and quarrying	3,864	0	6,333	0
Building and construction	3,367,122	6	3,183,758	5
Business services	26,888,988	42	19,659,843	30
Real estate	9,889,174	16	12,438,089	21
	62,800,609	100	64,244,815	100

Off balance sheet items	Group and Bank 2018		2017	
	Sh'000	%	Sh' 000	%
Social community and personal services	37,216	1	1,858,145	26
Business services	2,464,812	47	804,093	11
Wholesale and retail	69,917	1	2,393,300	33
Transport and communication	2,711,495	51	1,961,648	27
Manufacturing	2,000	0	220,647	3
	5,285,441	100	7,237,833	100

4.2 Settlement risk

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

For certain types of transactions the Group mitigates this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations.

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

4 Financial risk management (continued)

4.3 Liquidity risk

This represents the risk that the Group, despite being solvent, is unable to maintain or generate sufficient cash resources to meet its payment obligations as they fall due, or can only do so on materially disadvantageous terms. This inability to maintain or generate sufficient cash resources may arise where the Group's funding activities do not provide sufficient liquidity and/or counterparties who provide the Group with short-term funding withdraw or do not rollover that funding, or normally liquid assets become illiquid as a result of a generalised disruption in asset markets.

Management of liquidity risk

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

Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Group as a whole.

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

Details of the reported Bank ratio of net liquid assets to deposits and balances due to banking institutions and customer deposits at the reporting date and during the reporting period were as follows:

	Group and Bank	
	2018	**2017**
At 31 December	43%	36%
Average for the period	36%	32%
Maximum for the period	43%	38%
Minimum for the period	29%	27%
Statutory minimum requirement	20%	20%

Notes (continued)

4 Financial risk management (continued)

4.3 Liquidity risk (continued)

The tables below presents the cash flows payable by the Group under non-derivative financial liabilities by the remaining contractual maturities as at 31 December 2018 and 2017. The amounts disclosed in the table are the contractual undiscounted cash flows, whereas the Group manages the inherent liquidity risk based on expected un-discounted inflows.

Group	Carrying amount	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total unndiscounted cash flows
31 December 2018	**Sh'000**	**Sh'000**	**Sh'000**	**Sh'000**	**Sh'000**	**Sh'000**	**Sh'000**
Financial liabilities							
Customer deposits	98,865,959	88,603,125	5,482,967	8,535,750	-	-	102,621,842
Deposits and balances due to financial institutions	6,020,730	6,562,596	-	-	-	-	6,562,596
Other liabilities	2,930,379	2,930,379	-	-	-	-	2,930,379
Total financial liabilities	107,817,068	98,096,100	5,482,967	8,535,750	-	-	112,114,817
Financial assets							
Cash and balances with Central Bank of Kenya	6,117,711	6,117,711	-	-	-	-	6,117,711
Deposits and balances due from financial institutions	2,068,220	620,773	-	-	1,462,481	-	2,083,254
Government securities	46,341,772	-	3,930	773,365	17,892,179	46,587,015	65,256,489
Loans and advances to customers (net)	47,778,777	2,875,705	2,771,322	4,462,703	19,429,500	35,475,057	65,014,287
Other assets	1,766,246	1,766,246	-	-	-	-	1,766,246
Total financial assets	104,072,726	11,380,435	2,775,252	5,236,068	38,784,160	82,062,072	140,237,987
Net on-balance sheet liquidity gap	(3,744,342)	(86,715,665)	(2,707,715)	(3,299,682)	38,784,160	82,062,072	28,123,170
Unrecognised financial instruments							
Letters of credit and guarantees	5,285,441	-	109,422	3,669,916	1,494,453	11,650	5,285,441
Unutilised credit facilities	1,997,706	1,997,706	-	-	-	-	1,997,706
Net off-balance sheet liquidity gap	7,283,147	1,997,706	109,422	3,669,916	1,494,453	11,650	7,283,147
Net liquidity gap	(11,027,489)	(88,713,371)	(2,817,137)	(6,969,598)	37,289,707	82,050,422	20,840,023

Notes (continued)

4 Financial risk management (continued)

4.3 Liquidity risk (continued)

Bank 31 December 2018	Carrying amount Sh'000	Up to 1 month Sh'000	1-3 months Sh'000	3-12 months Sh'000	1-5 years Sh'000	Over 5 years Sh'000	Total unndiscounted cash flows Sh'000
Financial liabilities							
Customer deposits	99,223,459	88,963,306	5,482,967	8,535,750	-	-	102,982,023
Deposits and balances due to financial institutions	6,020,730	6,562,596	-	-	-	-	6,562,596
Other liabilities	2,904,352	2,904,352	-	-	-	-	2,904,352
Total financial liabilities	108,148,541	98,430,254	5,482,967	8,535,750	-	-	112,448,971
Financial assets							
Cash and balances with Central Bank of Kenya	6,117,711	6,117,711	-	-	-	-	6,117,711
Deposits and balances due from financial institutions	2,068,220	620,773	-	-	1,462,481	-	2,083,253
Government securities	46,310,604	-	-	769,175	17,892,031	46,556,621	65,217,827
Loans and advances to customers (net)	47,778,777	2,875,705	2,771,322	4,462,703	19,429,500	35,475,057	65,014,287
Due from subsidiary company	321,266	321,266	-	-	-	-	321,266
Other assets	1,761,892	1,761,892	-	-	-	-	1,761,892
Total financial assets	104,358,470	11,697,347	2,771,322	5,231,878	38,784,012	82,031,678	140,516,237
Net on-balance sheet liquidity gap	(3,790,071)	(86,732,907)	(2,711,645)	(3,303,872)	38,784,012	82,031,678	28,067,266
Unrecognised financial instruments							
Letters of credit and guarantees	5,285,441	-	109,422	3,669,916	1,494,453	11,650	5,285,441
Unutilised credit facilities	1,997,706	1,997,706	-	-	-	-	1,997,706
Net off-balance sheet liquidity gap	7,283,147	1,997,706	109,422	3,669,916	1,494,453	11,650	7,283,147
Net liquidity gap	(11,073,218)	(88,730,613)	(2,821,067)	(6,973,788)	37,289,559	82,020,028	20,784,119

Notes (continued)

4 Financial risk management (continued)

4.3 Liquidity risk (continued)

Group 31 December 2017	Carrying amount Sh'000	Up to 1 month Sh'000	1-3 months Sh'000	3-12 months Sh'000	1-5 years Sh'000	Over 5 years Sh'000	Total undiscounted cash flows Sh'000
Financial liabilities							
Customer deposits	94,275,768	84,629,875	4,954,605	5,840,405	-	-	95,424,885
Deposits and balances due to financial institutions	5,620,120	5,662,271	-	-	-	-	5,662,271
Other liabilities	2,489,626	2,489,626	-	-	-	-	2,489,626
Total financial liabilities	102,385,514	92,781,772	4,954,605	5,840,405	-	-	103,576,782
Financial assets							
Cash and balances with Central Bank of Kenya	7,500,172	7,500,172	-	-	-	-	7,500,172
Deposits and balances due from financial institutions	2,460,142	1,362,276	-	-	1,452,608	-	2,814,884
Government securities	35,718,032	347,335	252,803	1,451,036	28,560,465	20,291,227	50,902,866
Loans and advances to customers (net)	52,361,043	16,223,457	4,205,615	2,947,265	20,938,673	27,819,427	72,134,437
Other assets	2,005,650	2,005,650	-	-	-	-	2,005,650
Total financial assets	100,045,039	27,438,890	4,458,418	4,398,301	50,951,746	48,110,654	135,358,009
Net on-balance sheet liquidity gap	(2,340,475)	(65,342,882)	(496,187)	(1,442,104)	50,951,746	48,110,654	31,781,227
Unrecognised financial instruments							
Letters of credit and guarantees	7,237,833	8,155	7,167	7,221,730	780	-	7,237,832
Unutilised credit facilities	1,530,093	1,530,093	-	-	-	-	1,530,093
Net off-balance sheet liquidity gap	8,767,926	1,538,248	7,167	7,221,730	780	-	8,767,925
Net liquidity gap	(11,108,401)	(66,881,130)	(503,354)	(8,663,834)	50,950,966	48,110,654	23,013,302

Notes (continued)

4 Financial risk management (continued)

4.3 Liquidity risk (continued)

Bank 31 December 2017	Carrying amount Sh'000	Up to 1 month Sh'000	1-3 months Sh'000	3-12 months Sh'000	1-5 years Sh'000	Over 5 years Sh'000	Total undiscounted cash flows Sh'000
Financial liabilities							
Customer deposits	94,544,397	84,629,875	4,954,605	6,071,005	-	-	95,655,485
Deposits and balances due to financial institutions	5,620,120	5,662,271	-	-	-	-	5,662,271
Other liabilities	2,476,592	2,476,592	-	-	-	-	2,476,592
Total financial liabilities	102,641,109	92,768,738	4,954,605	6,071,005	-	-	103,794,348
Financial assets							
Cash and balances with Central Bank of Kenya	7,500,172	7,500,172	-	-	-	-	7,500,172
Deposits and balances due from financial institutions	2,460,142	1,362,276	-	-	1,452,608	-	2,814,884
Government securities	35,707,852	337,146	252,803	1,451,036	28,560,465	20,291,227	50,892,677
Loans and advances to customers (net	52,361,043	16,223,457	4,205,615	2,947,265	20,938,673	27,819,427	72,134,437
Due from subsidiary company	69,959	69,959	-	-	-	-	69,959
Other assets	2,002,034	2,002,034	-	-	-	-	2,002,034
Total financial assets	100,101,202	27,495,044	4,458,418	4,398,301	50,951,746	48,110,654	135,414,163
Net on-balance sheet liquidity gap	(2,539,907)	(65,273,694)	(496,187)	(1,672,704)	50,951,746	48,110,654	31,619,815
Unrecognised financial instruments							
Letters of credit and guarantees	7,237,833	8,155	7,167	7,221,730	780	-	7,237,832
Unutilised credit facilities	1,530,093	1,530,093	-	-	-	-	1,530,093
Net off-balance sheet liquidity gap	8,767,926	1,538,248	7,167	7,221,730	780	-	8,767,925
Net liquidity gap	(11,307,833)	(66,811,942)	(503,354)	(8,894,434)	50,950,966	48,110,654	22,851,890

Notes (continued)

4 Financial risk management (continued)

4.3 Liquidity risk (continued)

The previous table shows the undiscounted cash flows on the Group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity.

The Group's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognised loan commitments are not all expected to be drawn down immediately.

The gross nominal inflow/(outflow) disclosed in the previous table is the contractual, undiscounted cash flow on the financial liability or commitment.

4.4 Market risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Group's income or the value of its holdings of financial instruments.

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

4.4.1 Management of market risk

Overall responsibility for management of market risk rests with a management committee of the Group, the Asset and Liability Committee (ALCO). The risk department is responsible for the development of detailed market risk management policies (subject to review and approval by ALCO) and for the day to day implementation of those policies.

a) Interest rate risk

The Group is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The maturities of asset and liabilities and the ability to replace at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the Group's exposure to changes in interest rates and liquidity.

Interest rates on advances to customers and other risk assets are either pegged to the Group's base lending rate. The base rate is adjusted from time to time to reflect the cost of funds.

ALCO closely monitors the interest rate trends to minimise the potential adverse impact of interest rate changes.

The tables below summarise the exposure to interest rate risks as at 31 December 2018 and 2017. Included in the tables are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The Group does not bear an interest rate risk on off balance sheet items.

Notes (continued)

4 Financial risk management (continued)

4.4 Market risks (continued)

a) Interest rate risk (continued)

Group 31 December 2018	Less than 1 month Sh'000	1 month less than 3 months Sh'000	3 months less than 6 months Sh'000	6 months less than 1 year Sh'000	1 year less than 3 years Sh'000	3 years less than 5 years Sh'000	Over 5 years Sh'000	Non-interest bearing	Total
Financial assets									
Cash and balances with Central Bank of Kenya	-	-	-	-	-	-	-	6,117,711	6,117,711
Deposits and balances due from banking institutions	835,808	-	-	-	-	-	-	1,232,412	2,068,220
Government securities held to maturity	-	-	205,790	509,476	3,534,241	8,805,193	33,287,071	-	46,341,772
Loans and advances to customers (net)	-	47,778,777	-	-	-	-	-	-	47,778,777
Other investments	-	-	-	-	-	-	-	366,822	366,822
Other assets	-	-	-	-	-	-	-	1,766,246	1,766,246
Total financial assets	835,808	47,778,777	205,790	509,476	3,534,241	8,805,193	33,287,072	9,483,191	104,439,548
Financial liabilities									
Customer deposits	509,407	39,161,240	-	-	-	-	-	59,195,312	98,865,959
Deposits and balances due to banking institutions	4,645,138	-	50,000	-	-	-	-	1,325,592	6,020,730
Other liabilities	-	-	-	-	-	-	-	2,930,379	2,930,379
Total financial liabilities	5,154,546	39,161,240	50,000	-	-	-	-	63,451,282	107,817,068
Interest rate sensitivity gap	(4,318,737)	8,617,537	155,790	509,476	3,534,241	8,805,193	33,287,072	(53,968,091)	(3,377,520)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

a) Interest rate risk (continued)

Bank 31 December 2018	Less than 1 month Sh'000	1 month less than 3 months Sh'000	3 months less than 6 months Sh'000	6 months less than 1 year Sh'000	1 year less than 3 years Sh'000	3 years less than 5 years Sh'000	Over 5 years Sh'000	Non-interest bearing	Total
Financial assets									
Cash and balances with Central Bank of Kenya	-	-	-	-	-	-	-	6,117,711	6,117,711
Deposits and balances due from banking institutions	835,808	-	-	-	-	-	-	1,232,412	2,068,220
Government securities held to maturity	-	-	201,946	503,719	3,534,241	8,805,091	33,265,607	-	46,310,604
Loans and advances to customers (net)	-	47,778,777	-	-	-	-	-	-	47,778,777
Other investments	-	-	-	-	-	-	-	366,822	366,822
Other assets	-	-	-	-	-	-	-	1,761,892	1,761,892
Total financial assets	835,808	47,778,777	201,946	503,719	3,534,241	8,805,091	33,265,607	9,478,837	104,404,026
Financial liabilities									
Customer deposits	509,407	39,161,240	-	-	-	-	-	59,552,812	99,223,459
Deposits and balances due to banking institutions	4,645,138	-	50,000	-	-	-	-	1,325,592	6,020,730
Other liabilities	-	-	-	-	-	-	-	2,904,352	2,904,352
Total financial liabilities	5,154,545	39,161,240	50,000	-	-	-	-	63,782,756	108,148,541
Interest rate sensitivity gap	(4,318,737)	8,617,537	151,946	503,719	3,534,241	8,805,091	33,265,607	(54,303,911)	(3,744,515)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

a) Interest rate risk (continued)

Group 31 December 2017	Less than 1 month Sh'000	1 month less than 3 months Sh'000	3 months less than 6 months Sh'000	6 months less than 1 year Sh'000	1 year less than 3 years Sh'000	3 years less than 5 years Sh'000	Over 5 years Sh'000	Non-interest bearing	Total
Financial assets									
Cash and balances with Central Bank of Kenya	-	-	-	-	-	-	-	7,500,172	7,500,172
Deposits and balances due from banking institutions	-	-	-	-	-	-	-	2,460,142	2,460,142
Government securities held to maturity	-	357,497	190,936	1,378,465	3,681,236	16,251,648	13,858,250	-	35,718,032
Loans and advances to customers (net)	52,361,043	-	-	-	-	-	-	-	52,361,043
Other investments	-	-	-	-	-	-	-	334,134	334,134
Other assets	-	-	-	-	-	-	-	1,884,769	1,884,769
Total financial assets	52,361,043	357,497	190,936	1,378,465	3,681,236	16,251,648	13,858,250	12,179,217	100,258,292
Financial liabilities									
Customer deposits	20,674,248	30,702,161	-	-	-	-	-	42,899,359	94,275,768
Deposits and balances due to banking institutions	5,620,120	-	-	-	-	-	-	-	5,620,120
Other liabilities	-	-	-	-	-	-	-	2,743,344	2,743,344
Total financial liabilities	26,294,368	30,702,161	-	-	-	-	-	45,642,703	102,639,232
Interest rate sensitivity gap	26,066,675	(30,344,664)	190,936	1,378,465	3,681,236	16,251,648	13,858,250	(33,463,486)	(2,380,940)

4. Financial risk management (continued)

4.4 Market risks (continued)

a) Interest rate risk (continued)

Group 31 December 2017	Less than 1 month Sh'000	1 month less than 3 months Sh'000	3 months less than 6 months Sh'000	6 months less than 1 year Sh'000	1 year less than 3 years Sh'000	3 years less than 5 years Sh'000	Over 5 years Sh'000	Non-interest bearing	Total
Financial assets									
Cash and balances with Central Bank of Kenya	-	-	-	-	-	-	-	7,500,172	7,500,172
Deposits and balances due from banking institutions	-	-	-	-	-	-	-	2,460,142	2,460,142
Government securities held to maturity	-	354,587	190,936	1,378,465	3,681,236	16,251,648	13,850,940	-	35,707,812
Loans and advances to customers (net)	52,361,043	-	-	-	-	-	-	-	52,361,043
Other Investments	-	-	-	-	-	-	-	334,134	334,134
Other assets	-	-	-	-	-	-	-	1,881,153	1,881,153
Total financial assets	52,361,043	354,587	190,936	1,378,465	3,681,236	16,251,648	13,850,940	12,175,601	100,244,456
Financial liabilities									
Customer deposits	19,403,919	30,556,941	-	-	-	-	-	44,583,537	94,544,397
Deposits and balances due to banking institutions	5,620,120	-	-	-	-	-	-	-	5,620,120
Other liabilities	-	-	-	-	-	-	-	2,729,988	2,729,988
Total financial liabilities	25,024,039	30,556,941	-	-	-	-	-	47,313,525	102,894,505
Interest rate sensitivity gap	27,337,004	(30,202,354)	190,936	1,378,465	3,681,236	16,251,648	13,850,940	(35,137,924)	(2,650,049)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

a) Interest rate risk (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group.

Interest rate risks – Increase/decrease of 5 % in Net Interest Margin

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

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

The table below sets out the impact on future net interest income of an incremental 5% parallel fall or rise in all yield curves at the beginning of each quarter during the 12 months from 1 January 2019

	Amount at 31 December Sh'000	Scenario 1 5% increase in net interest margin Sh'000	Scenario 2 5% decrease in net interest margin Sh'000
2018			
Profit before taxation	50,915	448,907	(347,077)
Adjusted core capital	2,103,967	2,501,959	1,705,976
Adjusted total capital	3,432,369	3,830,360	3,034,377
Risk weighted assets (RWA)	92,858,549	92,858,549	92,858,549
Adjusted core capital to RWA	2.27%	2.69%	1.84%
Adjusted total capital to RWA	3.70%	4.12%	3.27%
2017			
Profit before taxation	740,373	1,075,770	404,976
Adjusted core capital	3,504,584	3,620,675	3,385,896
Adjusted total capital	4,772,225	4,888,315	4,653,537
Risk weighted assets (RWA)	87,997,708	87,997,708	87,997,708
Adjusted core capital to RWA	3.98%	4.11%	3.85%
Adjusted total capital to RWA	5.42%	5.56%	5.29%

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk

The Group operates wholly within Kenya and its assets and liabilities are carried in local currency.

The Group trades with correspondent banks and takes deposits and lends in foreign currencies. The Group is exposed to the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates.

The Group's currency position and exposure are managed within the exposure guideline of 10% (2017 - 10%) of the core capital as stipulated by the Central Bank of Kenya. This position is reviewed on a daily basis by management.

The exchange rates used for translating the major foreign currency balances at the year-end were as follows:

	Group and Bank	
	2018 Sh'000	2017 Sh'000
US Dollar	101.90	103.30
GB Pound	130.43	139.63
Euro	116.73	123.89

Notes (continued)

4 . Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk (continued)

The tables below summarise the Group's exposure to foreign currency exchange rate risk as at the end of 31 December 2018 and 2017.

Group 2018	KSHS Sh'000	USD Sh'000	GBP Sh'000	EUR Sh'000	Other Sh'000	Total Sh'000
Financial assets						
Cash and balances with Central Bank of Kenya	5,432,574	572,940	57,241	47,023	7,933	6,117,711
Deposits and balances due from financial institutions	1,461,155	369,519	80,424	125,189	31,933	2,068,220
Government securities	46,341,772	-	-	-	-	46,341,772
Loans and advances to customers (net)	37,692,125	9,944,044	78,357	64,251	-	47,778,777
Other investments	56,055	310,767	-	-	-	366,822
Other assets	1,448,289	316,966	991	-	-	1,766,246
Total financial assets	92,431,970	11,514,236	217,013	236,463	39,866	104,439,548
Financial liabilities						
Customer deposits	88,653,724	9,930,493	136,795	139,084	5,863	98,865,959
Deposits and balances due to financial institutions	3,952,160	2,068,570	-	-	-	6,020,730
Other liabilities	2,711,896	218,422	58	3	-	2,930,379
Total financial liabilities	95,317,780	12,217,485	136,853	139,087	5,863	107,817,068
Net foreign exchange gap	(2,885,810)	(703,249)	80,160	97,376	34,003	(3,377,520)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk (continued)

The tables below summarise the Bank's exposure to foreign currency exchange rate risk as at the end of 31 December 2018 and 2017.

Bank 2018	KSHS Sh'000	USD Sh'000	GBP Sh'000	EUR Sh'000	Other Sh'000	Total Sh'000
Financial assets						
Cash and balances with Central Bank of Kenya	5,432,574	572,940	57,241	47,023	7,933	6,117,711
Deposits and balances due from financial institutions	1,461,155	369,519	80,424	125,189	31,933	2,068,220
Government securities	46,310,604	-	-	-	-	46,310,604
Loans and advances to customers (net)	37,692,125	9,944,044	78,357	64,251	-	47,778,777
Other investments	56,055	310,767	-	-	-	366,822
Other assets	1,448,289	316,966	991	-		1,766,246
Total financial assets	92,400,802	11,514,236	217,013	236,463	39,866	104,408,380
Financial liabilities						
Customer deposits	89,011,223	9,930,493	136,795	139,084	5,863	99,223,459
Deposits and balances due to financial institutions	3,952,160	2,068,570	-	-	-	6,020,730
Other liabilities	2,685,869	218,422	58	3	-	2,904,352
Total financial liabilities	95,649,253	12,217,485	136,853	139,087	5,863	108,148,541
Net foreign exchange gap	(3,248,451)	(703,249)	80,160	97,376	34,003	(3,740,161)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk (continued)

The tables below summarise the Group's exposure to foreign currency exchange rate risk as at the end of 31 December 2018 and 2017.

Group 2017	KSHS Sh'000	USD Sh'000	GBP Sh'000	EUR Sh'000	Other Sh'000	Total Sh'000
Financial assets						
Cash and balances with Central Bank of Kenya	6,667,775	562,216	200,087	61,495	8,599	7,500,172
Deposits and balances due from financial institutions	1,838,643	-	621,500	-	-	2,460,142
Government securities	35,718,032	-	-	-	-	35,718,032
Loans and advances to customers (net)	41,377,065	10,983,918	2	58	-	52,361,043
Other investments	56,126	278,008	-	-	-	334,134
Other assets	3,304,455	357,067		17,288	10,588	3,689,398
Total financial assets	88,962,096	12,181,209	821,589	78,841	19,187	102,062,921
Financial liabilities						
Customer deposits	83,040,471	10,780,042	357,897	93,062	4,297	94,275,768
Deposits and balances due to financial institutions	3,539,852	2,080,268	-	-	-	5,620,120
Other liabilities	2,505,766	217,929	1,379	17,389	881	2,743,344
Total financial liabilities	89,086,089	13,078,239	359,276	110,451	5,178	102,639,232
Net foreign exchange gap	(123,993)	(897,030)	462,313	(31,610)	14,009	(576,311)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk (continued)

The tables below summarise the Bank's exposure to foreign currency exchange rate risk as at the end of 31 December 2018 and 2017.

Bank 2017	KSHS Sh'000	USD Sh'000	GBP Sh'000	EUR Sh'000	Other Sh'000	Total Sh'000
Financial assets						
Cash and balances with Central Bank of Kenya	6,667,775	562,216	200,087	61,495	8,599	7,500,172
Deposits and balances due from financial institutions	1,838,643	-	621,500	-	-	2,460,143
Government securities	35,707,852	-	-	-	-	35,707,852
Loans and advances to customers (net)	41,377,065	10,983,918	2	58	-	52,361,043
Other investments	56,126	278,008	-	-	-	334,134
Other assets	3,300,839	357,067	-	17,288	10,588	3,685,782
Total financial assets	88,948,300	12,181,209	821,589	78,841	19,187	102,049,126
Financial liabilities						
Customer deposits	83,309,100	10,780,042	357,897	93,062	4,297	94,544,398
Deposits and balances due to financial institutions	3,539,852	2,080,268	-	-	-	5,620,120
Other liabilities	2,492,410	217,929	1,379	17,389	881	2,729,988
Total financial liabilities	89,341,362	13,078,239	359,276	110,451	5,178	102,894,506
Net foreign exchange gap	(393,062)	(897,030)	462,313	(31,610)	14,009	(845,380)

Notes (continued)

4. Financial risk management (continued)

4.4 Market risks (continued)

b) Foreign exchange risk

Foreign exchange risk – Appreciation/depreciation of Shs against other currencies by 10%

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

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

The table below sets out the impact on future earnings of an incremental 10% parallel fall or rise in all foreign currencies at the beginning of each quarter during the 12 months from 1 January 2019.

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

	Amount at 31 December Sh'000	Scenario 1 10% appreciation Sh'000	Scenario 2 510% decrease Sh'000
2018			
Profit before taxation	50,915	(145,769)	247,599
Adjusted core capital	2,103,967	1,907,283	2,300,651
Adjusted total capital	3,432,369	3,235,685	3,629,052
Risk weighted assets (RWA)	92,858,549	92,858,549	92,858,549
Adjusted core capital to RWA	2.27%	2.05%	2.48%
Adjusted total capital to RWA	3.70%	3.48%	3.91%
2017			
Profit before taxation	740,373	681,240	799,506
Adjusted core capital	3,504,584	3,482,589	3,523,982
Adjusted total capital	4,772,225	4,750,230	4,791,623
Risk weighted assets (RWA)	87,997,708	87,997,708	87,997,708
Adjusted core capital to RWA	3.98%	3.96%	4.00%
Adjusted total capital to RWA	5.42%	5.40%	5.45%

4 Financial risk management (continued)

4.5 Fair value of financial assets and liabilities

Determination of fair value and fair values hierarchy

IFRS 7 and IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have been utilised to arrive at the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

The following table shows an analysis of financial and non- financial instruments measured at fair value by level of the fair value hierarchy:

Group	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000	Total Sh'000
At 31 December 2018				
Financial assets				
Equity investments	339,818	-	27,004	366,822
Loan notes at fair value through profit or loss	-	2,357,589	-	2,357,589
Securities at fair value through other comprehensive income	26,168,605	1,994,968	-	28,163,573
	26,508,423	4,352,557	27,004	30,887,984
Non- financial assets				
Leasehold land and buildings	-	-	2,264,949	2,264,949
Non-current assets held for sale	-	-	438,569	438,569
	-	-	2,703,518	2,703,518
At 31 December 2017				
Financial assets				
Equity investments	307,130	-	-	307,130
Loan notes at fair value through profit or loss	-	2,425,336	-	2,425,336
Available for sale securities	14,904,780	561,735	-	15,466,515
	15,211,910	2,987,071	-	18,198,891
Non- financial assets				
Leasehold land and buildings	-	-	1,558,295	1,558,295
Non-current assets held for sale	-	-	590,944	590,944
	-	-	2,149,239	2,149,239

Notes (continued)

4 Financial risk management (continued)

4.5 Fair value of financial assets and liabilities (continued)

Bank	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000	Total Sh'000
At 31 December 2018				
Financial assets				
Equity investments	339,818	-	27,004	366,822
Loan notes at fair value through profit or loss	-	2,357,589	-	2,357,816
Securities at fair value through other comprehensive income	26,137,437	1,994,968	-	28,132,405
	26,477,255	4,352,557	27,004	30,856,693
Non- financial assets				
Leasehold land and buildings	-	-	2,264,949	2,264,949
Non-current assets held for sale	-	-	438,569	438,569
	-	-	2,703,518	2,703,518
At 31 December 2017				
Financial assets				
Equity investments	307,130	-	-	307,130
Loan notes at fair value through profit or loss	-	2,425,336	-	2,425,336
Available for sale securities	14,894,599	561,735	-	15,456,334
	15,201,729	2,987,071	-	18,188,800
Non- financial assets				
Leasehold land and buildings	-	-	1,558,295	1,558,295
Non-current assets held for sale	-	-	590,944	590,944
	-	-	2,149,239	2,149,239

Notes (continued)

4 Financial risk management (continued)

4.5 Fair value of financial assets and liabilities (continued)

The following table summarises the carrying amounts and fair value of those assets and liabilities not held at fair value. The carrying amount of assets and liabilities held at amortised costs is considered to approximate the fair value of the assets and liabilities.

Group 2018	Carrying Value Sh'000	Fair Value Sh'000	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000
Assets at amortised cost					
Cash and balances from Central Bank	6,117,711	6,117,711	-	6,117,711	-
Deposits due from financial institutions	2,068,220	2,068,220	-	2,068,220	-
Financial Assets at amortised cost	18,178,199	17,709,491	17,709,491	-	-
Loans and advances at amortised cost	45,424,311	48,889,515	-	-	48,889,515
Total	71,788,441	74,784,937	17,709,491	8,185,931	48,889,515
Liabilities at amortised cost					
Customer deposits	98,865,959	101,246,198	-	-	101,246,198
Deposits and balances due to financial institutions	6,020,730	6,065,886	-	6,065,886	-
Other liabilities	2,930,379	2,688,421	-	-	2,688,421
Total	107,817,068	110,000,505		6,065,886	103,934,619

Group 2017	Carrying Value Sh'000	Fair Value Sh'000	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000
Assets at amortised cost					
Cash and balances from Central Bank	7,500,172	7,500,172	-	7,500,172	-
Deposits due from financial institutions	2,460,142	2,460,142	-	2,460,142	-
Held to maturity securities	20,813,253	18,825,982	18,825,982	-	-
Loans and advances at amortised cost	49,935,707	53,239,863	-	-	53,239,863
Equity investments	27,004	27,004		-	27,004
Total	80,736,278	82,053,163	18,825,982	9,960,314	53,266,867
Liabilities at amortised cost					
Customer deposits	94,275,768	94,837,047	-	-	94,837,047
Deposits and balances due to financial institutions	5,620,120	5,662,271	-	5,662,271	-
Other liabilities	2,743,344	2,516,829	-	-	2,516,829
Total	102,639,232	103,016,147	-	5,662,271	97,353,876

Notes (continued)

4 Financial risk management (continued)

iv) Fair value of financial assets and liabilities

Bank 2018	Carrying Value Sh'000	Fair Value Sh'000	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000
Assets at amortised cost					
Cash and balances from Central Bank	6,117,711	6,117,711	-	6,117,711	-
Deposits due from financial institutions	2,068,220	2,068,220	-	2,068,220	-
Held to maturity securities	18,178,199	17,699,889	17,699,889	-	-
Loans and advances at amortised cost	45,424,311	48,889,515	-	-	48,889,515
Due from subsidiary companies	321,266	321,266	-	-	321,266
Total	72,109,707	72,096,601	17,699,889	8,185,931	49,210,781
Liabilities at amortised cost					
Customer deposits	99,223,459	101,603,697	-	-	101,603,697
Deposits and balances due to financial institutions	6,020,730	6,065,886	-	6,065,886	-
Other liabilities	2,904,352	2,664,542	-	-	2,664,542
Total	108,148,541	110,334,125	-	6,065,886	104,268,239

Bank 2017	Carrying Value Sh'000	Fair Value Sh'000	Level 1 Sh'000	Level 2 Sh'000	Level 3 Sh'000
Assets at amortised cost					
Cash and balances from Central Bank	7,500,172	7,500,172	-	7,500,172	-
Deposits due from financial institutions	2,460,142	2,460,142	-	2,460,142	-
Held to maturity securities	20,813,253	18,825,982	18,825,982	-	-
Loans at amortised cost	49,935,707	53,239,863	-	-	53,239,863
Equity investments	27,004	27,004	-	-	27,004
Due from a subsidiary company	69,959	69,959	-	-	69,959
Total	80,826,237	82,123,122	18,825,982	9,960,314	53,336,826
Liabilities at amortised cost					
Customer deposits	94,544,397	95,086,636	-	-	95,086,636
Deposits and balances due to financial institutions	5,620,120	5,662,271	-	5,662,271	-
Other liabilities	2,729,988	2,504,576	-	-	2,504,576
Total	102,894,505	103,253,483	-	5,662,271	97,591,212

Notes (continued)

4. Financial risk management (continued)

4.6 Capital management

(a) Regulatory capital

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

There have been no material changes in the Bank's management of capital during the period.

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

	Bank	
	2018	2017
	Sh'000	Sh'000
Tier 1 capital		
Ordinary share capital	7,368,906	7,368,906
Accumulated losses	(4,892,016)	(3,711,873)
Other reserves	(136,403)	(132,828)
Deductions	(248,573)	(19,620)
	2,091,914	3,504,585
Tier 2 capital		
Revaluation surplus (25%)	167,669	167,669
Statutory reserve	1,159,569	1,099,971
	1,327,238	1,267,640
Total regulatory capital	3,419,152	4,772,225
Risk weighted assets		
On- balance sheet	92,765,531	87,294,097
Off- balance sheet	1,373,622	703,611
Total risk weighted assets	94,139,153	87,997,708
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum - 14.5%)	3.70%	7.60%
Tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum - 10.5%)	2.27%	4.20%
Tier 1 capital expressed as a percentage of total deposits (CBK minimum - 8.0%)	2.05%	3.90%

For the purpose of calculating tier 2 capital statutory reserve is taken as the lower of 1.25% of total risk weighted assets and the actual statutory reserve value.

Notes (continued)

4. Financial risk management (continued)

4.6 Capital management (continued)

(a) Regulatory capital (continued)

The Group's objectives when managing capital are:

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

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

Banking business

The Central Bank of Kenya requires each bank to:

a) Hold the minimum level of regulatory capital of Shs 1 billion;
b) Maintain a ratio of total regulatory capital to risk weighted assets plus risk weighted off balance assets at above the required minimum of 12%;
c) Maintain a core capital of not less than 8% of total deposit liabilities; and
d) Maintain total capital of not less than 12% of risk weighted assets plus risk weighted off balance sheet items.

In addition to the above minimum capital adequacy ratios of 8% and 12%, with effect from January 2015, institutions are required to hold a capital conservation buffer of 2.5% over and above these minimum ratios to enable institutions withstand future periods of stress. This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets requirements to 10.5% and 14.5% respectively. The capital conservation buffer is made up of high quality capital which should comprise mainly of common equity, premium reserves and retained earnings.

As at 31 December 2017 and 2018, the Bank did not meet any of the minimum requirements

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

- Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for intangible assets (excluding computer software), investments in equity instruments of other institutions and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.

- Tier 2 capital, which includes 25% revaluation surplus which have received prior CBK approval, qualifying subordinated liabilities and collective impairment allowances.

(b) Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation

Notes (continued)

4 Financial risk management (continued)

4.6 Capital management (continued)

(b) Capital allocation (continued)

of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but, in some cases, the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes.

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Bank Risk and Bank Credit Committees, and is subject to review by the Bank Credit, Finance, Information and Technology Committee or the Assets and Liabilities Committee (''ALCO'') as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives are also taken into account.

The Bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

4.7 Segmental reporting

The major reporting segments are Corporate, Retail and Project finance banking.

Corporate Banking – Government, parastatals, large corporates, multinationals and private companies with an annual credit turnover of above 2 billion.

Retail banking – Small microfinance enterprises and individual customer's current accounts, savings, deposits, credit and debit cards, consumer loans and mortgages.

Project finance banking – Corporate & retail banking customers enjoying Shariah compliant products.

Segmented management reporting is measured by contribution consisting of net interest income, fees and commission income, other income, operating expenses and loan impairment expense. Income and expenses not arising from the principal activities of the Group, such as rental income & proceeds from disposal of property, are reported as unallocated for IFRS 8 purposes.

Assets and liabilities are interest earning assets and liabilities, which are the majority of the consolidated statement of financial position, but exclude non-earning assets as property and equipment, cash, taxes, other assets and liabilities, which are reported as unallocated.

Notes (continued)

4 Financial risk management (continued)

4.7 Segmental reporting (continued)

Statement of comprehensive income

	Corporate Sh'000	Retail Sh'000	Project finance Sh'000	Unallocated Sh'000	Total Sh'000
2018					
Interest income	7,831,260	2,422,227	616,531	-	10,870,018
Interest expense	(2,272,243)	(529,092)	(83,627)	-	(2,884,962)
Net interest income	5,559,017	1,893,135	532,904	-	7,985,056
Non funded income	890,573	850,196	91,974	69,042	1,901,785
Total operating income	6,449,590	2,743,331	624,878	69,042	9,886,841
Operating costs	(3,147,491)	(3,730,515)	(913,512)		(7,791,518)
Loan loss provisions	(1,092,817)	(968,041)	(119,366)	-	(2,180,224)
Total costs	(4,240,308)	(4,698,556)	(1,032,878)	-	(9,971,742)
Contribution	2,209,282	(1,955,225)	(408,000)	69,042	(84,901)
2017					
Interest income	8,437,171	2,786,054	785,297	-	12,008,522
Interest expense	(2,710,999)	(448,172)	(78,402)	-	(3,237,573)
Net interest income	6,610,256	2,337,882	706,895	-	8,770,949
Non funded income	884,084	1,238,843	47,028	65,219	2,235,174
Total operating income	6,610,256	3,576,725	753,923	65,219	11,006,123
Operating costs	(3,449,822)	(3,246,207)	(915,750)	-	(7,418,274)
Loan loss provisions	(2,237,969)	(587,616)	(32,653)	55,471	(2,802,767)
Total costs	(5,494,286)	(3,833,823)	(948,403)	55,471	(10,221,041)
Contribution	1,115,970	(257,098)	(194,480)	120,690	785,082

Notes (continued)

4. Financial risk management (continued)

4.7 Segmental reporting (continued)

Statement of financial position	Corporate Sh'000	Retail Sh'000	Project finance Sh'000	Unallocated Sh'000	Total Sh'000
2018					
Assets					
Loans and advances to customers	25,739,696	17,313,696	4,725,385	-	47,778,777
Government securities	46,341,772	-	-	-	46,341,772
Unallocated assets	-	-	-	20,728,556	20,728,556
Total assets	72,081,468	17,313,696	4,725,385	20,728,556	114,849,105
Liabilities					
Customer deposits	65,841,355	26,583,974	6,440,630	-	98,865,959
Other liabilities	-	-	-	9,010,292	9,010,292
Total liabilities	65,841,355	26,583,974	6,440,630	9,010,292	107,876,251
2017					
Assets					
Loans and advances to customers	32,772,059	14,010,170	5,578,814	-	52,361,043
Government securities	35,718,032	-	-	-	35,718,032
Unallocated assets	-	-	-	21,794,065	21,794,065
Total assets	68,490,091	14,010,170	5,578,814	21,794,065	109,873,140
Liabilities					
Customer deposits	61,496,578	25,385,949	7,393,241	-	94,275,768
Other liabilities	-	-	-	8,363,464	8,363,464
Total liabilities	61,496,578	25,385,949	7,393,241	8,363,464	102,639,232

Other disclosures	2018	2017
Fixed assets additions	(779,723)	512,318
Depreciation and amortisation	(1,025,122)	(1,105,374)

Notes (continued)

4. Financial risk management (continued)

4.7 Segmental reporting (continued)

Statement of financial position	Corporate Sh'000	Retail Sh'000	Project finance Sh'000
2018			
Loans and advances to customers	9,266,876	-	2,318,821
Concentration	36%	-	49%
Number of customers	3	-	3
Customer deposits	14,064,677	-	2,571,670
Concentration	21%	-	39%
Number of customers	1	-	1
2017			
Loans and advances to customers	11,092,407	-	1,277,269
Concentration	34%	-	23%
Number of customers	3	-	1
Customer deposits	14,883,100	-	3,521,541
Concentration	23%	-	48%
Number of customers	1	-	1

Notes (continued)

5. Interest income and expense	Group		Bank	
	2018	2017 (Restated)	2018	2017 (Restated)
	Sh'000	Sh'000	Sh'000	Sh'000
(a) Interest income				
Loans and advances to customers	6,384,732	7,746,782	6,384,732	7,746,782
Deposits and balances due from banking institutions at amortised cost	52,829	97,463	52,828	97,463
Treasury bills - FVOCI	217	40,977	-	40,977
Treasury bonds - at amortised cost	3,559,852	1,332,488	3,559,566	1,332,488
Treasury bonds - FVOCI	872,388	2,790,812	872,388	2,790,631
Total interest income	10,870,018	12,008,522	10,869,514	12,008,341
(b) Interest expense				
Deposits from banks	319,688	313,189	319,688	313,189
Deposits from customers	2,565,274	2,924,384	2,589,995	2,941,176
Total interest expense	2,884,962	3,237,573	2,909,683	3,254,365
Net interest income	7,985,056	8,770,949	7,959,831	8,753,976

6. Fees and commissions				
(a) Fee and commission income				
Retail banking transaction and services fees	1,107,986	940,924	1,065,324	940,924
Corporate banking transaction and services fees	121,179	297,803	121,179	437,473
Total fee and commission income	1,229,165	1,435,462	1,186,503	1,378,397
(b) Fee and commission expense				
Brokerage	34,201	39,715	34,201	39,715
Other	92,957	153,790	92,957	153,652
Total fee and commission expense	127,158	193,505	127,158	193,367
Net fee and commission income	1,102,007	1,241,957	1,059,345	1,185,030

7. Foreign exchange gains and other fair value changes

(a) Gains from foreign exchange dealings

Gains on foreign currency dealings arose from dealings in foreign currency transactions and also on the translation of foreign currency assets and liabilities.

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
Foreign currency trading	437,265	646,977
Revaluation of foreign notes held	163,849	(120,014)
Total gains on foreign exchange dealings	601,114	526,963

Notes (continued)

7 (b) Fair value changes on instruments at fair value through profit or loss

	Group and Bank	
	2018 Sh'000	2017 Sh'000
Other investments (Note 18)	32,688	97,127
Loan notes at fair value (Note 16 (b))	(38,000)	-
Total gains on foreign exchange dealings	(5,312)	97,127

8. Other operating income	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Recoveries from previously written off loans and advances	149,177	159,012	149,177	159,012
Rental income	62,137	49,913	62,137	49,913
(Loss)/gain on disposal of property and equipment	(17,715)	11,573	(17,715)	11,573
Dividend income	1,367	-	162,867	-
Miscellaneous income	(28,990)	148,629	(19,686)	148,940
Total other operating income	165,976	369,127	336,780	369,439

9. Operating expenses				
Operating expenses include:				
Staff costs (note 10)	4,405,822	3,916,494	4,392,410	3,908,839
Directors' emoluments- fees	28,159	30,851	28,159	30,851
Depreciation of property and equipment (note 21)	549,616	565,759	549,430	565,520
Amortisation of intangible assets (note 23)	475,506	376,525	475,506	376,525
Impairment of intangible assets (note 23)	-	163,329	-	163,329
Auditors' remuneration	11,403	11,890	7,221	11,890
Operating lease rentals	443,714	394,986	443,186	394,986

10 Staff costs				
Salaries and wages	2,974,243	3,092,796	2,950,759	3,069,742
Pension costs - defined contribution scheme	395,690	408,362	392,511	405,139
National Social Security Fund contributions	3,489	3,741	3,458	3,711
Other staff costs	491,148	411,595	509,095	430,248
Voluntary early retirement costs	541,252	-	536,587	-
	4,405,822	3,916,494	4,392,410	3,908,839

During the year, the Group implemented a voluntary early retirement scheme incurring a one off restructuring cost of Shs 541,252,000. A total of 112 employees participated in the voluntary early retirement scheme.

Average number of employees	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Management	721	791	714	780
Clerical	432	494	429	494
Contract	203	214	199	214
Totals	1,356	1,499	1,342	1,488

Notes (continued)

11. Income tax expense	Group		Bank	
	2018	2017	2018	2017
	Sh'000	Sh'000	Sh'000	Sh'000
Recognised in the profit or loss				
Current tax expense	53,611	62,703	39,881	49,233
Deferred income tax expense (Note 19)	(145,520)	311,595	(145,105)	311,143
Income tax (credit) / expense	(91,909)	374,298	(105,224)	360,376
Reconciliation of effective tax rate				
(Loss) / profit before income tax	(84,901)	785,082	50,915	740,373
Income tax using the enacted tax rate 30% (2017: 30%)	(25,470)	235,524	15,275	222,112
Tax effect of:				
- Expenses not deductible for tax purposes	304,651	249,753	252,024	249,140
- Tax effect of income not subject to tax	(374,180)	(145,135)	(374,180)	(145,135)
Adjustments for prior years:				
- Under provision of current tax in prior years	1,432	34,155	-	34,259
- Under provision of deferred tax in prior years	1,658	-	1,658	-
Income tax (credit) / expense	(91,909)	374,298	(105,224)	360,376

12. Earnings per share

Earnings per share is calculated by dividing the profit or loss for the year attributable to ordinary shareholders by the number of ordinary shares in issue during the year as follows:

	Group		Bank	
	2018	2017	2018	2017
	Sh'000	Sh'000	Sh'000	Sh'000
profit for the year attributable to equity holders of the Bank	7,008	410,784	156,139	379,997
Weighted average number of ordinary shares	338,781	325,953	338,781	325,953
Earnings per share :				
Basic and diluted (Sh)	0.02	1.26	0.46	1.17

The holders of the non-cumulative preference shares are entitled to a non-cumulative dividend at a negotiable rate not exceeding 6% per annum on the paid up preference shares. The dividend is payable if directors declare a dividend on ordinary shares. In addition, whenever the profits of the Group in respect of any year are more than sufficient to pay the preferential dividend, the holders of preference shares are entitled to participate in the surplus pari passu with the holders of ordinary shares. There were no potentially dilutive instruments outstanding at the end of the reporting period (2017: Nil).

Notes (continued)

13. Cash and balances with Central Bank of Kenya	Group		Bank	
	2018	2017	2018	2017
	Sh'000	Sh'000	Sh'000	Sh'000
Cash in hand	1,744,786	2,006,949	1,744,786	2,006,949
Balances with Central Bank of Kenya:				
- Cash reserve ratio requirement	5,168,060	4,967,358	5,168,060	4,967,358
- Other current accounts	(795,135)	525,865	(795,135)	525,865
	6,117,711	7,500,172	6,117,711	7,500,172

At 31 December 2018, the cash reserve ratio requirement was 5.25% (2017 - 5.25%) of eligible deposits. The cash ratio requirement funds are not available for the day to day operations of the Bank and are non-interest bearing.

14. Deposits and balances due from financial institutions	Group and Bank	
	2018	2017
	Sh'000	Sh'000
Gross balances	131,527	621,500
Foreign currency deposits	2,305,978	2,191,893
Local currency deposits	2,437,505	2,813,393
Less: Provision for expected credit losses	(369,285)	(353,251)
	2,068,220	2,460,142
Maturity analysis of deposits and balances due from banking institutions:		
Maturing within 91 days from placement date	849,734	1,007,534
Maturing after 91 days from placement date	1,218,485	1,452,608
	2,068,220	2,460,142

The effective interest rate on deposits due from banking institutions at 31 December 2018 was 5.7 % (2017 - 7.5%).

15. Financial investments	Group		Bank	
	2018	2017	2018	2017
	Sh'000	Sh'000	Sh'000	Sh'000
Financial assets (government securities) at fair value through other comprehensive income (2017: Available for sale)				
Maturing after 90 days from the date of acquisition	28,163,573	15,466,515	28,132,405	15,456,334
	28,163,573	15,466,515	28,132,405	15,456,334
Financial assets at amortised cost (2017: Held to maturity)				
Maturing after 90 days from the date of acquisition	18,178,199	20,251,517	18,178,199	20,251,518
	18,178,199	20,251,517	18,178,199	20,251,518
	46,341,772	35,718,032	46,310,604	35,707,852

Notes (continued)

15 (b) Maturity analysis of financial investments	Group			Bank		
	Maturing within 12 months Sh'000	Maturing after 12 months Sh'000	Total Sh'000	Maturing within 12 months Sh'000	Maturing after 12 months Sh'000	Total Sh'000
Year ended 31 December 2018	18,813	28,144,758	28,163,572	9,212	28,123,193	28,132,405
Financial assets carried at FVOCI	696,395	17,481,806	18,178,201	696,395	17,481,804	18,178,199
Financial assets carried at amortised costs						
	715,208	45,626,564	46,341,772	705,607	45,604,997	46,310,604
Year ended 31 December 2017	561,735	14,904,779	15,466,515	561,735	14,894,599	15,456,334
Financial assets carried at FVOCI	1,780,834	18,470,684	20,251,517	1,780,834	18,470,684	20,251,518
Financial assets carried at amortised costs	2,342,569	33,375,463	35,718,032	2,342,569	33,365,283	35,707,852

15 (c) The weighted average effective interest rate for financial investments is as summarised below:

	Group		Bank	
	2018	**2017**	**2018**	**2017**
Treasury bills – FVOCI (2017: Available for sale)	10%	11%	10%	11%
Treasury bonds - At amortised cost (2017: Held to maturity)	11%	12%	11%	12%
Treasury bonds – FVOCI (2017: Available for sale)	13%	13%	13%	13%

16 Loans and advances to customers (continued)

a) Summary of loans and advances at carrying values

	Group and Bank 2018 Sh'000	Group and Bank 2017 Sh'000
Loans at fair value through profit or loss	2,357,589	2,425,336
Loans at amortised cost	45,421,188	49,935,707
	47,778,777	52,361,043

b) Loan notes at fair value through profit or loss

	2018 Sh'000	2017 Sh'000
At start of year	2,425,336	2,425,336
Fair value loss	(38,000)	-
Foreign exchange loss	(29,747)	-
At end of year	2,357,589	2,425,336

Loan notes at fair value through profit or loss relate to amounts due from a Special Purpose Entity (SPE) formed as part of a restructuring arrangement between lender banks and a customer in 2017. Under the terms of the restructuring, the amounts owing to the banks were transferred to the SPE, which in exchange was allocated equity shares of the customer. Principally, the banks will recover the amounts due through the sale of the customer's equity shares in 9 years' time. In the intervening period, the banks will receive a fixed interest income on the amounts due, at a rate that is largely below the market rates.

c) Loans and advances at amortised cost

	Corporate Sh'000	Retail Sh'000	Project finance Sh'000	Total Sh'000
2018				
Gross carrying amount	36,964,840	17,918,802	5,559,378	60,443,020
Credit loss allowance:				
- Collectively assessed	(227,909)	(612,764)	(90,068)	(930,741)
- Individually assessed	(10,667,813)	(2,732,745)	(690,533)	(14,091,091)
	(10,895,722)	(3,345,509)	(780,601)	(15,021,832)
Net carrying amount	26,069,118	14,573,293	4,778,777	45,421,188
2017 (Restated)				
Gross carrying amount	37,429,539	18,844,081	5,545,859	61,819,479
Credit loss allowance:				
- Collectively assessed	(144,224)	(110,825)	(27,986)	(283,035)
- Individually assessed	(9,397,824)	(1,864,324)	(338,589)	(11,600,738)
	(9,542,048)	(1,975,149)	(366,575)	(11,883,772)
Net carrying amount	27,887,491	16,868,932	5,179,284	49,935,707

Notes (continued)

16 Loans and advances to customers (continued)

c) Loans and advances at amortised cost (continued)

Included in net advances are loans and advances amounting to Shs 18,696,293,000 (2017 - Shs 15,712,346,000), net of specific provisions, which were classified as non-performing (impaired) at the year end.

Included in loans and advances to customers are staff loans amounting to Shs 4,532,368,790 (2017 - Shs 3,973,498,443). The effective interest rate on loans and advances to staff was 9.825% at 31 December 2018 (2017 - 11.67%).

d) Movement in provision for credit loss allowance	Corporate Sh'000	Retail Sh'000	Project finance Sh'000	Total Sh'000
Year ended 31 December 2017				
At start of year	7,868,379	1,333,782	330,404	9,532,565
Charge for the year (Restated)	2,067,954	698,642	36,171	2,802,767
Write-offs	(394,285)	(57,275)	-	(451,560)
At end of year (Restated)	9,542,048	1,975,149	366,575	11,883,772
Year ended 31 December 2018				
At start of year (Restated)	9,542,048	1,975,149	366,575	11,883,772
Initial application of IFRS 9	517,952	546,049	79,541	1,143,542
Charge for the year	862,954	944,785	334,485	2,142,224
Write-offs	(27,232)	(120,474)	-	(147,706)
At end of year	10,895,722	3,345,509	780,601	15,021,832

As explained in Note 34, the gross carrying amount and the credit loss allowance on loans and advances at 3 1 December 2017 have been restated to include interest income on the amortised amount of non-performing loans. The restatement had no impact on the net carrying amount of loans and advances at 31 December 2017.

Notes (continued)

16 Loans and advances to customers (continued)

d) Analysis of gross loans and advances by maturity

d) Analysis of gross loans and advances by maturity	Group and Bank				Group and Bank			
	Retail	Project finance	Corporate	Total	Retail	Project finance	Corporate	Total
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
	2018	2018	2018	2018	2017	2017	2017	2017
Maturing:								
Within 1 year	674,175	3,596,224	18,258,919	22,529,318	1,479,621	3,013,756	22,378,385	26,871,762
1 - 3 years	3,055,504	92,303	2,480,240	5,628,047	3,382,150	1,183,198	740,945	5,306,293
3 - 5 years	3,608,411	315,458	2,552,029	6,475,898	3,370,780	225,947	2,473,398	6,070,125
Over 5 years	10,580,712	1,555,393	13,673,652	25,809,757	10,611,530	1,122,958	11,836,811	23,571,299
Total advances	17,918,802	5,559,378	36,964,840	60,443,020	18,844,081	5,545,859	37,429,539	61,819,479

17 Other assets	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Rent and service charge receivable	110,494	115,214	110,494	115,214
Less: Provision for expected credit losses	(60,932)	(21,597)	(60,932)	(21,597)
	49,562	93,617	49,562	93,617
Mobile money deposits	372,298	341,006	372,298	341,006
Items in the course of collection	502,399	920,063	502,399	920,063
Deferred staff loan benefits	1,686,802	1,683,748	1,686,802	1,683,748
Prepaid expenses	221,488	120,881	221,488	120,881
Other receivables	841,987	530,083	837,633	526,467
	3,674,536	3,689,398	3,670,182	3,685,782

The movement in the provision for credit losses on rent and service charge receivable is as follows:

	Group and Bank	
	2018 Sh'000	2017 Sh'000
At start of year	21,597	-
Initial application of IFRS 9	33,632	-
Net charge to profit or loss	5,703	21,597
At end of year	60,932	21,597

18 Other investments	Group and Bank	
	2018 Sh'000	2017 Sh'000
Unquoted equities		
IDB Capital Limited	1,501	1,501
African Export Import Bank	19,620	19,620
SWIFT	5,883	5,883
	27,004	27,004
Quoted equities		
VISA International	310,767	272,125
Safaricom Limited	29,051	35,005
	339,818	307,130
	366,822	334,134
Movement in investments:		
At start of year	334,134	237,007
Fair value gain	32,688	97,127
At end of year	366,822	334,134

Other investments are measured at fair value through profit or loss.

Notes (continued)

18 Other investments (continued)

Visa International shares were allotted to the Bank at no cost by virtue of the Bank's membership to the Visa International network of users and are quoted at the New York Stock Exchange. Safaricom shares are quoted on the Nairobi Securities Exchange. The fair value of quoted shares is determined by the prices quoted on the relevant exchanges.

Society for Worldwide Interbank Financial Telecommunication (SWIFT) shares are allocated to an institution based on the institution contribution to the SWIFT network. The last of which was done in early 2015. The transfer value of one SWIFT share was fixed at EUR 3,300 at the June 2011 General Meeting of shareholders.

Based on directors assessment, the cost of the IDB capital shares approximates their fair value.

The Group does not have either management or voting control over the investee companies and it's percentage shareholding is insignificant.

19 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2017 - 30%). The movements in the deferred income tax account were as follows:

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
At start of year	(1,862,363)	(2,136,531)	(1,862,181)	(2,135,897)
Initial application of IFRS 9	(371,348)	-	(371,348)	-
	(2,233,711)	(2,136,531)	(2,233,529)	(2,135,897)
(Credit) / charge to profit or loss (Note 10)	(145,520)	311,595	(145,105)	311,143
Charge / (credit) to other comprehensive income	89,063	(37,427)	89,107	(37,427)
At end of year	(2,290,168)	(1,862,363)	(2,289,527)	(1,862,181)

Notes (continued)

19 Deferred income tax (continued)

Year ended 31 December 2018 Group	At start of year Sh'000	(Credited) / charged to profit or loss Sh'000	Credited to other comprehensive income Sh'000	At end of year Sh'000
Deferred income tax liability				
Property and equipment:				
- historical cost basis	21,647	(2,305)	-	19,342
- revaluation surplus	288,952	(4,659)	93,948	378,241
	310,599	(6,964)	93,948	397,583
Deferred income tax asset				
Other deductible differences	(2,234,240)	318,157	(4,885)	(1,920,968)
Tax losses carried forward	(310,070)	(456,713)	-	(766,783)
	(2,544,310)	(138,556)	(4,885)	(2,687,751)
Net deferred income tax asset	(2,233,711)	(145,520)	89,063	(2,290,168)
Year ended 31 December 2017				
Deferred income tax liability				
Property and equipment:				
- historical cost basis	9,709	11,938	-	21,647
- revaluation surplus	291,802	(2,850)	-	288,952
	301,511	9,088	-	310,599
Deferred income tax asset	(1,978,664)	153,199	(37,427)	(1,862,892)
Other deductible differences	(459,378)	149,308	-	(310,070)
Tax losses carried forward	(2,438,042)	302,507	(37,427)	(2,172,962)
Net deferred income tax asset	(2,136,531)	311,595	(37,427)	(1,862,363)

Notes (continued)

19 Deferred income tax (continued)

Year ended 31 December 2018 Bank	At start of year Sh'000	(Credited) / charged to profit or loss Sh'000	Credited to other comprehensive income Sh'000	At end of year Sh'000
Deferred income tax liability				
Property and equipment:				
- historical cost basis	21,647	(2,303)	-	19,344
- revaluation surplus	288,952	(4,659)	93,948	378,060
	310,599	(6,962)	93,948	397,585
Deferred income tax asset				
Other deductible differences	(2,234,058)	315,275	(4,841)	(1,923,624)
Tax losses carried forward	(310,070)	(453,418)	-	(763,488)
	(2,544,128)	(138,143)	(4,841)	(2,687,112)
Net deferred income tax asset	(2,233,529)	(145,105)	89,107	(2,289,527)
Year ended 31 December 2017				
Deferred income tax liability				
Property and equipment:				
- historical cost basis	10,343	11,486	-	21,829
- revaluation surplus	291,802	(2,850)	-	288,952
	302,145	8,636	-	310,781
Deferred income tax asset				
Other deductible differences	(1,978,664)	153,199	(37,427)	(1,862,892)
Tax losses carried forward	(459,378)	149,308	-	(310,070)
	(2,438,042)	302,507	(37,427)	(2,172,962)
Net deferred income tax asset	(2,135,897)	311,143	(37,427)	(1,862,181)

The deferred tax asset has been recognised based on the projected future taxable profits that will be available against which the deductible temporary differences and tax losses carried forward can be utilised.

20 Investment in subsidiaries	Percentage Ownership	2018 Sh'000	2017 Sh'000
Investment in subsidiary companies			
NatBank Trustee and Investment Services Ltd	100%	19,963	19,963
Kenya National Capital Corporation Limited	100%	-	-
NBK Insurance Agency Limited	100%	-	-
Totals		19,963	19,963

All the subsidiary companies have their financial year ending 31 December and are incorporated as limited liability companies. They are incorporated in Kenya under the Companies Act and domiciled in Kenya.

All the subsidiaries are 100% owned and fully controlled by the Bank.

The Group financial statements include the results of two of the subsidiaries, NBK Insurance Agency Limited and Natbank Trustee and Investment Services Limited which are consolidated.

The other subsidiary, Kenya National Capital Corporation Limited is dormant and has not been consolidated since it is insignificant. Consolidation of this subsidiary would have no material impact on the Group's net assets and profit for the year and would not add any real value to the shareholders.

Notes (continued)

21 Property plant and equipment –Group

	Long leasehold land and buildings	Motor vehicles, equipment, furniture and fittings	Computers	Capital work in progress	Leasehold improvements	Total
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Cost or valuation						
At 1 January 2017	1,589,104	1,907,476	1,082,028	976,459	1,568,139	7,123,207
Additions	-	92,806	66,682	-	73,336	232,825
Reclassifications	91,262	-	-	-	(91,262)	-
Transfer to intangible assets	-	-	-	(67,801)	-	(67,801)
Transfers from work in progress	-	214,510	-	(899,118)	684,608	-
At 31 December 2017	1,680,366	2,214,792	1,148,710	9,540	2,234,822	7,288,230
Comprising:						
Cost	300,168	2,214,792	1,148,710	9,540	2,234,822	5,908,032
Valuation – 2017	1,380,198	-	-	-	-	1,380,198
At 31 December 2017	1,680,366	2,214,792	1,148,710	9,540	2,234,822	7,288,230
Year ended 31 December 2018						
At 1 January 2018	1,680,366	2,214,792	1,148,710	9,540	2,234,822	7,288,409
Revaluation	605,000	-	-	-	-	605,000
Additions	-	47,129	46,047	-	48,456	141,631
Reclassifications	-	(53,903)	158,395	-	(104,492)	-
Disposals	-	(7,765)	-	-	-	(7,765)
At 31 December 2018	2,285,366	2,200,253	1,353,152	9,540	2,178,785	8,027,096
Comprising:						
Cost	300,168	2,200,253	1,353,152	9,540	2,178,785	6,041,898
Valuation – 2018	1,985,198	-	-	-	-	1,985,198
At 31 December 2018	2,285,366	2,200,253	1,353,152	9,540	2,178,785	8,027,096

Notes (continued)

21 Property plant and equipment –Group (continued)

	Long Leasehold land and buildings	Motor vehicles, equipment, furniture and fittings	Computers	Capital work in progress	Leasehold improvements	Total
	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000	Sh'000
Year ended 31 December 2017						
Depreciation						
At 1 January 2017	58,947	1,080,276	915,474	-	956,825	3,011,522
Charge for the year	63,124	152,591	63,160	-	286,884	565,759
Disposal	-	-	-	-	-	-
At 31 December 2017	122,071	1,232,867	978,634	-	1,243,709	3,577,281
Year ended 31 December 2018		.				
At 1 January 2018	122,071	1,232,867	978,634	-	1,243,709	3,577,281
Charge for the year	(9,096)	72,208	216,815	-	269,689	549,616
Written back on revaluation	(90,691)	-	-	-	-	(90,691)
Disposal		(7,942)				(7,942)
At 31 December 2018	22,284	1,297,133	1,195,449	-	1,513,398	4,028,264
Net book value						
At 31 December 2018	2,263,082	903,120	157,703	9,540	665,388	3,998,833
At 31 December 2017	1,558,295	981,925	170,076	9,540	991,113	3,710,949

Notes (continued)

21 Property plant and equipment – Bank

Year ended 31 December 2017	Long Leasehold land and buildings Sh'000	Motor vehicles, equipment, furniture and fittings Sh'000	Computers Sh'000	Capital work in progress Sh'000	Leasehold improvements Sh'000	Total Sh'000
Cost or valuation						
At 1 January 2017	1,589,104	1,906,204	1,081,661	976,459	1,568,139	7,121,567
Additions	-	92,806	66,682	-	73,336	232,825
Reclassifications	91,262	-	-	-	(91,262)	-
Transfer to intangible assets	-	-	-	(67,801)	-	(67,801)
Transfers from work in progress	-	214,510	-	(899,118)	684,608	-
At 31 December 2017	1,680,366	2,213,520	1,148,343	9,540	2,234,821	7,286,590
Comprising:						
Cost	300,168	2,213,520	1,148,343	9,540	2,234,821	5,906,392
Valuation – 2017	1,380,198	-	-	-	-	1,380,198
At 31 December 2017	1,680,366	2,213,520	1,148,343	9,540	2,234,821	7,286,590
Year ended 31 December 2018						
At 1 January 2018	1,680,366	2,213,520	1,148,343	9,540	2,234,822	7,286,592
Revaluation	605,000	-	-	-	-	605,000
Additions	-	47,121	46,047	-	48,455	141,623
Reclassifications	-	(53,903)	158,395	-	(104,492)	-
Disposals	-	(7,942)	-	-	-	(7,942)
At 31 December 2018	2,285,366	2,198,795	1,352,785	9,540	2,178,785	8,025,271
Comprising:						
Cost	300,168	2,198,795	1,352,785	9,540	2,178,785	6,040,073
Valuation – 2018	1,985,198	-	-	-	-	1,985,198
At 31 December 2018	2,285,366	2,198,795	1,352,785	9,540	2,178,785	8,025,271

Notes (continued)

21 Property plant and equipment – Bank (continued)

	Leasehold land and buildings Sh'000	Motor vehicles, equipment, furniture and fittings Sh'000	Computers Sh'000	Capital work in progress Sh'000	Leasehold improvements Sh'000	Total Sh'000
Year ended 31 December 2017						
Depreciation						
At 1 January 2017	58,947	1,079,653	915,317	-	956,825	3,010,742
Charge for the year	63,124	152,424	63,089	-	286,883	565,520
At 31 December 2017	122,071	1,232,077	978,406	-	1,243,708	3,576,262
Year ended 31 December 2018						
At 1 January 2018	122,071	1,232,077	978,406	-	1,243,709	3,576,263
Charge for the year	(9,096)	72,094	216,743	-	269,689	549,430
Written back on revaluation	(90,869)			-		(90,869)
Disposal	-	(7,942)	-	-	-	(7,942)
At 31 December 2018	22,106	1,296,229	1,195,149	-	1,513,398	4,026,882
Net book value						
At 31 December 2018	2,263,260	902,566	157,636	9,540	665,388	3,998,390
At 31 December 2017	1,558,295	981,443	169,937	9,540	991,113	3,710,328

21 Property and equipment (continued)

Included in computers, motor vehicles, equipment and furniture & fittings are assets with a cost of Shs 2,376,643,736 (2017 - Shs 1,411,723,619) which were fully depreciated. The normal annual depreciation charge on these assets would have been Shs 258,479,858 (2017 - Shs 225,060,417).

The Group's leasehold land and buildings were revalued in 2018 by independent valuers, Legend Valuers Limited & Lloyd Masika Limited, registered valuers and estate agents. Valuations were made on the basis of open market value for existing use. The book values of the revalued assets were adjusted to the revalued amounts. Increase arising on the revaluation was recognised in other comprehensive income and accumulated in the revaluation surplus. At 31 December 2018, the net book value of the leasehold land and buildings based on original cost was Shs 548,737,000 (2017 - Shs 600,185,000).

Land and building with a total carrying value of Shs 2,264,949,000 (2016 - Shs 1,587,143,000) are categorised under Level 3 fair value hierarchy as their value is based on inputs other than quoted prices, or inputs that are observable for the asset or liability, either directly as prices or indirectly as derived from prices. There were no transfers between the various levels during the year.

22 Non-current asset held for sale	Group and Bank	
	2018 Sh'000	2017 Sh'000
Cost		
At 1 January	590,944	590,944
Disposal	(152,375)	-
At 31 December	438,569	590,944

The non-current asset held for sale relates to a property for which the Group has initiated the sale process. The property has been placed in the market with the sale expected within the 2019 financial year.

23 Intangible assets	Group			Bank		
	Computer software	Capital work in progress	Total	Computer software	Capital work in progress	Total
Cost						
At 1 January 2017	2,567,688	618,513	3,186,201	2,567,409	618,513	3,185,922
Additions	279,493	-	279,493	279,493	-	279,493
Transfers from property and equipment	68,546	-	68,546	67,801	-	67,801
Transfers from work in progress	618,513	(618,513)	-	618,513	(618,513)	-
At 31 December 2017	3,534,241	-	3,534,241	3,533,216	-	3,533,216
At 1 January 2018	3,534,241	-	3,534,241	3,533,216	-	3,533,216
Additions	604,538	25,570	630,108	604,811	11,127	615,938
At 31 December 2018	4,138,779	25,570	4,164,349	4,138,027	11,127	4,149,154
Amortisation						
At 1 January 2017	1,834,769	-	1,834,769	1,833,744	-	1,833,744
Charge for the year	376,525	-	376,525	376,525	-	376,525
Impairment for the year	163,329	-	163,329	163,329	-	163,329
At 31 December 2017	2,374,623	-	2,374,623	2,373,598	-	2,373,598
At 1 January 2018	2,374,623	-	2,374,623	2,373,598	-	2,373,598
Charge for the year	475,506	-	475,506	475,506	-	475,506
At 31 December 2018	2,850,129	-	2,850,129	2,849,104	-	2,849,104
Net book value						
At 31 December 2018	1,288,651	25,570	1,314,221	1,288,923	11,127	1,300,050
At 31 December 2017	1,159,618	-	1,159,618	1,159,618	-	1,159,618

Included in intangible assets are assets with a cost of Shs 2,080,579,554 (2017 – Shs 1,430,110,229) which were fully amortised. The normal annual amortisation charge on these assets would have been Shs 416,115,911 (2017 – Shs 286,022,046).

24 Customer deposits	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Customer deposits				
Fixed deposit accounts	10,990,224	12,048,173	10,990,224	12,048,173
Savings accounts	1,918,297	2,164,454	1,918,298	2,164,454
Non-interest bearing current accounts	41,352,839	41,774,250	41,352,839	41,774,250
Interest bearing current and demand accounts	44,604,599	38,288,891	44,962,098	38,557,520
	98,865,959	94,275,768	99,223,459	94,544,397
Maturity analysis of customer deposits				
From Government and parastatals:				
Payable within 90 days	54,713,167	55,059,750	54,713,167	55,059,750
Payable after 90 days and within one year	5,011,096	2,712,432	5,011,096	2,712,432
	59,724,263	57,772,182	59,724,263	57,772,182
From Private Sector and individuals:				
Payable within 90 days	35,740,570	33,535,962	36,098,070	33,804,592
Payable after 90 days and within one year	3,401,126	2,967,623	3,401,126	2,967,623
	39,141,696	36,503,586	39,499,196	36,772,215
	98,865,959	94,275,768	99,223,459	94,544,397

25 Deposits and balances due to financial institutions	Group and Bank	
	2018 Sh'000	2017 Sh'000
Deposits at end of year	6,020,730	5,620,120

The effective interest rate on deposits due to Banking institutions at 31 December 2018 was 4% (2017 - 3.0%). The deposits are payable within 90 days after the end of the reporting period.

26 Other liabilities	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Margins held on guarantees	108,571	673,760	108,571	673,760
Bills payable	100,509	109,714	100,509	109,714
Due to subsidiaries	-	-	879	575
Unclaimed dividends	24,315	24,446	24,315	24,446
Sundry creditors	803,240	902,524	793,514	888,847
General expenses payable	330,092	253,718	330,092	253,396
Other accruals and payables	1,563,651	770,434	1,546,471	770,502
	2,930,379	2,734,597	2,904,352	2,721,241

27 Provisions for liabilities	Group and Bank					
	Expected credit loss on off-balance sheet commitments and guarantees					
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
At start of year	-	-	8,747	-	8,747	-
Initial application of IFRS 9	54,014	-	-	-	54,014	-
Charge/(credit) to profit or loss	(20,366)	-	16,788	8,747	(3,578)	8,747
At end of year	33,648	-	25,535	8,747	59,183	8,747

28 Share capital	Group and Bank	
	2018 Sh'000	2017 Sh'000
Authorised:		
1,400,000,000 Ordinary shares of Sh 5 each	7,000,000	7,000,000
1,200,000,000 Preference shares of Sh 5 each	6,000,000	6,000,000
	13,000,000	13,000,000
Issued and fully paid:		
338,781,200 Ordinary shares of Sh 5 each	1,693,906	1,693,906
1,135,000,000 Preference shares of Sh 5 each	5,675,000	5,675,000
	7,368,906	7,368,906

Notes (continued)

28 Share capital (continued)

At 31 December 2018, the issued and fully paid share capital comprised of 338,781,200 (2017: 338,781,200) ordinary shares with a par value of Shs 5.

The following special rights and privileges are attached to the preference shares:

a) The holders of the non-cumulative preference shares shall be entitled to receive out of the profits of the Bank as a first charge a non-cumulative preferential dividend at a negotiable rate not exceeding 6% per annum on the capital for the time being paid up on the Preference Shares held by them respectively if the directors declare a dividend on the distributable profits.

b) Whenever the profits of the Bank in respect of any year shall be more than sufficient to pay the preferential dividend aforesaid to the close of such year, the holders of the preference shares shall be entitled to participate in the surplus pari passu with the holders of the ordinary shares provided that such participation shall be non-cumulative.

c) In the event of the Bank being wound up or on a reduction of capital involving a return of capital, the surplus assets thereof shall be applied in the first place in repaying the holders of the said preference shares, and of any other shares entitled to rank pari passu with them, the full amount paid up thereon, and, subject as aforesaid, such surplus assets shall belong to and be divided among the other members of the Bank.

d) The holders of the preference shares shall not be entitled to receive notice of, or attend, or vote at any general meeting of the Bank.

e) The preference shares aforesaid shall be issued to such persons and on such terms and conditions as the Board may think fit.

Nature and purpose of reserves

a) Property revaluation surplus represents the surplus arising from the revaluation of properties and is not distributable.

b) Statutory reserve represents the excess of loan loss provisions computed in accordance with Central Bank of Kenya prudential guidelines over the impairment of loans and advances arrived at in accordance with International Financial Reporting Standard 9. The statutory reserve is not distributable.

c) Other reserves represents the unrealised increase or decrease in the value of financial assets at fair value through other comprehensive income, excluding impairment losses. The reserve is not distributable to the shareholders.

Notes (continued)

29 Notes to the statement of cash flows

	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Reconciliation of profit before taxation to cash generated from operations				
Profit before taxation	(84,901)	785,082	50,915	740,373
Adjustments for:				
Depreciation of property and equipment (Note 21)	549,616	565,759	549,430	565,520
Amortisation and impairment of intangible assets (Note 23)	475,506	539,854	475,506	539,854
Write-off of property and equipment		-		-
Loss on disposal of equipment	17,715	-	17,715	-
Fair value gain on quoted investments (Note 18)	(32,688)	(97,127)	(32,688)	(97,127)
Cash flows from operating activities before working capital changes	925,248	1,793,568	1,060,878	1,748,620
Changes in working capital:				
Cash ratio requirement	(200,701)	(243,452)	(200,701)	(243,452)
Government securities (Note 15)	(10,632,123)	(1,296,954)	(10,611,135)	(1,286,774)
Deposits and balances due from financial institutions	234,122	(1,355,959)	234,122	(1,355,959)
Loans and advances to customers	3,309,486	2,658,741	3,309,486	2,658,741
Other assets	(18,770)	24,482	(18,032)	(3,302)
Non-current assets held for sale	152,375	-	152,375	-
Amount due from subsidiary	-	-	(251,307)	(69,181)
Customer deposits	4,590,191	405,480	4,679,062	652,133
Other liabilities	200,320	(1,250,378)	190,182	(1,240,370)
Cash generated from operating activities	(1,439,852)	735,528	(1,455,070)	860,456
Analysis of the balances of cash and cash equivalents				
Cash in hand (Note 13)	1,744,786	2,006,949	1,744,786	2,006,949
Balances with Central Bank of Kenya (Note 13)	(795,135)	525,865	(795,135)	525,865
Deposits and balances due from banking institutions (Note 14)	849,735	1,007,534	849,735	1,007,534
Deposits and balances due to banking institutions (Note 25)	(6,020,730)	(5,620,120)	(6,020,730)	(5,620,120)
	(4,221,344)	(2,079,772)	(4,221,344)	(2,079,772)

Notes (continued)

29 Notes to the statement of cash flows (continued)

Analysis of the increase in government securities	Group		Bank	
	2018 Sh'000	2017 Sh'000	2018 Sh'000	2017 Sh'000
Movement in government securities (Note 15)	(10,623,740)	(1,172,200)	(10,602,752)	(1,162,020)
Non-cash items - revaluation of bonds - FVOCI (Note 15)	(8,383)	(124,754)	(8,383)	(124,754)
	(10,632,123)	(1,296,954)	(10,611,135)	(1,286,774)

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

30 Contingencies and commitments including off balance sheet items

(a) Off-balance sheet items

In common with other banks, the Group conducts business involving acceptances, guarantees, performances and indemnities. The majority of these facilities are offset by corresponding obligations of third parties.

	Group and Bank	
	2018 Sh'000	2017 Sh'000
Letters of credit	2,051,769	2,015,942
Letters of guarantee	3,233,672	5,221,891
Swaps, spots and forwards	357,391	178,779
Total	5,642,832	7,416,612

Swaps, spots and forward contracts disclosed above represent notional values of shortdated contracts outstanding at year end. The resultant derivative balances were not recognised on the statement of financial position as they are immaterial.

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

Letters of guarantee are issued by the Group to guarantee performance by the customers to third parties. The Group will only be required to meet these obligations in the event of customer default.

(b) Contingent liabilities

The Bank has a number of pending court cases but directors, having undertaken legal consultation, believe no material financial liabilities will arise from these cases.

The Group has received a tax assessment from the Kenya Revenue Authority regarding certain aspects of its business. A portion of the assessment has been challenged on various principles and the Group continues to engage the tax authority to resolve the matter. Management is confident that no material liabilities will crystallise from these, beyond the provisions already recorded.

Notes (continued)

30 Contingencies and commitments including off balance sheet items (continued)

(c) Operating lease arrangements

The Group as a lessor

Rental income earned during the year was Shs 62,137,402 (2017 – Shs 49,912,847). At the end of the reporting period, the Group had contracted with tenants for the following future lease receivables:

Leases are negotiated for an average term of 6 years and rentals are reviewed annually. The leases are cancellable with a penalty. Tenants are required to pay full rent for the quarter in which termination of lease notice is given.

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
Within one year		
In the second to fifth year inclusive	28,819	25,047
After five years	90,354	83,610
	1,075	5,357
Total	120,248	114,014

The Group as a lessee

At the end of the reporting period, the Group had outstanding commitments under operating leases which fall due as follows:

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
Within one year	552,204	287,901
In the second to fifth year inclusive	187,280	662,006
After five years	262,603	258,770
Total	1,002,087	1,208,677

Operating lease payments represent rentals payable by the Group for some of its branch premises. Leases are negotiated for an average term of 6 years.

(d) Unutilised credit facilities

Unutilised credit facilities refers to undrawn credit card balances and overdrafts. In 2018, this amounted to Sh 1,997,706,000 (2017 – Sh 1,530,093,000).

Notes (continued)

31 Related party transactions and balances

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

Placings are made in the Bank by directors and companies associated to directors. Advances to customers at 31 December 2018 include advances and loans to companies associated to directors.

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

	Bank	
	2018	2017
	Sh'000	Sh'000
Details of intercompany balances are as follows:		
Due from subsidiaries		
Natbank Trustee and Investment Services Limited	28,643	7,966
NBK Insurance Agency Limited	292,623	61,993
	321,266	69,959
Due to subsidiary		
Natbank Trustee and Investment Services Limited	879	575

Details of balances and transactions with related parties are as follows:

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
(a) Advances to related parties		
Directors	31,322	15,790
Entities affiliated to directors	7,822	3,361
Employees	5,155,000	4,728,314
Total	5,194,144	4,747,465
(b) Related party deposits		
Directors	9,964	23,933
Natbank Trustee & Investment Services Limited	7,925	17,169
NBK Insurance Agency	349,574	251,460
National Social Security Fund	2,543,258	2,474,676
Total	2,910,721	2,767,238

31 Related party transactions and balances (continued)

The related party transactions with directors during the year and the outstanding amounts at the year-end are as follows:

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
(c) Directors		
Loans and advances:		
At 1 January	15,790	14,461
Advanced during the year	26,702	12,990
Interest charged	2,490	271
Repayments during the year	(13,660)	(11,932)
At end of year	31,322	15,790
Deposits:		
At 1 January	23,933	62,460
Received during the year	53,661	431,651
Withdrawn during the year	(67,630)	(470,178)
At end of year	9,964	23,933

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

	Group and Bank	
	2018	2017
	Sh'000	Sh'000
(d) Directors emoluments and key management remuneration		
Salaries and other short-term employment benefits	166,098	249,987
Pension and gratuity	20,235	27,918
Total	186,333	277,905
(e) Directors' fees		
Fees for services as a director	28,535	30,851
Other emoluments (included in key management compensation above)	50,252	48,060
Total	78,787	78,911

Notes (continued)

32 Fiduciary activities

The Group holds asset security documents on behalf of customers with a value of Sh 2,679,194,835 (2017 - Sh 1,170,452,526). Most of these securities are held by the custody services department. The assets held comprise deposits with financial institutions, government securities, and quoted and unquoted securities.

33 Assets pledged as security

Bonds pledged as security were Shs 2,095,000,000 in addition to deposits due from foreign banks amounting to Shs 98,989,800 (Shs 2017 - Shs 97,308,600) which were under lien as collateral for the letters of credit and guarantees issued on behalf of the Group's customers.

34 Prior year restatement

The prior year financial statements have been restated to recognise interest income on non-performing loans that should have been recognised in line with the requirements of IAS 39. The interest income ought to have been recognised on the amortised balance i.e. net of specific impairments, using the original effective interest rate of the impaired financial assets. The interest recognised was assessed as fully impaired and therefore the adjustment had no impact on the statement of financial position, changes in equity or cash flows.

The effect of the restatement on the statement of comprehensive income, which is effectively a gross up of the interest income and credit impairment charges for the year ended 31 December 2017 is as follows;

Group statement of comprehensive income	2017 Sh'000	Increase/ (decrease) Sh'000	Restated 2017 Sh'000
Interest income	9,962,495	2,046,027	12,008,522
Net interest income	6,724,922	2,046,027	8,770,949
Impairment losses on loans and advances	(756,740)	(2,046,027)	(2,802,767)
Profit before taxation	785,082	-	785,082
Income tax expense	(374,298)	-	(374,298)
Profit for the year	410,784	-	410,784

Bank statement of comprehensive income	2017 Sh'000	Increase/ (decrease) Sh'000	Restated 2017 Sh'000
Interest income	9,962,314	2,046,027	12,008,341
Net interest income	6,707,949	2,046,027	8,753,976
Impairment losses on loans and advances	(756,740)	(2,046,027)	(2,802,767)
Profit before taxation	740,373	-	740,373
Income tax expense	(360,376)	-	(360,376)
Profit for the year	379,997	-	379,997

PROXY FORM

Shareholder's Member/CDSC No. ______________________________

The Company Secretary
National Bank of Kenya
Harambee Avenue
P.O. Box 72866 - 00200
NAIROBI

I/We.. of (address) .... being a member/ members of National Bank of Kenya Limited, hereby appoint :- ....of (address)... an failing him, the Chairman of the meeting to be my/our proxy, to vote on my / our behalf at the 50th Annual General Meeting of the Company held on Friday 14th June 2019 at 10:00am or at any adjournment thereof.

As witness my/our hand/ hands is/ are set this .... Day of .... (Month) 2019

Signed ________________________________

NOTE: 1. A proxy need not be a member.

2. In the case of a corporate body the proxy must be under its Common Seal.

3. This proxy must be delivered to the Company's registered office not later than 10.00 a.m. on **Wednesday 12th June 2019**

Shareholder Admission Letter

Please complete this form and note that it must be produced at the Company's Annual General Meeting by your proxy for admission.

Name .... Signature ....

Shareholder's Member/CDSC Number ....

The 50th Annual General Meeting of National Bank of Kenya Limited to be held at Moi International Sports Centre Kasarani, Indoor Arena, off Thika Super Highway on 14th June 2019 at 10.00 a.m.

FOMU YA UWAKILISHI

Nambari ya mwanachama/ akaunti ya CDSC ____________________________

Katibu wa Kampuni
National Bank of Kenya Limited
Harambee Avenue
SLP 72866-00200
NAIROBI

Mimi/sisi ....
Kutoka (anwani) ....
Kama Mwanachama/ wanachama wa National Bank of Kenya Limited, namteua/twamteua:-
....
Kutoka (anwani)...
au akikosa, mwenyekiti wa mkutano kuwa wakala wangu/wetu, ili kupiga kura kwa niaba yangu/yetu wakati wa mkutano wa 50 wa pamoja wa mwaka wa Kampuni utakaofanyika **Ijumaa Juni 14, 2019 kuanzia saa nne asubuhi** au kuahirishwa kwake.

Kama shahidi ninatia /tunatia sahihi hii/hizi siku ya .... Mwezi wa 2019

Sahihi ______________________________________

MUHIMU

1. Si lazima kwa wakala kuwa mwanachama
2. Katika hali ambapo mwanachama ni shirika, fomu ya uwakilishi iwe imepigwa mhuri Wake
3. Ni lazima fomu hii ya uwakilishi kuwasilishwa katika ofisi za benki zilizosajiliwa kabla ya Jumatano Juni 12, 2019

Barua ya Kumruhusu mwanachama kuhudhuria mkutano

Tafadhali jaza fomu hii na ufahamu kwamba ni lazima itolewe nawe au wakala wako ili kukuruhusu kuhudhuria Mkutano wa pamoja wa mwaka wa kampuni.

Jina .... Sahihi ....

Nambari ya mwanachama/ nambari ya CDSC ....

Mkutano wa 50 wa pamoja wa mwaka wa wanahisa wa National Bank of Kenya Limited (kampuni) utafanyika katika ukumbi wa uwanja wa Kimataifa wa Michezo wa Moi Kasarani katika ukumbi wa Indoor Arena Ijumaa Juni 14, 2019 kuanzia saa nne asubuhi.

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Email: callcentre@nationalbank.co.ke

70. Wajir Branch
P.O. B ox 597 – 70200, Wajir
Tel: 020-2828000
Mobile: 0711038000
Email: wajirbranch@nationalbank.co.ke

71. Nyali Centre
P.O. Box 34440-80118, Mombasa
Tel: 020-2828000
Mobile: 0711038000
Email: callcentre@nationalbank.co.ke

72. Kericho
P.O. Box 1266-20200 Kericho
Tel: 020-2188235/2828000
Mobile: 0711038000
Email: callcentre@nationalbank.co.ke

73. Mandera
P.O. Box 379-70300 Mandera
Tel: 020-2188235/2828000
Mobile: 0711038000
Email: callcentre@nationalbank.co.ke

74. Isiolo
P.O. Box 709-60300 Isiolo
Tel: 020-2828900
Mobile: 0703088900
Email: IsioloBranch@nationalbank.co.ke

75. Kisumu Premium
P.O. Box 7254 40100 Kisumu
Tel: 020-2828900
Mobile: 0703088900
Email: PremiumBankingKisumuBranch@nationalbank.co.ke

76. South C – Red Cross Branch
P.O. Box 38645 00100 Nairobi
Tel: 020-2828900
Mobile: 0703088900
Email:SouthCRedCrossBranch@nationalbank.co.ke

77. Yaya Centre
P.O. Box 76193-00508 Nairobi
Tel: 020-2828900
Mobile: 0703088900
Email: YayaCentre@nationalbank.co.ke

78. Gigiri
P.O. Box 72866-00200 Nairobi
Tel: 020-2828900
Mobile: 0703088900
Email: GigiriBranch@nationalbank.co.ke

79. JKIA Terminal 2
P.O. Box 30763-00100 Nairobi
Tel: 020-2828900
Mobile: 0703088900
Email: jkia@nationalbank.co.ke

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