DIB BANK KENYA LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

AT

31 DECEMBER 2018

DIB BANK KENYA LIMITED

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

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DIB BANK KENYA LIMITED

DIRECTORS AND STATUTORY INFORMATION

BOARD OF DIRECTORS

Dr. Adnan Chilwan*	Chairman	
Dr. Steve Mainda**	Non-Executive Director	
Mr Michael Murphy***	Non-Executive Director	
Mr Mohamed Al Nahdi****	Non-Executive Director	
Mr Mohamed Al Sharif ****	Non-Executive Director	
Mr Dan Omoro**	Managing Director/CEO	Resigned 13 March 2018
Mr Peter Makau**	Managing Director/CEO	Joined 13 March 2018

*Indian **Kenyan ***British **** Emirati

COMPANY SECRETARY
Njeri Waitimu
Certified Public Secretary (Kenya)
P.O. Box 6450 – 00200
Nairobi

AUDITORS
KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
P.O. Box 40612 – 00100
Nairobi, Kenya

LAWYERS
Hamilton Harrison & Mathews
Delta Office Suites
P.O. Box 30333 – 00100
Nairobi, Kenya

REGISTERED OFFICE/ HEAD OFFICE
Upper Hill Building
Bunyala Road / Lower Hill Road Junction
P.O. Box 6450 – 00200
Nairobi, Kenya

BRANCHES
Upper Hill Branch
Sandview Building
Bunyala Road / Lower Hill Road Junction
P.O. Box 6450 – 00200
Nairobi, Kenya

Kilindini Branch
Baywood Building
Kilindini
P.O. Box 4016 – 80107
Mombasa, Kenya

Goodman Branch
Goodman Tower – Waiyaki Way
P.O. Box 6450 – 00200
Nairobi, Kenya

DIB BANK KENYA LIMITED

STATEMENT OF CORPORATE GOVERNANCE

Board/Management Committees

Tabulated below are Board/Management Committees, their composition and membership, functions and the frequency of meetings.

	Board Audit Committee	**Board Risk and IT Committee**	**Board Credit Committee**	**Board Nominations and Remuneration Committee**
Membership	Michael Murphy - Non-Executive Director* Steve Mainda - Non-Executive Director Mohamed Al Sharif - Non-Executive Director	Steve Mainda - Non-Executive Director Michael Murphy - Non-Executive Director* Mohamed Al Nahdi-Non-Executive Director	Steve Mainda - Non-Executive Director * Michael Murphy- Non-Executive Director Mohamed Al Sharif - Non-Executive Director	Steve Mainda - Non-Executive Director * Michael Murphy - Non-Executive Director Mohamed Al Nahdi - Non-Executive Director
Functions	The objective is to provide independent oversight of the institution's financial reporting and internal control system, ensure checks and balances within the institution are in place and to recommend appropriate remedial action regularly, preferably at least once in three months.	This committee is responsible for the management of significant risks and compliance issues affecting the Bank.	This committee is responsible for assisting the board in reviewing and overseeing the financing process of the institution.	The purpose of the Committee is to make nomination and recommendations to the Board on selection of directors, appropriate remuneration policies and practices including the Short Term / Long Term Incentive plans and its amendments as appropriate with the objective of attracting and retaining staff.
Frequency of meetings	Once per quarter	Once per quarter	Once per quarter	Once per quarter

*Chairman

DIB BANK KENYA LIMITED

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

Board/Management Committees – continued

	Country Management Committee	**Management Credit Committee**	**Risk Management Committee**	**Crisis Management Committee**	**Assets & Liabilities Management Committee**
Membership	Chief Executive Officer (CEO)* Head of Finance Head of Risk Management Head of Corporate and Investment Banking Head of Retail and SME Banking Head of Operations Head of HR & Admin Head of IT Sharia Co-ordinator Head of Credit Head of Treasury	Chief Executive Officer* Head of Credit Head of Treasury Head of Retail & SME Head of Corporate & Investments	Chief Executive Officer* Head of Risk Management & Compliance Head of Finance Head of HR & Admin Head of Operations Head of Retail & Business Banking Head of Corporate Investment Banking Head of Legal Head of IT	Chief Executive Officer* Head HR/Administration Head of Risk Head of Operations Head of Retail & SME Head of Marketing Head of Finance Head of Treasury Head of Internal Audit Head of Credit Head of IT Head of Corporate & Investment Banking Sharia Coordinator Head of Legal	Chief Executive Officer (CEO)* Head of Finance (CFO) Head of Treasury Head of Corporate and Investment Banking Head of Retail and SME Banking Head of Risk Management Head of Credit
Functions	The committee is responsible for supervising all the activities of the Bank. The committee manages the strategic intent and thrust of the Bank's operations in line with the approved country strategy.	To review the credit and risk exposures policies of the Bank and monitor the implementation of the credit and risk policies.	The committee will support the Board Risk Committee and the CEO in implementing the risk management framework, drive the right risk culture, ensure business trades within the approved risk appetite through continuous risk monitoring and challenging the status quo.	The committee is responsible for handling of disasters and any crisis arising requiring immediate response as soon as it occurs to reduce the impact on business continuity of the Bank.	The committee is responsible for balance sheet (Asset & Liability) risk Management.
Frequency of meeting	At least once a month	At least once a month	At least once a month	Meets on a need basis	At least once a month

*Chairman

Board meetings attendance

There were 6 scheduled board meetings in the year. The meetings were held in an atmosphere of intellectual honesty of purpose, integrity and mutual respect, requiring reporting of the highest standard by management and direct, robust and constructive challenge and debate among Board and committee members.

The Central Bank of Kenya Prudential Guidelines requires that every Board member attend a minimum of 75% of all Board meetings.

The schedule below shows attendance by directors for the period to 31 December 2018.

	Director	Executive/ Non-executive	Number of meetings attended	% attendance	Date Joined* /resigned**
1	Dr Adnan Chilwan	Chairman	6	100%	
2	Dr Steve Mainda	Non-Executive Director	6	100%	
3	Mr Michael Murphy	Non-Executive Director	6	100%	
4	Mr Mohamed Al Nahdi	Non-Executive Director	6	100%	
5	Mr Mohamed Al Sharif	Non-Executive Director	6	100%	
6	Mr Dan Omoro	Managing Director/CEO	3	100%	**13 March 2018
7	Mr Peter Makau	Managing Director/CEO	3	100%	*13 March 2018

Board performance evaluation

Under the Prudential guidelines issued by the Central Bank of Kenya, the Board of Directors is responsible for ensuring that a rigorous evaluation is carried out of its performance, its committees and individual Directors. This evaluation is conducted annually, and the results are provided to the Central Bank of Kenya.

In the financial year ended 2018, the Board undertook a formal evaluation of its performance and that of its committees and individual directors. This performance evaluation is an annual exercise aimed at ensuring that the Board remains efficient and effective while discharging its responsibilities. Overall, the results for the evaluation were positive and indicated that the Board and committees were effective and that no major changes were required.

DIB BANK KENYA LIMITED

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2018

The Directors have pleasure in submitting their report with the audited financial statements for the year ended 31 December 2018 which disclose the state of affairs of the Company, in accordance with the Kenyan Companies Act, 2015.

1. Principal activities

The Company is licensed to operate as a bank under the Banking Act. The Banking Licence was issued by Central Bank of Kenya on 28 April 2017.

2. Results

The results for the year are set out on page 11.

3. Dividend

The directors do not recommend the payment of a dividend (2017 – Nil).

4. Directors

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

5. Business overview

Performance

The Bank reported a loss before tax of KShs 873 million (2017 – KShs 839 million). The Bank began banking operations in June 2017 and has since grown to a customer deposits base of KShs 3.2bn and granted financing assets worth KShs 2.13bn as of the period ended 31 December 2018. As a result, income from financing and investing activities increased to KShs 178.9 million from KShs 13.2 million in 2017 and Depositors share of profits increased to KShs 126.8m (2017 – KShs 8.9m).

The increase in the reported loss is as a result of increased operating expenses and impairment provision on financing assets.

The Bank adopted International Financial Reporting Standard (IFRS) 9, Financial instruments effective 1 January 2018.

The Bank recorded a charge to its opening 1 January 2018 total equity of KShs 1.05m net of tax, to reflect the impact of the new requirements of impairment and classification and measurement of financial instruments at the adoption date and did not restate comparative periods, as permitted by the standard.

Accordingly, the current year 2018 results are based on IFRS 9, while the prior years' results are based on International Accounting Standard (IAS) 39, Financial Instruments: Recognition and Measurement and therefore, certain amounts herein and related ratios are not comparable. The main impact under IFRS 9 is related to impairment provisions on financing arrangements. The provision for impairment on performing financing arrangements is stages 1 and 2 under IFRS 9, while impairment provision for credit losses on impaired financing arrangements is stage 3. For detailed description of the changes, refer to Notes 4 (g) and 5 (a) in the financial statements.

DIB BANK KENYA LIMITED

REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2018 (CONTINUED)

5. **Business overview - continued**

Risk management

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established various committees, which are responsible for developing and monitoring risk management policies in their specified areas.

The Bank's approach to risk management include financial risk management objectives and policies. Information on the Bank's exposure to credit, liquidity, market and operational risk is discussed in note 5 of these financial statements.

Post balance sheet events

No material events or circumstances have arisen between the accounting date and the date of this report.

6. **Relevant audit information**

The Directors in office at the date of this report confirm that:

(i) There is no relevant audit information of which the Company's auditor is unaware; and
(ii) Each director has taken all the steps that they ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

7. **Auditors**

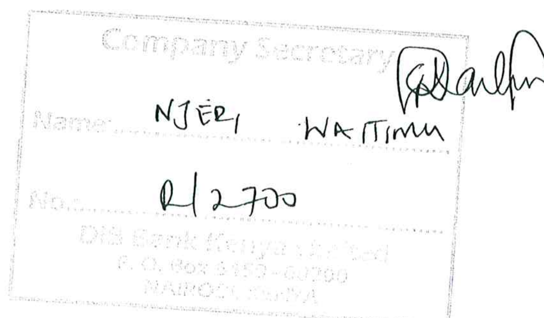
The auditors, KPMG Kenya, have expressed their willingness to continue in office in accordance with the Kenyan Companies Act, 2015 and subject to Section 24(1) of the Banking Act (Cap 488).

8. **Approval of financial statements**

The financial statements were approved and authorised for issue by the Board of Directors on 19 February 2019

BY ORDER OF THE BOARD

Secretary



Date: 19 February 2019

DIB BANK KENYA LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of DIB Bank Kenya Limited set out on pages 11 to 74 which comprise the statement of financial position at 31 December 2018, the statement of profit or loss and other comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and fairly presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by 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 misstatements, whether due to fraud or error.

Under the Kenyan Companies Act, 2015 the Directors are required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Company as at the end of the financial year and of the profit or loss of the Company for that year. It also requires the Directors to ensure the Company keeps proper accounting records which disclose with reasonable accuracy the financial position of the Company.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. The Directors are of the opinion that the financial statements give a true and fair view of the financial position of the Company and of its profit or loss.

The Directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

The Directors have made an assessment of the Company's ability to continue as a going concern and have no reason to believe the Company will not be a going concern for at least the next twelve months from the date of this statement.

Approval of the financial statements

The financial statements, as indicated above, were approved and authorised for issue by the Board of Directors on 19 February 2019

Peter Makau
Managing Director/CEO

Mohamed Al Sharif
Director

Date: 19 February 2019

KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
PO Box 40612 00100 GPO
Nairobi, Kenya

Telephone +254 20 2806000
Email info@kpmg.co.ke
Website www.kpmg.com/eastafrica

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF DIB BANK KENYA LIMITED

Report on the audit of the financial statements

Opinion

We have audited the financial statements of DIB Bank Kenya Limited ("the Company") set out on pages 11 to 74 which comprise the statement of financial position as at 31 December 2018, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows, for the year then ended and notes to the financial statements and a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of DIB Bank Kenya Limited at 31 December 2018, and of the financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act, 2015.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *"Auditors' Responsibilities for the Audit of the Financial Statements"* section of our report. We are independent of the 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 other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The Directors are responsible for the other information. The other information comprises the information included in the *Annual Report and Financial Statements* but does not include the financial statements and our auditors' report thereon.

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

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

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

KPMG Kenya is registered partnership and a member of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Partners (British*)

EE Aholi
BC D'Souza
JM Gathecha
JI Kariuki
PI Kinuthia
AM Mbai
JL Mwaura
BM Ndung'u
JM Ndunyu
AW Pringle*

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF
DIB BANK KENYA LIMITED (CONTINUED)

Report on the audit of the financial statements (Continued)

Directors' responsibilities for the financial statements

As stated on page 7, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards (IFRSs) and in the manner required by the Kenyan Companies Act, 2015 and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

The directors are responsible for overseeing the Company's financial reporting process.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an 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 judgment and maintain professional scepticism throughout the audit. We also:

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

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF DIB BANK KENYA LIMITED (CONTINUED)

Report on the audit of the financial statements (Continued)

Auditors' responsibilities for the audit of the financial statements - continued

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

Report on other legal and regulatory requirements

As required by the Kenyan Companies Act, 2015 we report to you, based on our audit that;

— In our opinion, the information given in the report of the directors for the year ended 31 December 2018 on page 5 to 6 is consistent with the financial statements; and

— We have issued an unqualified audit report on the annual financial statements.

The Engagement Partner responsible for the audit resulting in this independent auditors' report is CPA Jacob Gathecha Maina – P/1610.

KPMG Kenya

Date: 19 February 2019

KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
P.O. Box 40612 – 00100
Nairobi, Kenya

DIB BANK KENYA LIMITED

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

	Note	2018 KShs'000	2017 KShs'000
Income from financing and investing activities	7	178,903	13,162
Depositors share of profits	8	(126,841)	(8,909)
Net profit income		**52,062**	**4,253**
Fees and commission income	9(a)	66,440	9,237
Other income	9(b)	16,683	-
		83,123	9,237
Operating income		**135,185**	**13,490**
Personnel expenses	10(a)	(436,312)	(387,344)
Other operating expenses	10(b)	(380,597)	(304,239)
Depreciation	16	(107,627)	(125,325)
Amortisation	17	(63,313)	(34,737)
Total expenses		**(987,849)**	**(851,645)**
Operating loss before impairment losses and taxation		**(852,664)**	**(838,155)**
Impairment provision on financing assets	5(a)	(20,661)	(1,146)
Loss before income tax	11	**(873,325)**	**(839,301)**
Income tax credit	12	247,571	239,454
Loss for the year		**(625,754)**	**(599,847)**
Other comprehensive income, net of income tax		-	-
Total comprehensive income for the year		**(625,754)**	**(599,847)**

The notes set out on pages 15 to 74 are an integral part of these financial statements.

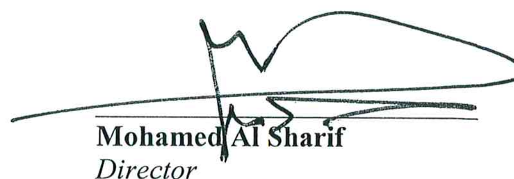
DIB BANK KENYA LIMITED

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

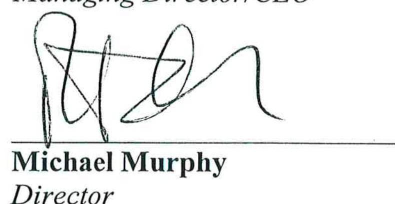
	Note	2018 KShs'000	2017 KShs'000
Assets			
Cash and balances with Central Bank	13	519,857	109,584
Balances due from banking institutions	14	1,008,732	761,400
Financing arrangements	15	2,131,658	290,621
Property and equipment	16	244,092	336,996
Intangible assets	17	449,630	492,607
Other assets	18	127,154	97,631
Deferred tax asset	19	769,491	521,470
Total assets		**5,250,614**	**2,610,309**
Liabilities			
Balances due to banking institutions	20	-	103,337
Customer deposits	21	3,197,859	1,181,421
Other liabilities	22	107,495	56,711
Total liabilities		**3,305,354**	**1,341,469**
Equity			
Share capital	24(a)	3,864,494	2,000,000
Funds awaiting allotment of shares	24(b)	-	561,270
Retained earnings		(1,920,667)	(1,294,202)
Statutory credit risk reserve	24(c)	1,433	1,772
Total equity		**1,945,260**	**1,268,840**
TOTAL LIABILITIES AND EQUITY		**5,250,614**	**2,610,309**

The financial statements on pages 11 to 74 were approved and authorised for issue by the Board of Director and were signed on its behalf by:

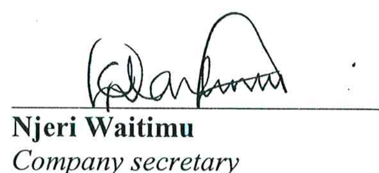
Peter Makau
Managing Director/CEO



Mohamed Al Sharif
Director



Michael Murphy
Director



Njeri Waitimu
Company secretary

19 February 2019

The notes set out on pages 15 to 74 are an integral part of these financial statements.

DIB BANK KENYA LIMITED

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

	Share capital KShs'000	Shares awaiting allotment KShs'000	Statutory credit risk reserve KShs'000	Retained earnings KShs'000	Total equity KShs'000
2018					
Balance at 31 December 2017	2,000,000	561,270	1,772	(1,294,202)	1,268,840
Adjustment on initial application of IFRS 9 (See Note 6)	-	-	-	(1,500)	(1,500)
Tax impact (See Note 6)	-	-	-	450	450
IFRS 9 Re-measurements (See Note 6)	-	-	(1,500)	1,500	-
Restated balance at 1 January 2018	**2,000,000**	**561,270**	**272**	**(1,293,752)**	**1,267,790**
Comprehensive income for the period					
Loss for the year	-	-	-	(625,754)	(625,754)
Total comprehensive income	**-**	**-**	**-**	**(625,754)**	**(625,754)**
Other comprehensive income					
Transfer to statutory credit risk reserve	-	-	1,161	(1,161)	-
Transaction with owners					
Issue of shares (Note 24(a))	1,864,494	(561,270)	-	-	1,303,224
At 31 December 2018	**3,864,494**	**-**	**1,433**	**(1,920,667)**	**1,945,260**
2017					
At 1 January 2017	2,000,000	-	-	(692,583)	1,307,417
Comprehensive income for the period					
Loss for the year	-	-	-	(599,847)	(599,847)
Total comprehensive income	**-**	**-**	**-**	**(599,847)**	**(599,847)**
Other comprehensive income					
Transfer to statutory credit risk reserve	-	-	1,772	(1,772)	-
Transaction with owners					
Issue of shares (Note 24(a))	-	561,270	-	-	561,270
At 31 December 2017	**2,000,000**	**561,270**	**1,772**	**(1,294,202)**	**1,268,840**

The notes set out on pages 15 to 74 are an integral part of these financial statements.

DIB BANK KENYA LIMITED

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 KShs'000	2017 KShs'000
Net cash used in operating activities	25	(709,900)	262,013
Investing activities			
Purchase of property and equipment	16	(14,723)	(36,167)
Purchase of intangible assets	17	(20,336)	(26,802)
Net cash used in investing activities		**(35,059)**	**(62,969)**
Financing activities			
Shareholders' funds awaiting allotment	24(b)	-	561,270
Proceeds from issue of share capital	24(a)	1,303,224	-
Net cash flows from investing activities		**1,303,224**	**561,270**
Net increase in cash and cash equivalents		558,265	760,314
Cash and cash equivalents at 1 January		832,144	71,830
Cash and cash equivalents at 31 December	25	**1,309,409**	**832,144**

The notes set out on pages 15 to 74 are an integral part of these financial statements.

1. REPORTING ENTITY

DIB Bank Kenya Limited ("the Bank" or "the Company") is incorporated as a limited Company in Kenya under the Kenyan Companies Act, and is domiciled in Kenya. The Bank is involved in investment, corporate and retail banking. The address of the Company's registered office is as follows:

Upper Hill Building
Bunyala Road/Lower Hill Road Junction
P.O. Box 6450 – 00200
Nairobi

2. BASIS OF PREPARATION

(a) Statement of compliance

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

Details of the bank's significant accounting policies are included in Note 4.

This is the first set of the Company's annual financial statements in which IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers have been applied. Resultant changes to significant accounting policies are described in Note 4.

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

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis of accounting, except where otherwise stated in the accounting policies below.

(c) Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and assumptions are based on the Directors' best knowledge of current events, actions, historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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

In particular, information about significant areas of estimation and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is set out below:

2. BASIS OF PREPARATION (Continued)

(c) Use of estimates and judgments (continued)

(i) Taxation

Judgment is required in determining the provision for income taxes due to the complexity of legislation. There are many transactions and calculations for which ultimate tax determination is uncertain during the ordinary course of business. The Company recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

The Company recognises the net future tax benefit that relates to deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires the Company to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realise the net deferred tax assets recorded at the reporting date could be impacted.

(ii) Useful lives and residual values of property and equipment

The Company tests annually whether the useful life and residual value estimates were appropriate and in accordance with its accounting policy. Useful lives and residual values of property and equipment have been determined based on previous experience and anticipated disposal values when the assets are disposed. The rates used are set out in Note 4(c) (iii).

(iii) Allowance for credit losses

Assets accounted for at amortised cost and fair value through other comprehensive income are evaluated for impairment on a basis described in accounting policy 4(g).

The Bank recognises loss allowance at an amount equal to either 12-month expected credit losses (ECLs) or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

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

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

For credit exposures that are credit impaired and in default, similar to stage 2 assets, a loss allowance is required for lifetime ECLs however the probability of default for these assets is presumed to be 100% less any determined recovery and cure rate. These are classified as Stage 3 assets.

2. BASIS OF PREPARATION (Continued)

(c) Use of estimates and judgments (continued)

(iv) Critical accounting judgements in applying the Company's accounting policies

Classification of financial assets
Assessment of the business model within which assets are held and assessment of whether the contractual terms of the financial asset are Solely Payment Principle and Interest (SPPI) on the principle amount outstanding. Whereas IFRS refers to the assessment of cash flow characteristics as SPPI review, throughout these financial statements, income from financing arrangements is referred to as profit income.

Determination of significant increase in credit risk
Establishing the criteria for whether credit risk on the financial asset has increased significantly since initial recognition, determining methodology for incorporation of forward-looking information into measurement of ECL and selection and approval of models used to measure ECL.

3. DEFINITIONS OF THE BANK'S PRODUCTS

The following terms are used in the financial statements with the meaning specified:

(a) Murabaha

An Islamic financing transaction which represents an agreement whereby the Bank buys a commodity/good and sells it to a counterparty based on a promise received from that counterparty to buy the commodity according to specific terms and conditions. The selling price comprises of the cost of the commodity/goods and a pre-agreed profit margin.

(b) Diminishing Musharaka

An Islamic financing transaction whereby the Bank will enter into agreement to jointly purchase an asset with another party and income will be received by the Bank relating to that proportion of the asset owned by the Bank at any point in time. The other party to the agreement will make separate payments to purchase additional proportion of the asset from the Bank thereby reducing the Bank's effective share.

(c) Ijarah

An Islamic financing transaction whereby the Bank purchases an asset for lease according to the customer's request (lessee) based on his promise to lease the asset for a specific period and against certain rent instalments. Ijarah could end by transferring the ownership of the asset to the lessee.

(d) Mudaraba

An Islamic investing transaction between the Bank and another party (Rab ul Mal) whereby the latter would provide a certain amount of funds, which the Bank (Mudarib) would then invest in a specific enterprise or activity against a specific share in the profit. The Mudarib would bear the loss in case of negligence or violation of any of the terms and conditions of the Mudaraba.

(e) Customer deposits

Deposits are generated on two modes; Qard and Mudaraba. Deposits taken on the basis of Qard are classified as current accounts while deposits generated on Mudaraba basis are classified as savings and time deposit accounts. No profit or loss is passed to current account depositors. Profit realised in investment pools is distributed among depositors in pre-agreed profit sharing ratio. Rab ul Maal share is distributed among depositors according to weightages assigned at the inception of the profit calculation period.

3. DEFINITIONS OF THE BANK'S PRODUCTS (Continued)

(f) Income paid to depositors

Profit sharing accounts are based on the principle of Mudaraba whereby the Bank and the customer share any profit earned on the customer deposits on a pre-agreed profit sharing ratio. The customer's share of profit is paid in accordance with the terms and conditions of the account. The profit calculation is undertaken at the end of each calendar month.

(g) Tawarruq

An Islamic financing arrangement in which a customer purchases a commodity/good from the bank on deferred payment plan, then sells the commodity immediately to obtain liquidity.

4. SIGNIFICANT ACCOUNTING POLICIES

Except for changes explained in Note 4 (q) (i), the bank has consistently applied the following accounting policies to all period presented in this financial statements.

(a) Revenue recognition

Income is recognised on an accrual basis using the effective interest rate method.

(i) Income from Islamic financing and investing activities

Effective Interest rate

Income from financing arrangements is recognised in profit or loss using the effective interest rate method. Whereas IFRS refers to effective interest rate method, within these financial statements, income from financing arrangements is referred to as profit income. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- The gross carrying amount of the financial asset; or
- The amortised cost of the financial liability

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not the expected credit loss (ECL). For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset is the amount at which the financial asset is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest rate method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any ECL (or impairment allowance before 1 January 2018).

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Revenue recognition (continued)

(i) Income from Islamic financing and investing activities - continued

Amortised cost and gross carrying amount - continued

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of profit income

The effective interest rate of a financial asset is calculated on initial recognition of a financial asset. In calculating profit income, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired). The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

However, for financial assets that have become credit-impaired subsequent to initial recognition, profit income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of profit income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, Purchased originated credit impaired (POCI) assets, profit income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of profit income does not revert to a gross basis, even if the credit risk of the asset improves.

(ii) Non-Shari'ah compliant income

The Bank does not, as a policy, engage in any activities that involve receipt or payment of interest.

(iii) Fees and commission income

Fees and commission income is recognised on an accrual basis when the service is provided. Fee and commission income mainly relates to account servicing fees, account transaction fees and charges on issuance of letters of credit, acceptances, guarantees and performance bonds. Other fees and commission expense relate mainly to interbank transaction and other fees, which are expensed as the services are received.

(b) Foreign currencies

(i) Functional and presentation currency

The financial statements are presented in Kenya shillings (KShs) which is the Bank's functional and presentation currency. Except as otherwise indicated, financial information presented in Kenya shillings has been rounded to the nearest thousand (KShs'000).

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Foreign currencies (continued)

(ii) Translation of foreign currencies

Transactions in foreign currencies during the year are translated into Kenya shillings at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies as at the reporting date are translated into Kenya shillings at the exchange rate ruling at that date. Resulting exchange differences are recognised in profit or loss for the year. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated into Kenya shillings at the exchange rate ruling at the date on which the fair value is determined. Non-monetary assets and liabilities denominated in foreign currencies that are measured based on historical cost are translated in to Kenya shillings using the exchange rate ruling at the date of the transaction.

(c) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at historical cost less accumulated depreciation and impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the asset.

(ii) Subsequent cost

The cost of replacing a component of an item of property or equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. The costs of the day-to-day servicing of property, plant and equipment are recognised in the profit or loss.

(iii) Depreciation

Depreciation is charged to the profit or loss on a straight line basis over the estimated useful lives of each item of property, plant and equipment. The estimated useful lives are as follows:

Asset class	Depreciation rate
— Leasehold improvements	16.7%
— Equipment, fixtures and fittings	20.0%
— Motor vehicle	25.0%
— Computers	33.3%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

(iv) Disposal of property and equipment

Gain and losses on disposal of an item of property and equipment are determined by comparing the proceeds from the disposal with the carrying amount of the property and equipment and are recognised net in profit or loss.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Intangible assets

Computer software licenses are stated at cost less accumulated amortisation and accumulated impairment.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Software is amortised on a straight-line basis in profit or loss over its estimated useful life, from the date that is available for use. The estimated useful life of software is 5 years and 10 years for the core banking system.

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

(e) Leases

Leases are divided into finance leases and operating leases.

(i) Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by another party, the lessor, are classified as operating leases. Payments, including pre-payments, made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

The total payments made under operating leases are charged to 'other operating expenses' on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(ii) Finance leases

Leases of assets where the Bank has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding.

The corresponding rental obligations, net of finance charges, are included in deposits from banks or deposits from customers depending on the counter party. The profit element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of profit on the remaining balance of the liability for each period.

The leases entered into by the Bank are primarily operating leases.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Taxation

Tax on the profit or loss for the year comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. It is measured using tax rates enacted or substantively enacted at the reporting date.

Deferred tax is provided on all temporary differences between the carrying amounts of financial assets and financial liabilities for financial reporting purposes and the amounts used for taxation purposes, except temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future and taxable temporary differences arising on the initial recognition of goodwill.

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

Deferred tax is calculated on the basis of the tax rates currently enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

In determining the amount of current and deferred tax, the Bank considers the impact of tax exposures, including whether additional taxes and interest may be due. This assessment relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Bank to change its judgement regarding the adequacy of existing tax liabilities; such changes to tax liabilities would impact tax expense in the period in which such a determination is made.

(g) Financial instruments

(i) Classification

The Company classifies its financial assets into three principal classification categories based on the cash flow characteristics of the asset and the business model assessment:

- measured at Amortised Cost;
- Fair Value through Other Comprehensive Income (FVOCI); and
- Fair Value through Profit or Loss (FVTPL)

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(i) Classification - continued

The previous categories of Held to Maturity, Loans and Receivables and Available for Sale under IAS 39 have been replaced. Financial instruments defined as loans and receivables, per IFRS, in this AFS refer to financing arrangements and other assets.

Amortised cost

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

— it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
— its contractual terms give rise on specified dates to cash flows that are solely payments of principal and Interest (SPPI) on the principal amount outstanding.

The Company recognises cash and balances with Central Bank, balances due from banking institutions, financing arrangements and other assets at amortised cost.

Fair Value through Other Comprehensive Income (FVOCI) – Debt

A financial asset which is a debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

— it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
— its contractual terms give rise on specified dates to cash flows that are solely payments of principal and Interest (SPPI) on the principal amount outstanding.

The Company has no financial assets classified at FVOCI.

Fair Value through Other Comprehensive Income (FVOCI) – Equity

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by investment basis. The Company currently does not have any equity investments.

Fair Value through Profit or Loss (FVTPL)

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. In addition, on initial recognition the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Company does not have financial assets classified at FVTPL. A financial asset is classified into one of these categories on initial recognition.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(i) Classification - continued

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of IFRS 9 are not separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Assessment of whether contractual cash flows are solely payments of principal and Interest (SSPI)

To determine whether a financial asset should be classified as measured at amortised cost, FVOCI or FVTPL, an entity assesses whether the cash flows from the financial asset represent, on specified dates, solely payments of principal and interest on the principal amount outstanding - i.e. the SPPI criterion. A financial asset that does not meet the SPPI criterion is always measured at FVTPL, unless it is an equity instrument for which an entity applies the FVOCI election.

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. The definition of principal reflects the economics of the financial asset from the perspective of the current holder. This means that an entity assesses the asset's contractual cash flow characteristics by comparing the contractual cash flows to the amount that it actually invested.

'Profit' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Company considered the contractual terms of the instrument. This included assessing whether the financial asset contained a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Company considered:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Company's claim to cash flows from specified assets – e.g. non-recourse asset arrangements; and
- features that modify consideration for the time value of money – e.g. periodic reset of Interest rates.

Contractual features that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, give rise to contractual cash flows that do not meet the SPPI criterion.

The bank has determined that the contractual cash flows of these Financing arrangements are SPPI because the profit is not leveraged and though may vary will still represent consideration for time value of money, other basic lending risks and costs associated with the principal amount outstanding.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(i) Classification - continued

Assessment of whether contractual cash flows are solely payments of principal and Interest - continued

De minimis

A contractual cash flow characteristic does not affect the classification of a financial asset if it could have only a de minimis effect on the financial asset's contractual cash flows.

To make this determination, the Company considers the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial asset.

Business model assessment

The Company makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- how the performance of the portfolio is evaluated and reported to the Company's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Company's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

The Company's financial assets are all held in held within a business model whose objective is to hold assets to collect contractual cash flows.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(i) Classification - continued

Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, although under IAS 39 fair value changes of liabilities designated under the fair value option were recognised in profit and loss, under IFRS 9, fair value changes are generally presented as follows:

- the amount of change in fair value that is attributable to changes in credit risk of the liability is presented in OCI and;
- the remaining amount of change in fair value is presented in profit or loss.

The Company classifies all financial liabilities as subsequently measured at amortised cost.

Customer deposits, balances due to banking institutions and other liabilities are classified at amortised cost.

(ii) Reclassification

The Company only reclassifies financial assets when management changes the business model for managing the financial assets. In that instance all affected financial assets are reclassified. Such changes are expected to be very infrequent, and are determined by the Company's senior management as a result of external or internal changes.

(iii) Derecognition and contract modification

The Company derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognised as a separate asset or liability.

However, when the modification of a financial instrument not measured at FVTPL does not result in derecognition, the Company will recalculate the gross carrying amount of the financial asset (or the amortised cost of the financial liability) by discounting the modified contractual cash flows at the original effective interest rate and recognise any resulting adjustment as a modification gain or loss in profit or loss.

The Company derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

(iv) Write-off

The Company directly reduces the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event.

4. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(g) Financial instruments (continued)

(v) Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a Company of similar transactions such as in the Company's trading activity.

(vi) Impairment – financing arrangements, off balance sheet commitments and financial guarantee contracts

IFRS 9 replaced the previous 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model.

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

— financial assets that are debt instruments – this applies to the Company's financing arrangements to customers, cash and balances with Central Bank, balances due from banking institutions and other assets; and
— Off balance sheet financing arrangement commitments and financial guarantee contracts issued (previously, impairment was measured under IAS 37 Provisions, Contingent Liabilities and Contingent Assets) - this applies to the Company's off balance sheet exposures where credit intervention is not required for the counterparty to access the credit facility.

No impairment loss is recognised on equity investments.

The Company recognises loss allowance at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring.

The Company recognises loss allowances at an amount equal to lifetime ECLs, except in the cases where credit risk has not increased significantly since initial recognition. Loss allowances for trade and lease receivables will always be measured at an amount equal to lifetime ECLs applying the simplified approach.

The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in the following areas, which are discussed in detail below and in note 5(a):

— assessing whether the credit risk of an instrument has increased significantly since initial recognition; and
— incorporating forward-looking information into the measurement of ECLs.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(vi) Impairment – financing arrangements, Financing commitments and financial guarantee contracts - continued

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses and will be measured as follows:

— financial assets that are not credit-impaired at the reporting date: the present value of all cash shortfalls – i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive;
— financial assets that are credit-impaired at the reporting date: the difference between the gross carrying amount and the present value of estimated future cash flows;
— undrawn Financing commitments: the present value of the difference between the contractual cash flows that are due to the Company if the commitment is drawn down and the cash flows that the Company expects to receive; and
— financial guarantee contracts: the present value of the expected payments to reimburse the holder less any amounts that the Company expects to recover.

An asset is credit-impaired if one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset. The following are examples of such events:

— significant financial difficulty of the issuer or the borrower;
— a breach of contract - e.g. a default or past-due event;
— a lender having granted a concession to the borrower - for economic or contractual reasons relating to the borrower's financial difficulty - that the lender would not otherwise consider;
— it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
— the disappearance of an active market for that financial asset because of financial difficulties; or
— the purchase of a financial asset at a deep discount that reflects the incurred credit losses.

(vii) Classification and measurement, de-recognition, and impairment of financial instruments effective prior to 1 January 2018

(a) Classification

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability of another entity. Financial instruments are classified as follows:

Islamic financing assets and receivables

Islamic financing assets and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods and services directly to a debtor, with no intention of trading the receivable.

Islamic financing assets and receivables comprise other Cash and balances with Central Bank, Deposits and balances due from Banking institutions, financing arrangements and other receivables.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Financial instruments (continued)

(vii) Classification and measurement, de-recognition, and impairment of financial instruments effective prior to 1 January 2018 - continued

(a) Classification - continued

Other Financial liabilities
The Company classifies financial liabilities as other financial liabilities at amortised cost. Other financial liabilities include Balances due to other banking institutions, customer deposits and other payables.

(b) Recognition and measurement

The Company initially recognises financing assets and advances, deposits and debt securities issues on the date at which they are originated. All other financial assets and liabilities (including assets designated at fair value through the income statement) are initially recognised on the trade date, which is the date the Company becomes party to the contractual provisions of the instrument.

A financial asset or financial liability is initially measured at fair value plus, for items not at fair value through profit or loss, translation costs that are directly attributable to the acquisition or issue.

Subsequent to initial recognition, they are measured at their amortised cost using the effective interest method except where the Company design liabilities at fair value through profit or loss.

(c) De-recognition

A financial asset is derecognised when the Company loses the control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when its contractual obligations are discharged or cancelled or expire.

On de-recognition of a financial asset, the difference between the carrying amount of the asset and the consideration received is recognised in profit or loss.

(d) Identification and measurement of impairment of financial assets

At each reporting date the Company assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired.

Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

The Company considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by Banking together financial assets (carried at amortised cost) with similar risk characteristics.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Impairment of non-financial assets

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

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the profit or loss. Impairment losses recognised in respect of cash-generating units reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. 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 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.

(i) Contingent liabilities

Letters of credit, guarantees, bills for collection and swaps are accounted for as off balance sheet transactions and disclosed as contingent liabilities. Estimates of the outcome and of the financial effect of contingent liabilities are made by the management based on the information available up to the date the financial statements are approved for issue by the directors. Financing commitments are measured as follows:

- *From 1 January 2018:* The Company recognises a loss allowance (Note 4 (g) and 5(a))
- *Before 1 January 2018*: The Company recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

(j) Cash and cash equivalents

For the purpose of presentation of the cash flows in the financial statements the cash and cash equivalents include notes and coins in hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to insignificant risk of changes in their fair value and are used by the bank in the management of its short term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(k) Employee benefits

Short term employee benefits

Short term employee benefits are expensed as the related services are provided. A liability is recognised for the amount expected to be paid if the Company has a present or constructive obligation to pay this amount as a result of past services provided by the employee and the obligation can be estimated reliably.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(l) Dividends

Dividends on ordinary shares are recognised as a liability in the period in which they are declared and proposed dividends are disclosed as a separate component of equity.

(m) Foreign exchange income and expenses

This comprises foreign exchange differences. Foreign exchange gains and losses are reported on a net basis and are recognised in profit or loss.

(n) Determination of fair values

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Company has access at that date.

The fair value of a liability reflects its non-performance risk. When available, the Company measures the fair value of an instrument using the quoted price in an active market for that instrument.

A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If there is no quoted prices in an active market, then the Company uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

(o) Share capital

Incremental costs directly attributable to the issue of ordinary shares, net of any taxes are recognised as a deduction in equity.

(p) Related party transactions

The Company enters into transactions, arrangements and agreements involving directors, senior management and their related concerns in the ordinary course of business. The related party transactions are at arm's length.

(q) New standards, amendments and interpretations

(i) New standards, amendments and interpretations effective and adopted during the year

The Company has adopted the following new standards and amendments during the year ended 31 December 2018, including consequential amendments to other standards with the date of initial application by the Company being 1 January 2018. The nature and effects of the changes are as explained here in.

4. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(q) **New standards, amendments and interpretations (continued)**

(i) ***New standards, amendments and interpretations effective and adopted during the year - continued***

New standard or amendments	Effective for annual periods beginning on or after
— IFRS 15 Revenue from Contracts with Customers	1 January 2018
— IFRS 9 Financial Instruments (2014)	1 January 2018
— Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)	1 January 2018
— Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)	1 January 2018
— IFRIC 22 Foreign Currency Transactions and Advance Consideration	1 January 2018
— IAS 40 Transfers of Investment Property	1 January 2018
— Annual improvements cycle (2014-2016)	1 January 2018

IFRS 15 Revenue from Contracts with Customers

This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC-31 Revenue – Barter of Transactions Involving Advertising Services.

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The standard specifies how and when the Company will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.

The Company applied IFRS 15 on 1 January 2018 using the modified retrospective approach in which the cumulative effect of initially applying this Standard is recognised at the date of initial application as an adjustment to the opening balance of retained earnings as at 1 January 2018 without restating comparative periods.

There was no material impact of application of IFRS 15 and no adjustment to retained earnings was required.

IFRS 9: Financial Instruments (2014)

On 24 July 2014 the IASB issued the final IFRS 9 Financial Instruments Standard, which replaces earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement.

The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

IFRS 9: Financial Instruments (2014) - continued

As a result of the adoption of IFRS 9, the Company has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018, but have not been applied to the comparative information.

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 5(a).

Classification of financial assets and financial liabilities
IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows.

The standard eliminates the previous IAS 39 categories of held-to-maturity, Financing arrangements and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9, see Note 4(g).

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

— the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
— the remaining amount of change in the fair value is presented in profit or loss.

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see Note 4(g).

Impairment of financial assets
IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain Financing commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 4(g) and note 5(a).

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

IFRS 9: Financial Instruments (2014) - continued

Transition
Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

Comparative periods generally have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9. The Company used the exemption not to restate comparative periods.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

— The determination of the business model within which a financial asset is held.
— Determination of factors to consider in determining whether there has been a significant increase in credit risk.
— If a debt security had low credit risk at the date of initial application of IFRS 9, then the Company has assumed that credit risk on the asset had not increased significantly since its initial recognition.

For more information and details on the changes and implications resulting from the adoption of IFRS 9, see Note 4(g).

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

The following clarifications and amendments are contained in the pronouncement:

— *Accounting for cash-settled share-based payment transactions that include a performance condition*

Up until this point, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

— *Classification of share-based payment transactions with net settlement features*

IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

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

— *Accounting for modifications of share-based payment transactions from cash-settled to equity-settled*

Up until this point, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognised in respect of the cash-settled share-based payment is derecognised and the equity-settled share-based payment is recognised at the modification date fair value to the extent services have been rendered up to the modification date.
- Any difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date would be recognised in profit and loss immediately.

The amendments were effective for annual periods beginning on or after 1 January 2018. Earlier application was permitted. The amendments were to be applied prospectively. However, retrospective application was allowed if possible without the use of hindsight. If an entity applies the amendments retrospectively, it must do so for all of the amendments described above.

The adoption of this standard did not have a material impact on the Company's financial statements.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)

The amendments in Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts' (Amendments to IFRS 4) provide two options for entities that issue insurance contracts within the scope of IFRS 4:

- an option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets; this is the so-called overlay approach;
- an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4; this is the so-called deferral approach.

The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.

An entity applies the overlay approach retrospectively to qualifying financial assets when it first applies IFRS 9. Application of the overlay approach requires disclosure of sufficient information to enable users of financial statements to understand how the amount reclassified in the reporting period is calculated and the effect of that reclassification on the financial statements.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4) - continued

An entity applies the deferral approach for annual periods beginning on or after 1 January 2018. Predominance is assessed at the reporting entity level at the annual reporting date that immediately precedes 1 April 2016. Application of the deferral approach needs to be disclosed together with information that enables users of financial statements to understand how the insurer qualified for the temporary exemption and to compare insurers applying the temporary exemption with entities applying IFRS 9. The deferral can only be made use of for the three years following 1 January 2018. Predominance is only reassessed if there is a change in the entity's activities.

The adoption of this standard did not have a material impact on the Company's financial statements.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

This Interpretation applies to a foreign currency transaction (or part of it) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income (or part of it).

This Interpretation stipulates that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

This Interpretation does not apply to income taxes, insurance contracts and circumstances when an entity measures the related asset, expense or income on initial recognition:

(a) at fair value; or
(b) at the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying IFRS 3 Business Combinations).

The amendments apply retrospectively for annual periods beginning on or after 1 January 2018, with early application permitted.

The adoption of this standard did not have a material impact on the Company's financial statements.

Transfers of Investment property (Amendments to IAS 40)

The IASB has amended the requirements in IAS 40 Investment property on when a Company should transfer a property asset to, or from, investment property.

The adoption of this standard did not have a material impact on the amounts and disclosures of the Company's financial statements.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

(i) New standards, amendments and interpretations effective and adopted during the year - continued

Annual improvement cycle (2014 – 2016) – various standards

Standards	Amendments
IFRS 1 First-time Adoption of IFRS	Outdated exemptions for first-time adopters of IFRS are removed. The amendments apply prospectively for annual periods beginning on or after 1 January 2018.
IAS 28 Investments in Associates and Joint Ventures	A venture capital organisation, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss. This election can be made on an investment-by-investment basis. A non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture. The amendments apply retrospectively for annual periods beginning on or after 1 January 2018; early application is permitted.

The adoption of these standards did not have a material impact on the amounts and disclosures of the Company's financial statements.

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

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2018, and have not been applied in preparing these financial statements.

The Company does not plan to adopt these standards early. These are summarised below;

Standard	Effective date
— IFRS 16 Leases	1 January 2019
— IFRIC 23 Uncertainty over income tax treatments	1 January 2019
— IFRS 9 Prepayment Features with Negative Compensation	1 January 2019
— IAS 28 Long-term Interests in Associates and Joint Ventures	1 January 2019
— Annual improvements cycle (2015-2017)	1 January 2019
— IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)	1 January 2019
— IFRS 3 Definition of a Business	1 January 2020
— Amendments to references to the Conceptual Framework in IFRS Standards	1 January 2020
— Amendments to IAS 1 and IAS 8 Definition of Material	1 January 2020
— IFRS 17 Insurance contracts	1 January 2022
— Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28).	To be determined

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

All standards and interpretations will be adopted at their effective date (except for those standards and interpretations that are not applicable to the entity).

IFRS 16: Leases

On 13 January 2016 the IASB issued IFRS 16 Leases, completing the IASB's project to improve the financial reporting of leases. IFRS 16 replaces the previous leases standard, IAS 17 Leases, and related interpretations.

IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The standard defines a lease as a contract that conveys to the customer ('lessee') the right to use an asset for a period of time in exchange for consideration.

A Company assesses whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and introduces a single lessee accounting model. All leases are treated in a similar way to finance leases.

Applying that model significantly affects the accounting and presentation of leases and consequently, the lessee is required to recognise:

assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A Company recognises the present value of the unavoidable lease payments and shows them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a Company also recognises a financial liability representing its obligation to make future lease payments.

(a) depreciation of lease assets and interest on lease liabilities in profit or loss over the lease term; and

(b) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the statement of cash flows

IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. However, compared to IAS 17, IFRS 16 requires a lessor to disclose additional information about how it manages the risks related to its residual interest in assets subject to leases.

The standard does not require a Company to recognise assets and liabilities for:

(a) short-term leases (i.e. leases of 12 months or less) and;
(b) leases of low-value assets

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

IFRS 16: Leases – continued

The new standard is effective for annual periods beginning on or after 1 January 2019. Early application is permitted insofar as the recently issued revenue Standard, IFRS 15 Revenue from Contracts with Customers is also applied.

The Company has done preliminary workings and the potential impact on the amounts and disclosures of the Company's financial statements would be an increase of 3% in the total assets.

IFRIC 23 Clarification on accounting for Income tax exposures

IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency.

IFRIC 23 explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority.

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made. Uncertainty is reflected in the overall measurement of tax and separate provision is not allowed.

The entity is required to measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty (that is, the entity should use either the most likely amount method or the expected value method when measuring an uncertainty).

The entity will also need to provide disclosures, under existing disclosure requirements, about

(a) judgments made;
(b) assumptions and other estimates used; and
(c) potential impact of uncertainties not reflected.

The new Standard is effective for annual periods beginning on or after 1 January 2019.

The Company is assessing the potential impact on its financial statements resulting from the application of IFRIC 23.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

Prepayment Features with Negative Compensation (Amendments to IFRS 9)

The amendments clarify that financial assets containing prepayment features with negative compensation can now be measured at amortised cost or at fair value through other comprehensive income (FVOCI) if they meet the other relevant requirements of IFRS 9.

The amendments apply for annual periods beginning on or after 1 January 2019 with retrospective application, early adoption is permitted.

The adoption of these amendments will not have an impact on the financial statements of the Group and Company.

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

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

The amendments apply for annual periods beginning on or after 1 January 2019. Early adoption is permitted.

The adoption of these standards will not have an impact on the financial statements of the Company.

Annual improvement cycle (2015 – 2017) – various standards

Standards	Amendments
IFRS 3 Business Combinations and IFRS 11 Joint Arrangements	Clarifies how a Company accounts for increasing its interest in a joint operation that meets the definition of a business: — If a party maintains (or obtains) joint control, then the previously held interest is not remeasured. — If a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value.
IAS 12 *Income taxes*	Clarifies that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.
IAS 23 *Borrowing costs*	Clarifies that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets – are included in that general pool. As the costs of retrospective application might outweigh the benefits, the changes are applied prospectively to borrowing costs incurred on or after the date an entity adopts the amendments.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

Annual improvement cycle (2015 – 2017) – various standards - continued

The amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The adoption of these amendments is not expected to affect the amounts and disclosures of the Company's financial statements.

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

The amendments clarify that:

- on amendment, curtailment or settlement of a defined benefit plan, a Company now uses updated actuarial assumptions to determine its current service cost and net interest for the period; and
- the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income (OCI).

Consistent with the calculation of a gain or loss on a plan amendment, entities will now use updated actuarial assumptions to determine the current service cost and net interest for the period. Previously, entities would not have updated the calculation of these costs until the year-end.

Further, if a defined benefit plan is settled, any asset ceiling would be disregarded when determining the plan assets as part of the calculation of gain or loss on settlement.

The amendments apply for plan amendments, curtailments or settlements that occur on or after 1 January 2019, or the date on which the amendments are first applied. Earlier application is permitted.

The adoption of this standard will not have an impact on the financial statements of the Company.

IFRS 3 Definition of a Business

With a broad business definition, determining whether a transaction results in an asset or a business acquisition has long been a challenging but important area of judgement. These amendments to IFRS 3 Business Combinations seek to clarify this matter as below however complexities still remain.

- Optional concentration test
  The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets.

- Substantive process
  If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.

  The definition of a business is now narrower and could result in fewer business combinations being recognised.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

IFRS 3 Definition of a Business - continued

The amendment applies to businesses acquired in annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted. The adoption of this standard will not have an impact on the financial statements of the Company.

Amendments to References to the Conceptual Framework in IFRS Standards

This amendment sets out amendments to IFRS Standards (Standards), their accompanying documents and IFRS practice statements to reflect the issue of the International Accounting Standards Board (IASB) revised Conceptual Framework for Financial Reporting in 2018 (2018 Conceptual Framework).

Some Standards, their accompanying documents and IFRS practice statements contain references to, or quotations from, the IASC's Framework for the Preparation and Presentation of Financial Statements adopted by the IASB in 2001 (Framework) or the Conceptual Framework for Financial Reporting issued in 2010. Amendments to References to the Conceptual Framework in IFRS Standards updates some of those references and quotations so that they refer to the 2018 Conceptual Framework, and makes other amendments to clarify which version of the Conceptual Framework is referred to in particular documents.

These amendments are based on proposals in the Exposure Draft Updating References to the Conceptual Framework, published in 2015, and amend Standards, their accompanying documents and IFRS practice statements that will be effective for annual reporting periods beginning on or after 1 January 2020.

The adoption of these changes will not affect the amounts and disclosures of the Company's financial statements.

IAS 1 and IAS 8 Definition of Material

The amendment refines the definition of Material to make it easier to understand and aligning the definition across IFRS Standards and the Conceptual Framework.

The amendment includes the concept of 'obscuring' to the definition, alongside the existing references to 'omitting' and 'misstating'. Additionally, the amendments also adds the increased threshold of 'could influence' to 'could reasonably be expected to influence' as below.

"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."

However, the amendment has also removed the definition of material omissions or misstatements from IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments are effective from 1 January 2020 but may be applied earlier.

The Company is assessing the potential impact on its financial statements resulting from the application of the refined definition of materiality.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

IFRS 17 Insurance Contracts

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

(a) insurance contracts, including reinsurance contracts, it issues;
(b) reinsurance contracts it holds; and
investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

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

(a) the fulfilment cash flows—the current estimates of amounts that the entity expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and
(b) the contractual service margin—the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

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

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

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

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

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

The adoption of these changes will not affect the amounts and disclosures of the Company's financial statements.

4. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) New standards, amendments and interpretations (continued)

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

Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28)

The amendments require the full gain to be recognised when assets transferred between an investor and its associate or Company meet the definition of a 'business' under IFRS 3 Business Combinations. Where the assets transferred do not meet the definition of a business, a partial gain to the extent of unrelated investors' interests in the associate or Company is recognised. The definition of a business is key to determining the extent of the gain to be recognised.

The effective date for these changes has now been postponed until the completion of a broader review.

The adoption of these changes will not affect the amounts and disclosures of the Company's financial statements.

The Company did not early adopt new or amended standards in the year ended 31 December 2018.

5. FINANCIAL RISK MANAGEMENT

Introduction and overview

The Company has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- Currency risk
- settlement risk
- operational risks and
- capital management

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital.

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has established the Asset and Liability (ALCO), Country Management, Credit Management, Crisis Management and Risk Management committees, which are responsible for developing and monitoring risk management policies in their specified areas.

All Board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities.

The Company's risk management policies are established to identify and analyse the risks faced by the Company, 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 Company, 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.

5. FINANCIAL RISK MANAGEMENT (Continued)

Risk management framework - continued

The Risk Management Committee is responsible for monitoring compliance with the Company's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Company. The Company's Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

(a) Credit risk

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

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

Management of credit risk

The Board of Directors has delegated responsibility for the management of credit risk to its Credit Management Committee. A separate Credit department, reporting to the Credit Committee, is responsible for oversight of the Company's credit risk, including:

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

— *Establishing the authorisation structure* for the approval and renewal of credit facilities. Authorisation limits are allocated to business unit Credit Officers. Larger facilities require approval by the Credit Department, Head of Credit, Credit Committee or the Board of Directors 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 financing assets and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

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

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

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Management of credit risk

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

Each business unit is required to implement the Company credit policies and procedures, with credit approval authorities delegated from the Credit Committee. Each business unit has a Chief Credit Risk officer who reports on all credit related matters to local management and the Credit Committee. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval. Regular audits of business units and Credit processes are undertaken by Internal Audit.

Credit quality

The following table sets out information about the credit quality and credit risk exposure of financial assets measured at amortised cost (31 December 2018) and Financing arrangements and receivables (31 December 2017). Unless specifically indicated, the amounts in the table represent gross carrying amounts. For Off balance sheet commitments the amounts in the table represent the undrawn portion of amounts committed. Off balance sheet commitments are overdraft facilities.

Explanation of the terms 'Stage 1', 'Stage 2', 'Stage 3' and Purchased originated credit impaired (POCI) assets is included in Note 2 (c (iii)) and 4 (a (i)).

	2018					2017
In '000 of KShs	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Financing arrangements - Murabaha						
Normal	1,184,395	-	-	-	**1,184,395**	**132,108**
Watch	-	148,092		-	**148,092**	**-**
Non-performing	-	-	375	-	**375**	**-**
	1,184,395	148,092	375	-	**1,332,862**	**132,108**
Loss allowance	(13,429)	(366)	(88)	-	**(13,883)**	**(519)**
Carrying amount	**1,171,153**	**147,726**	**287**	**-**	**1,318,979**	**131,589**

	2018					2017
In '000 of KShs	**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	**Total**	**Total**
Financing arrangements - Ijarah						
Normal	798,692	-	-	-	**798,692**	**159,659**
Watch	-	15,532	-	-	**15,532**	**-**
Non-performing	-	-	7,757	-	**7,757**	**-**
	798,692	15,532	7,757	-	**821,981**	**159,659**
Loss allowance	(7,389)	(93)	(1,821)	-	**(9,302)**	**(627)**
Carrying amount	**791,303**	**15,439**	**5,936**	**-**	**812,679**	**159,032**

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Credit quality - continued

In '000 of KShs	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
Off balance sheet commitments						
Normal	52,913	-	-	-	**52,913**	-
Watch	-	-	-	-	-	-
Non-performing	-	-	-	-	-	-
	52,913	-	-	-	**52,913**	-
Loss allowance (Note 22)	(122)	-	-	-	**(122)**	-
Carrying amount	**52,791**	-	-	-	**52,791**	-

The following table sets out the overdue status of financing arrangements in stage 1, 2 and 3.

In KShs'000	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Financing arrangements at amortised cost-Murabaha-Gross carrying amount					
Current	999,805	-	-	**999,805**	**132,108**
Overdue < 30	184,590	-	-	**184,590**	-
Overdue >30<90	-	148,092		**148,092**	-
Overdue >90	-	-	375	**375**	-
Total	**1,184,395**	148,092	375	**1,332,862**	**132,108**

In KShs'000	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Financing arrangements at amortised costs - Ijarah-Gross carrying amount					
Current	770,644	-	-	**770,644**	**159,659**
Overdue < 30	28,048	-	-	**28,048**	-
Overdue >30<90	-	15,532	-	**15,532**	-
Overdue >90	-	-	7,757	**7,757**	-
Total	**798,692**	**15,532**	**7,757**	**821,981**	**159,659**

Write-off policy

The Company may write off a financing arrangement balance (and any related allowances for impairment losses) when Credit determines that the financing arrangements are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the customer's financial position such that the customer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Write-off policy - continued

In the year the Company did not have any written off financial arrangements.

Collateral

The Company holds collateral against financing arrangements to customers in the form of mortgage profits over property, 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 financing asset is individually assessed as impaired.

Collateral generally is not held over deposits and balances due from Banking institutions, except when securities are held as part of reverse repurchase and securities borrowing activity.

There have been no significant changes in the quality of the collateral held.

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

Fair values of collateral held:

	2018 KShs'000	%	2017 KShs'000
Stage 1	2,735,249	69	489,645
Stage 2	24,000	81	-
Stage 3	8,500	100	-
	2,767,749		489,645

The percentages above represent the portion of financing arrangements that are covered by collateral.

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

The Company in determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition considered reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Company's historical experience and expert credit assessment.

Information that is more forward-looking than past due status (either on an individual or a collective basis) is not available without undue cost or effort, hence the Company has used past due information and qualitative information to determine whether there have been significant increases in credit risk since initial recognition.

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment - continued

Determining whether credit risk has increased significantly

The Company has established a framework that incorporates both past due information and qualitative information to determine whether the credit risk on a particular financial instrument has increased significantly since initial recognition.

The framework aligns with the Company's internal credit risk management process.

The Company will deem the credit risk of a particular exposure to have increased significantly since initial recognition if, the financial asset is more than 30 days in arrears.

Additionally, in certain instances, using its expert credit judgement and, where possible, relevant historical experience, the Company may determine that an exposure has undergone a significant increase in credit risk and classify the exposure as 'watch' if particular qualitative factors indicate so and those indicators may not be fully captured by its past due status on a timely basis.

The following qualitative criteria is applied:

- Classification of exposures by any other Banks and Financial institutions or local Credit Reference Bureau (CRB).
- Unavailable/inadequate financial information/financial statements;
- Qualified report by external auditors;
- Significant contingent liabilities;
- Loss of key staff in the organization;
- Increase in operational risk and higher occurrence of fraudulent activities;
- Continued delay and non-cooperation by the borrower in providing key relevant documentation;
- Deterioration in credit worthiness due to factors other than those listed above

As a backstop, and as required by IFRS 9, the Company will presumptively consider that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due. The Company will determine days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Also see note 4(g).

Definition of default

The Company will consider a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Company to actions such as realising security (if any is held); or
- the borrower is more than 90 days past due on any material credit obligation to the Company. This definition is largely consistent with the Central Bank of Kenya definition that is used for regulatory purposes.

In assessing whether a borrower is in default, the Company will consider indicators that are:

- qualitative: e.g. breaches of covenant;
- quantitative: e.g. overdue status and non-payment of another obligation of the same issuer to the Company; and
- based on data developed internally and obtained from external sources.

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment - continued

Definition of default - continued

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Forward-looking information

Under IFRS 9, the Company will incorporate forward-looking information in its measurement of ECLs.

The Company is in its inception phase and does not have sufficient history of defaults to determine relationships between its credit risk and credit losses and external macroeconomic variables. The Bank has therefore identified the weighted average 5 year historic growth in the banking industry Non Performing Loans (NPL) ratio as the basis for the lifetime probability of default (PD) and a macroeconomic adjustment applied to the base 12-month PD. The NPL ratio is obtained from reports published by the Central Bank of Kenya. The 12-month probability of default is determined based on the weighting of three possible scenarios.

Modified financial assets

The contractual terms of a financing arrangements may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing financing arrangement whose terms have been modified may be derecognised and the renegotiated financing arrangements recognised as a new financing arrangement at fair value.

Under IFRS 9, when the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of the borrower's initial credit risk assessment and the current assessment at the point of modification.

The Company renegotiates financing arrangements with customers in financial difficulties (referred to as 'restructuring') to maximise collection opportunities and minimise the risk of default. Under the Company's restructuring policy, financing arrangements restructuring is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of financing arrangements covenants. The Bank Credit Committee regularly reviews reports on restructuring activities.
Generally, forbearance is a qualitative indicator of default and credit impairment and expectations of restructuring are relevant to assessing whether there is a significant increase in credit risk (see above).

Following forbearance, a customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be in default/credit-impaired or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECLs.

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment - continued

Inputs into measurement of ECLs

The key inputs into the measurement of ECLs are likely to be the term structures of the following variables:

— PD;
— loss given default (LGD); and
— exposure at default (EAD).

These parameters will be derived from internally developed models and other historical data that leverage industry information. The PD will be adjusted to reflect forward-looking information as described above.

PD

PD estimates for financing arrangements are estimates at a certain date. Based on lack of internal default history the Company has applied NPL ratios for its peer banks as a basis of determining the PDs. Using available NPL data on the Company's peer banks, and specifically the NPL ratios in the inception years of these peer banks given the bank is at its inception phase, the PDs were developed using a range of scenarios as below:

— The worst case scenario is based on the average NPL of the Company's peer Banks plus a 5 years average banking industry NPL growth rate.
— The best case scenario is based on the average NPL of the Company's peer Banks in their inception years
— Baseline scenario is the average NPL rate for the Company's two peer banks at their inception plus a 5 years average banking industry NPL growth rate.

The 12-month PD is therefore probability weighted having incorporated three scenarios as above. Lifetime PDs will be estimated by growing the weighted 12-month PD year on year by adding the 5 year average growth rate for the banking industry.

Loss Given Default (LGD)

LGD is the magnitude of the likely loss if there is a default. The Company will estimate LGD parameters based on collateral available against exposures and the history of recovery rates of claims against defaulted counterparties. The LGD models will consider the type of collateral, seniority of the claim, time to recover in the event of foreclosure, counterparty industry and recovery costs of any collateral that is integral to the financial asset. LGD estimates are calibrated to consider the time to recover cash flows for different collateral types and apply the forced sale value (FSV) of collateral. The collateral values to consider will be calculated on a discounted cash flow basis using the effective interest rate (EIR) or a close proxy of the EIR. The LGD for unsecured financial assets is 100% unless management assessment of the borrower supports a lower LGD.

Exposure at Default

EAD represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortisation, and prepayments. The EAD of a financial asset will be the gross carrying amount at default plus profit payments that would have been missed at the point of default. For lending commitments and financial guarantees, the EAD will consider the amount drawn, as well as potential future amounts that may be drawn or repaid under the contract, which will be estimated based on historical observations and forward-looking forecasts.

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment - continued

Exposure at Default - continued

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Bank will measure ECLs considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Company considers a longer period.

The maximum contractual period extends to the date at which the Company has the right to require repayment of an advance or terminate a financing arrangements commitment or guarantee.

For guarantee facilities, overdrafts and other revolving facilities that include both a financing arrangement and an undrawn commitment component, the Bank will measure ECLs over a period of one year unless the expected life of the exposure can be reasonably determined. Where modelling of a parameter is carried out on a collective basis, the financial instruments will be grouped on the basis of shared risk characteristics that include:

- Product type; and
- Industry.

The groupings will be subject to regular review to ensure that exposures within a particular Bank remain appropriately homogeneous.

Amount arising from ECL

Loss allowance

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

Loss allowance	**2018**				**2017**	
In KShs'000	**12-month ECL**	**Lifetime ECL not credit-impaired**	**Lifetime ECL credit-impaired**	**Total**	**Collective**	**Total**
Financing arrangements – Murabaha*						
Balance at 1 January	1,490	-	-	1,490	-	-
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	(93)	93	-	-	-	-
Transfer to Stage 3	(3)	-	3	-	-	-
Net re-measurement of loss allowance	(99)	29	85	15	-	-
Net financial assets originated or purchased	12,258	244	-	12,502	519	519
Financial assets that have been derecognised	(124)	-	-	(124)	-	-
Write offs	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-
Foreign exchange and other movements	-	-	-	-	-	-
Balance at 31 December	**13,429**	**366**	**88**	**13,883**	**519**	**519**

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Amount arising from ECL - continued

Loss allowance	2018				2017	
In KShs'000	12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Total	Collective	Total
Financing arrangements – Ijarah*						
Balance at 1 January	1,156	-	-	1,156	-	-
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Net remeasurement of loss allowance	(793)	-	-	(793)	-	-
Net financial assets originated or purchased	7,026	93	1,821	8,939	627	627
Financial assets that have been derecognised	-	-	-	-	-	-
Write offs	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-
Foreign exchange and other movements	-	-	-	-	-	-
Balance at 31 December	**7,389**	**93**	**1,821**	**9,302**	**627**	**627**

Loss allowance	2018				2017	
In KShs'000	12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Total	Collective	Total
Financing arrangements – Off balance sheet commitments (Note 22)						
Balance at 1 January	-	-	-	-	-	-
Transfer to Stage 1	-	-	-	-	-	-
Transfer to Stage 2	-	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-	-
Net financial assets originated or purchased	122	-	-	122	-	-
Financial assets that have been derecognised	-	-	-	-	-	-
Write offs	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-
Foreign exchange and other movements	-	-	-	-	-	-
Balance at 31 December	**122**	-	-	**122**	-	-

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Amount arising from ECL – continued

*The loss allowance in these tables includes ECL on off balance sheet financing arrangement commitments for overdrafts, because the Group cannot separately identify the ECL on the off balance sheet commitment component from those on the financial instrument component.

The Company has carried out an assessment of the expected credit losses arising from the Company's cash and balances with central bank, balances due from banking institutions and other assets and determined these to be immaterial. The credit losses have therefore not been recorded in these financial statements.

The ECL on financing arrangements and off balance sheet commitments are presented in financing arrangements and other liabilities respectively in the statement of financial position.

The following table provides a reconciliation between:

- Amounts shown in the above tables reconciling opening and closing balances of loss allowance for financing arrangements.
- The 'Impairment provision on financing assets' line item in the statement of profit or loss and other comprehensive income.

In KShs'000	Financing arrangements- Murabaha at amortised cost	Financing arrangements - Ijara at amortised cost	Off balance sheet commitments	Total
Net re-measurement of loss allowance	15	(793)	122	(656)
Net financial assets originated or purchased	12,502	8,939	-	21,441
Financial assets that have been derecognised	(124)	-	-	(124)
	12,393	**8,146**	**122**	**20,661**

Offsetting financial assets and financial liabilities

There are no financial assets and financial liability amounts in the statement of financial position that have been offset in these financial statements.

Monitoring concentration risk

The Company monitors concentrations of credit risk by economic sector. An analysis of concentrations of credit risk at the reporting date is shown below:

	2018 KShs'000	2018 %
Concentration by Sector - 2018		
Energy	-	0
Manufacturing	37,542	2
Real estate	102,420	5
Wholesale and retail trade	1,162,415	54
Transport and communication	302,374	14
Others	550,092	25
Total gross financing arrangements	**2,154,843**	**100**

5. FINANCIAL RISK MANAGEMENT (Continued)

(a) Credit risk (continued)

Monitoring concentration risk – continued	KShs'000	%
Concentration by Sector - 2017		
Energy	-	0
Manufacturing	-	0
Real estate	51,910	18
Wholesale and retail trade	47,050	16
Transport and communication	81,638	28
Others	111,169	38
Total gross financing arrangements	**291,767**	**100**

The Company's other exposures to credit risk relates to:

	2018 KShs'000	2017 KShs'000
Cash and balances with Central Bank	519,857	109,584
Balances due from Banking institutions	1,008,732	761,400
Other receivables	17,493	17,493
	1,546,082	**888,477**

(b) Liquidity risk

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

Management of liquidity risk

The Company'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 Company's reputation.

The Company's treasury unit receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business.

Treasury then maintains a portfolio of short-term liquid assets, largely made up of deposits and balances due from Banking institutions and other inter-Company facilities, to ensure that sufficient liquidity is maintained within the Company. The liquidity requirements of business units are met through short-term financing arrangements from treasury to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Company. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

Exposure to liquidity risk

The key measure used by the Company 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 other liquid assets. Details of the reported Company ratio of net liquid assets to deposits and customers at the reporting date and during the reporting period were as follows:

5. FINANCIAL RISK MANAGEMENT (Continued)

(b) Liquidity risk (continued)

Exposure to liquidity risk – continued

	2018 %	2017 %
Average for the period	50.6	184.1
Maximum for the period	61.9	503.1
Minimum for the period	31.8	63.3

The following are the residual contractual maturities of assets and liabilities.

Residual contractual maturities of assets and liabilities

31 December 2018	**Due within 3 months KShs'000**	**Due between 3 and 12 months KShs'000**	**Due between 1 and 5 years KShs'000**	**Due after 5 years KShs'000**	**Total KShs'000**
Assets					
Cash and balances with Central Bank	519,857	-	-	-	519,857
Balances with other Companies	1,008,732	-	-	-	1,008,732
Financing arrangements	819,453	11,898	645,098	655,209	2,131,658
Other assets	-	-	17,493	-	17,493
Total financial assets	**2,348,042**	**11,898**	**662,591**	**655,209**	**3,677,740**
Liabilities					
Customer deposits	2,818,105	379,754	-	-	3,197,859
Due to related parties	13,000				13,000
Other liabilities	94,373	-	-	-	94,373
Total financial liabilities	**2,925,478**	**379,754**	**-**	**-**	**3,305,232**
	(577,436)	**(367,856)**	**662,591**	**655,209**	**372,508**
31 December 2017					
Cash and balances with Central Bank	109,584	-	-	-	109,584
Balances with other Companies	761,400	-	-	-	761,400
Financing arrangements	-	772	208,777	81,072	290,621
Other assets	-	-	17,493	-	17,493
Total financial assets	**870,984**	**772**	**226,270**	**81,072**	**1,179,098**
Liabilities					
Customer deposits	1,139,047	42,374	-	-	1,181,421
Balances due to Banking institutions	103,337	-	-	-	103,337
Due to related parties	14,079	-	-	-	14,079
Other liabilities	42,632	-	-	-	42,632
Total financial liabilities	**1,299,095**	**42,374**	**-**	**-**	**1,341,469**
	(428,111)	**(41,602)**	**226,270**	**81,072**	**(162,371)**

5. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk

Market risk is the risk that changes in market prices, such as profit rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Company'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.

Overall authority for market risk is vested in ALCO. Risk management is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation. The Company is primarily exposed to currency risk. Due to the nature of the Company's current products, the exposure to any other market risk is minimal.

(d) Currency risk

The Company is exposed to currency risk through transactions in foreign currencies. The Company's transactional exposures give rise to foreign currency gains and losses that are recognised in the statement of comprehensive income. In respect of monetary assets and liabilities in foreign currencies, the Company ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate. The table below summarises the foreign currency exposure as at 31 December 2018 and 31 December 2017:

	2018 KShs'000	2017 KShs'000
Assets in foreign currencies	1,251,723	637,549
Liabilities in foreign currencies	(1,237,946)	(640,144)
Net foreign currency exposure	**13,777**	**(2,595)**

The table below analyses the currencies to which the Company is exposed at 31 December 2018:

Assets	USD KShs'000	EUR KShs'000	GBP KShs'000	AED KShs'000	ZAR KShs'000	Total KShs'000
Cash on hand	168,614	3,808	4,437	798	-	**177,657**
Deposits and balances due from Banking institutions	469,957	3,069	21,948	9,882	93	**504,949**
Financing arrangements	569,028	-	-	-	-	**569,028**
Other assets	62	6	6	15	-	**89**
Total foreign currency assets	**1,207,661**	**6,883**	**26,391**	**10,695**	**93**	**1,251,723**
Customer deposits	1,160,706	151	26,160	9,948	-	**1,196,965**
Due from other Banking institutions	-	-	-	-	-	-
Other liabilities	40,977	2	2	-	-	**40,981**
Total foreign currency liabilities	**1,201,683**	**153**	**26,162**	**9,948**	**-**	**1,237,946**
Exposure as at 31 December 2018	**5,978**	**6,730**	**229**	**747**	**93**	**13,777**

5. FINANCIAL RISK MANAGEMENT (Continued)

(d) Currency risk (continued)

2017 Assets	USD KShs'000	EUR KShs'000	GBP KShs'000	AED KShs'000	ZAR KShs'000	Total KShs'000
Cash on hand	18,695	713	436	112	-	**19,956**
Deposits and balances due from Banking institutions	512,447	882	1,373	3,836	418	**518,956**
Financing arrangements	98,563	-	-	-	-	**98,563**
Other assets	53	14	3	4	-	74
Total foreign currency assets	**629,758**	**1,609**	**1,812**	**3,952**	**418**	**637,549**
Customer deposits	534,806	808	809	337	-	**536,760**
Due from other Banking institutions	103,337	-	-	-		**103,337**
Other liabilities	47	-	-	-	-	**47**
Total foreign currency liabilities	**638,190**	**808**	**809**	**337**	-	**640,144**
Exposure as at 31 December 2018	**(8,432)**	**801**	**1,003**	**3,615**	**418**	**(2,595)**

The following significant exchange rates were applied during the year.

Currency	Closing 2018	2017	Average 2018	2017
USD	101.75	103.30	101.20	103.40
GBP	128.87	138.75	135.19	133.11
EUR	116.31	108.17	119.56	116.70
AED	27.70	28.10	27.55	28.15
ZAR	7.07	8.35	7.69	7.78

There was no currency exposure for the period and therefore no probable sensitivity in the Company's profit before tax.

(e) Settlement risk

The Company'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 Company 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 Risk.

5. FINANCIAL RISK MANAGEMENT (Continued)

(f) Operational risk

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

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

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit.

This responsibility is supported by the development of overall Company standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

Compliance with Company standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Company.

(g) Capital management

The Company's objective when managing capital (regulatory capital) is to comply with the capital requirements as set out by the Central Bank of Kenya and safeguard the Company's ability to continue as a going concern as well as maintaining a strong capital base to support the development of its business.

Under the regulatory environment, the Central Bank of Kenya requires every financial institution to:

(a) Maintain a minimum capital of KShs 1,000 million (2017 – KShs 1,000 million).
(b) Maintain a core capital of not less than 8% (2017 – 8%) of total deposit liabilities.
(c) Maintain a minimum core capital to risk weighted assets including off-balance sheet assets of 10.5% (2017 – 10.5%) and
(d) Maintain a ratio of total capital to risk weighted assets including off-balance sheet assets of not less than 14.5% (2017 – 14.5%).

5. FINANCIAL RISK MANAGEMENT (Continued)

(g) Capital management (continued)

The Company is compliant with all the above requirements.

The Company calculates capital adequacy ratios for credit risk, market risk and operational risk based upon Basel requirements and the prudential guidelines as issued by the Central Bank of Kenya.

Capital adequacy and use of regulatory capital are monitored regularly by management employing techniques based on the guidelines developed by the Basel Committee, as implemented by the Central Bank of Kenya for supervisory purposes.

Credit risk weights are measured by means of a hierarchy of four risk weights classified according to the nature of (and reflecting an estimate of the credit risk associated with) each asset and counterparty. This treatment is also adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

Operational risk weighted assets is computed using the basic indicator approach which is based on the average gross revenue over the prior 3 year period.

Market risk weighted assets is computed using a standardised approach based on the foreign exchange exposure as at 31 December each year.

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

- Core capital (Tier 1), which includes ordinary share capital, share premium, and retained earnings.
- Supplementary capital (Tier 2), which includes statutory credit risk reserve and any other approved reserves.

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

	2018	2017
Core capital (Tier 1)	**KShs'000**	**KShs'000**
Paid up share capital	3,864,494	2,00,000
Funds awaiting allotment of shares	-	561,270
Retained earnings	(1,294,913)	(694,355)
Net after tax profits	(625,754)	(599,847)
	1,943,827	**1,267,068**
Deferred tax	(769,491)	(521,470)
Core capital	**1,174,336**	**745,598**
Supplementary capital (Tier 2)	1,433	1,772
Total capital	1,175,769	747,370
On balance sheet risk weighted assets	3,858,022	1,0560,627
Off balance sheet risk weighted assets	74,006	9,470
Total risk weighted assets	3,932,028	1,570,097
Capital adequacy ratios		
Percentage of Core Capital to Risk Weighted Asset ratio	29.9%	47.5%
Minimum requirement	10.5%	10.5%
Percentage of Total Capital to Risk Weighted Asset ratio	29.9%	47.6%
Minimum requirement	14.5%	14.5%
Percentage of Core Capital to Deposits ratio	36.7%	63.1%
Minimum requirement	8.0%	8.0%

5. FINANCIAL RISK MANAGEMENT (Continued)

(g) Capital management (continued)

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation 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 Risk Management Committee and is subject to review by the Credit Committee or Assets and Liability Management Committee as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Company to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Company's longer term strategic objectives. The Company's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

(h) Financial assets and liabilities and their fair values

The table below sets out the Company's classification of each class of financial assets and liabilities, and their fair values:

31 December 2018	Note	Amortised cost KShs'000	Total carrying amount KShs'000	Fair value KShs'000
Cash and balances with Central Bank	13	519,857	519,857	519,857
Balances due from banking institutions	14	1,008,732	1,008,732	1,008,732
Financing arrangements	15	2,131,658	2,131,658	2,131,658
Other assets	18	17,493	17,493	17,493
Total financial assets		**3,677,740**	**3,677,740**	**3,677,740**
Customer deposits	21	3,197,859	3,197,859	3,197,859
Other liabilities	22	107,373	107,373	107,373
Total financial liabilities		**3,305,232**	**3,305,232**	**3,305,232**

5. FINANCIAL RISK MANAGEMENT (Continued)

(h) Financial assets and liabilities and their fair values (continued)

31 December 2017 KShs'000	Note	Amortised cost KShs'000	Total carrying amount KShs'000	Fair value KShs'000
Cash and balances with Central Bank	13	109,584	109,584	109,584
Balances due from banking institutions	14	761,400	761,400	761,400
Financing arrangements	15	290,621	290,621	290,621
Other assets	18	17,493	17,493	17,493
Total financial assets		**1,179,098**	**1,179,098**	**1,179,098**
Balances due to banking institutions	20	103,337	103,337	103,337
Customer deposits	21	1,181,421	1,181,421	1,181,421
Other liabilities	22	56,711	56,711	56,711
Total financial liabilities		**1,341,469**	**1,341,469**	**1,341,469**

The fair value of the Company's financial assets and liabilities approximate their carrying amounts as the financial assets are repriced annually in line with the Central Bank of Kenya rates which represents the market rate.

6. IMPACT OF INITIAL APPLICATION OF IFRS 9

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

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Company's financial assets and financial liabilities as at 1 January 2018. Financial instruments defined as loans and receivables, per IFRS, in this AFS refer to financing arrangements and other assets.

	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial assets				**KShs'000**	**KShs'000**
Cash and balances with Central Bank	13	Loans and receivables	Amortised cost	109,584	109,584
Balances due from banking institutions	14	Loans and receivables	Amortised cost	761,400	761,400
Financing arrangements	15	Loans and receivables	Amortised cost	290,621	289,121
Other assets	18	Loans and receivables	Amortised cost	17,493	17,493
Total financial assets				**1,179,098**	**1,177,598**

6. IMPACT OF INITIAL APPLICATION OF IFRS 9 (Continued)

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

	Note	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Financial liabilities				**KShs'000**	**KShs'000**
Balances due to banking institutions	20	Other financial Liabilities	Amortised cost	103,337	103,337
Customer deposits	21	Other financial Liabilities	Amortised cost	1,181,421	1,181,421
Other liabilities	22	Other financial Liabilities	Amortised cost	56,711	56,711
Total financial liabilities				**1,341,469**	**1,341,469**

The application of the Company's policies in line with IFRS 9 did not result in any reclassification.

The following table reconciles the carrying amounts under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

In KShs'000	IAS 39 carrying amount	Re-measurement	IFRS 9 carrying amount
Financial assets			
Amortised cost			
Cash and balances with Central Bank			
Opening balance	109,584	-	-
Re-measurement	-	-	-
Opening balance under IFRS 9	-	-	109,584
Balances due from banking institutions			
Opening balance	761,400	-	-
Re-measurement	-	-	-
Opening balance under IFRS 9	-	-	761,400
Financing arrangements			
Opening balance	290,621	-	-
Re-measurement	-	(1,500)	-
Opening balance under IFRS 9	-	-	289,121
Other assets	17,493	-	17,493
Total amortised cost	**1,179,098**	**(1,500)**	**1,177,598**

6. IMPACT OF INITIAL APPLICATION OF IFRS 9 (Continued)

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

In KShs'000	IAS 39 carrying amount	Re-measurement	IFRS 9 carrying amount
Financial liabilities			
Amortised cost			
Balances due to banking institutions	103,337	-	103,337
Customer deposits	1,181,421	-	1,181,421
Other liabilities	56,711	-	56,711
Total amortised cost	**1,341,469**	-	**1,341,469**

Impact of transition of IFRS 9 on opening equity reserves

The following table summarises the impact of transition to IFRS 9 on the opening balance of the retained earnings and the statutory credit risk reserve. There is no impact on other components of equity.

In KShs'000	Impact of adopting IFRS 9 at 1 January 2018
Statutory credit risk reserve	
Closing balance under IAS 39 (31 December 2017)	1,772
Change in difference between Central Bank provisions and IFRS impairment	(1,500)
Related tax	-
Opening balance under IFRS 9 (1 January 2018)	**272**
Retained earnings	
Closing balance under IAS 39 (31 December 2017)	(1,294,202)
Recognition of expected credit losses under IFRS 9 (including Off balance sheet financing commitments)	(1,500)
Related tax (Note 19)	450
Re-measurement of the difference between Central Bank provisions and IFRS impairment	1,500
Opening balance under IFRS 9 (1 January 2018)	**(1,293,752)**

7. INCOME FROM FINANCING AND INVESTING ACTIVITIES

	2018 KShs'000	2017 KShs'000
Income from financing arrangements	130,716	5,198
Income from investing assets – Placements	48,187	7,964
	178,903	**13,162**

Included in income from investing activities is income derived from Murabaha and Wakala placements made with Islamic banks and Islamic windows of conventional banks.

8. DEPOSITORS SHARE OF PROFITS

	2018 KShs'000	2017 KShs'000
Time deposits	121,557	8,486
Savings deposits	2,046	386
Interbank deposits	3,238	37
	126,841	**8,909**

9. (a) FEES AND COMMISSION INCOME

	2018 KShs'000	2017 KShs'000
Credit related fees and commissions	33,517	6,320
Foreign exchange income	17,750	-
Other fees	15,173	2,917
	66,440	**9,237**

(b) OTHER INCOME

	2018 KShs'000	2017 KShs'000
Write back of partial recovery of Imperial Bank Limited (in Receivership) balances	**16,683**	-

10. OPERATING EXPENSES

(a) Personnel expenses

	2018 KShs'000	2017 KShs'000
Salaries	336,601	299,423
Directors' emoluments– executive	21,809	15,830
Other staff costs	77,902	72,091
	436,312	**387,344**

The number of persons employed by the Company as at the year-end was 114 (2017 – 106). These are analysed as follows:

Average number of employees	**2018**	**2017**
Senior Management	13	15
Junior Management and supervisors	34	39
Other Staff	67	52
	114	**106**

10. OPERATING EXPENSES (Continued)

(b) Other operating e xpenses

	2018 KShs'000	2017 KShs'000
Insurance expenses	8,003	7,244
Legal & professional expenses	10,148	22,677
Occupancy expenses	77,987	72,840
Directors' emoluments – non executive (Note 26(e))	9,450	8,566
Other operating expenses	275,009	192,912
	380,597	**304,239**

11. LOSS BEFORE INCOME TAX

Loss before income tax is arrived at after charging:

	2018	2017
Depreciation expense (Note 16)	107,627	125,325
Amortisation of intangible assets (Note 17)	63,313	34,737
Amortisation of prepaid operating lease rentals (Note 27)	77,987	72,840
Directors' remuneration – Non executive (Note 26(e))	9,450	8,566
– Executive 10(a)	21,809	15,830
Auditors' remuneration	2,400	2,400

12. INCOME TAX

(a) Current tax credit

	2018	2017
Current year	-	-
Deferred tax (Note 19):		
Deferred tax credit for the year	(247,870)	(239,159)
Prior year adjustments	299	(295)
Total tax credit	**(247,571)**	**(239,454)**

(b) The tax on the Company's loss differs from the theoretical amount using the basic tax rate as follows:

	2018 KShs'000	2017 KShs'000
Loss before income tax	**(873,325)**	**(839,301)**
Tax applicable at 30%	(261,998)	(251,790)
Prior year adjustments (Note 19)	299	(295)
Tax effect of non-chargeable income and non-deductible Expense	14,128	12,631
Income tax credit	**(247,571)**	**(239,454)**

13. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

	2018 KShs'000	2017 KShs'000
Cash on hand	266,331	70,744
Balances with Central Bank of Kenya:		
Restricted balances (cash reserve ratio)	138,180	38,840
Unrestricted balances with Central Bank of Kenya	115,346	-
	519,857	**109,584**

By law, commercial Banks are required to maintain prescribed cash balances with Central Bank of Kenya as a cash ratio requirement which is non-yield bearing. This balance is determined on the basis of outstanding customer deposits at the end of the preceding month and is maintained over a cycle of one month.

As at 31 December 2018, the cash ratio requirement was 5.25% (2017 – 5.25%) of customer deposits. These funds are however available for use by the Company in its day-to-day operations in a limited way provided that on any given day this balance does not fall below 3% of the requirement and provided that the overall average in the month is at least 5.25%.

14. DEPOSITS AND BALANCES DUE FROM BANKING INSTITUTIONS

	2018 KShs'000	2017 KShs'000
Placements with other banks	654,120	220,090
Deposits and other balances with banks	354,612	541,310
	1,008,732	**761,400**

15. FINANCING ARRANGEMENTS

	2018	2017
Classification		
Murabaha	1,332,862	132,108
Ijarah	821,981	159,659
Gross financing arrangements	**2,154,843**	**291,767**
Impairment provisions	(23,185)	(1,146)
Net financing arrangements	**2,131,658**	**290,621**
Repayable within:		
Less than 3 months	829,982	-
3 months to 1 year	12,018	775
1 to 5 years	652,571	209,600
Over 5 years	660,272	81,392
	2,154,843	**291,767**

16. PROPERTY AND EQUIPMENT

2018	Leasehold Improvements KShs'000	Equipment furniture and fittings KShs'000	Motor vehicles KShs'000	Work in progress KShs'000	Total KShs'000
Cost					
At 1 January 2018	260,169	297,610	6,734	691	565,204
Additions	-	13,669	-	1,054	14,723
Transfers	-	796	-	(796)	-
At 31 December 2018	260,169	312,075	6,734	949	579,927
Depreciation					
At 1 January 2018	41,556	183,568	3,084	-	228,208
Charge for the year	43,361	62,582	1,684	-	107,627
At 31 December 2018	84,917	246,150	4,768	-	335,835
Carrying amount as at December 2018	**175,252**	**65,925**	**1,966**	**949**	**244,092**
2017					
Cost					
At 1 January 2017	242,548	278,052	6,734	1,703	529,037
Additions	17,621	17,855	-	691	36,167
Transfers	-	1,703	-	(1,703)	-
At 31 December 2017	260,169	297,610	6,734	691	565,204
Depreciation					
At 1 January 2017	-	101,485	1398	-	102,883
Charge for the year	41,556	82,083	1,686	-	125,325
At 31 December 2017	41,556	183,568	3,084	-	228,208
Carrying amount as at December 2017	**218,613**	**114,042**	**3,650**	**691**	**336,996**

Computer hardware assets with a cost value of KShs 156,323,254 were fully depreciated as at 31 December 2018 (2017 – Nil). The notional depreciation for the fully depreciated assets was KShs 23,886,530 (2017 – Nil).

No assets were pledged as security as at 31 December 2018 (2017 – Nil).

As at 31 December 2018 and 31 December 2017, work in progress relates to IT equipment in progress of being set up.

17. INTANGIBLE ASSETS – SOFTWARE

2018 **Cost**	**Intangible assets KShs'000**	**Work in progress KShs'000**	**Total KShs'000**
At 1 January 2018	527,344	-	527,344
Additions	20,336	-	20,336
At 31 December 2018	547,680	-	547,680
Amortisation			
At 1 January 2018	34,737	-	34,737
Amortisation during the year	63,313	-	63,313
At 31 December	98,050	-	98,050
Carrying amount as at 31 December 2018	**449,630**		**449,630**
2017			
Cost			
At 1 January 2017	492,870	7,672	500,542
Additions	26,802	-	26,802
Transfer	7,672	(7,672)	-
At 31 December 2017	527,344	-	527,344
Amortisation			
At 1 January 2017	-	-	-
Amortisation during the year	34,737	-	34,737
At 31 December	34,737	-	34,737
Carrying amount as at 31 December 2017	**492,607**	**-**	**492,607**

18. OTHER ASSETS

	2018 KShs'000	**2017 KShs'000**
Deposits	17,493	17,493
Prepayments	103,498	74,355
Prepaid operating lease rentals	6,163	5,783
	127,154	**97,631**

19. DEFERRED TAX ASSET

The deferred tax asset at 31 December 2018 and 31 December 2017 are attributable to the items detailed in the table below:

2018	At January 2018 KShs'000	Recognised in profit or loss KShs'000	Recognised in equity KShs'000	Prior year adjustment KShs'000	At 31 December 2018 KShs'000
Property and equipment	59,901	(1,753)	-	296	58,444
Impairment losses	(344)	(6,198)	(450)	-	(6,992)
Tax losses	(581,027)	(239,919)	-	3	(820,943)
	(521,470)	**(247,870)**	**(450)**	**299**	**(769,491)**

2017	At January 2016 KShs'000	Recognised in profit or loss KShs'000	Recognised in equity KShs'000	Prior year adjustments KShs'000	At 31 December 2017 KShs'000
Property and equipment	57,375	2,821	-	(295)	59,901
Impairment losses	-	(344)	-	-	(344)
Tax losses	(339,391)	(241,636)	-	-	(581,027)
	(282,016)	**(239,159)**	-	**(295)**	**(521,470)**

The tax losses expire within 10 years from the year in which they arose under the current tax laws.

The ageing of tax losses for the Company is as follows:

Year of origin	Amount KShs'000	Year of expiry
2015	441,449	2024
2016	689,856	2025
2017	805,443	2026
2018	799,730	2027
Total	**2,736,478**	

20. BALANCES DUE TO BANKING INSTITUTIONS

	2018 KShs'000	2017 KShs'000
Deposits from banking institutions due within 12 months	-	103,337

21. CUSTOMER DEPOSITS

	2018 KShs'000	2017 KShs'000
Time deposits	1,226,879	605,345
Current accounts deposits	1,910,815	566,637
Savings accounts deposits	60,165	9,439
	3,197,859	**1,181,421**

22. OTHER LIABILITIES

	2018 KShs'000	2017 KShs'000
Accruals	32,954	26,533
Due to group	13,000	14,079
Impairment on off balance sheet commitments (Note 5(a))	122	-
Other payables	61,419	16,099
	107,495	**56,711**

23. CHARITABLE WELFARE ACTIVITIES

	2018	2017
As at January	1,438	610
Additions during the year	-	828
Donated to charitable activities	-	-
As at 31 December 2018	**1,438**	**1,438**

Transfers to welfare and charitable fund represents income deemed to be non-Shari'ah compliant either because it is from a non-Shari'ah compliant source or the underlying transactions had been found to be in breach of Shari'ah principles. The transfers as above have been presented within other liabilities.

24. SHARE CAPITAL AND RESERVES

(a) Share capital

Shares Authorised, issued and fully paid	2018 KShs'000	2017 KShs'000
At 1 January – 2,000,000 ordinary shares of Kshs 1,000 each	2,000,000	2,000,000
Issue of shares during the year – 1,303,224 ordinary shares at KShs 1,000 each (2017 – Nil)	1,303,224	-
Transfer from shares awaiting allotment - 561,270 (2017 Nil) ordinary shares of KShs 1,000 each	561,270	-
At 31 December 3,864,494 (2017 – 2,000,000 ordinary shares of Kshs 1,000 each	**3,864,494**	**2,000,000**

All ordinary shares rank equally with regard to the Company's residual assets. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at general meetings of the Company.

(b) Shares awaiting allotment

During the year ended 31 December 2018 the Company had KShs Nil worth of shares awaiting allotment (2017 – KShs 561,270,000).

	2018 KShs'000	2017 KShs'000
At 1 January	561,270	-
Transfer to authorised capital	(561,270)	
Additions in the year	-	561,270
At 31 December	-	**561,270**

24. SHARE CAPITAL AND RESERVES (Continued)

(c) Statutory credit risk reserve

This represents an amount set aside to cover additional provisions for credit losses required to comply with the requirements of Central Bank of Kenya Prudential Guidelines. The amount is not available for distribution. The reserve balance as at 31 December 2018 was KShs 1,433,000 (2017 – KShs 1,772,000).

25. NOTES TO THE STATEMENT OF CASH FLOWS

	2018 KShs'000	2017 KShs'000
Loss before income tax	(873,325)	(839,301)
Adjusted for:		
Depreciation (Note 16)	107,627	125,325
Amortisation of intangible asset (Note 17)	63,313	34,737
IFRS 9 day 1 adjustment (Note 6)	(1,500)	-
Operating loss before working capital changes	**(703,885)**	**(679,239)**
(Increase)/decrease in operating assets		
Central Bank of Kenya cash reserve ratio	(99,340)	(38,840)
Financing arrangements	(1,841,037)	(290,621)
Other assets	(29,523)	20,885
Increase/(decrease) in operating liabilities		
Customers' deposits	2,016,438	1,181,421
Balances due to Banking institutions	(103,337)	103,337
Other liabilities	50,784	(34,930)
Net cash flow from/(used in) operating activities	**(709,900)**	**262,013**

Analysis of the balances of cash and cash equivalents

	2018 KShs'000	2017 KShs'000	Change in the year KShs'000
Balances with Central Bank of Kenya	115,346	-	115,346
Cash on hand (Note 13)	266,331	70,744	195,587
Balances due from other banking institutions (Note 14)	1,008,732	761,400	247,332
	1,309,409	**832,144**	**558,265**

26. RELATED PARTY TRANSACTIONS

(a) Key management remuneration

	2018 KShs'000	2017 KShs'000
Salaries and other short-term employment benefits	128,361	114,619

Salaries and other short-term employment benefits include those relating to the executive director disclosed in Note 10 (a).

26. RELATED PARTY TRANSACTIONS (continued)

(b) Financing arrangements – key management

	2018 KShs'000	2017 KShs'000
At 1 January	42,534	-
Advanced during the year	57,082	43,016
Repaid during the year	(14,000)	(482)
At 31 December	**85,616**	**42,534**

Profit earned on financing arrangements to key management amounted to KShs 4,509,731 (2017 – KShs 208,686).

All outstanding balances with key management personnel are performing. No impairment losses have been recorded against balances outstanding during the period with key management personnel, and no specific allowance has been made for impairment losses on balances with key management personnel and their immediate relatives at the reporting date.

(c) Deposits - directors and their associates

	2018 KShs'000	2017 KShs'000
Deposits as at 31 December	28,522	2,633

(d) Deposits – key management

	2018 KShs'000	2017 KShs'000
Deposits as at 31 December	6,190	26,240

(e) Directors remuneration

	2018 KShs'000	2017 KShs'000
Fees for services as directors	6,000	3,812
Other remuneration	3,450	4,754
	9,450	8,566

(f) Due to group

	2018 KShs'000	2017 KShs'000
Dubai Islamic Company PJSC (Note 22)	13,000	14,079

The balances due to group of KShs 13,000,000 in 2018 (2019 – KShs 14,079,000) related to reimbursements of expenses incurred by the subsidiary but paid for by the parent.

27. OPERATING LEASES

Operating lease rentals are payable as follows:

	2018 KShs'000	2017 KShs'000
Within one year	83,173	77,987
Between one and five years	177,117	260,290
	260,290	**338,117**

27. OPERATING LEASES (Continued)

The bank leases a number of premises under operating leases. The leases typically run for an initial period of 6 years with an option to renew the leases at expiry. During the year ended 31 December 2018, KShs 77,987,000 (2017 - KShs 72,840,000) was recognised as an expense in the statement of profit and loss and other comprehensive income in respect of operating leases.

28. CONTINGENT LIABILITIES

	2018 KShs'000	2017 KShs'000
Letters of credit	60,356	9,470
Others	13,650	-
	74,006	**9,470**

29. HOLDING COMPANY

The holding Company is Dubai Islamic Company PJSC, which is incorporated in United Arab Emirates.

30. CAPITAL COMMITMENTS

The Company is committed to incur a capital expenditure of KShs 67,185,227 (2017 – KShs 46,201,000) to purchase intangible assets. These commitments are expected to be settled in 2019.

31. EVENTS AFTER THE REPORTING DATE

No material events or circumstances have arisen between the accounting date and the date of this report.