



**Faulu** 

A MEMBER OF THE  OLDMUTUAL GROUP

**2018**  
ANNUAL  
**REPORT**

**WAKENYA TUFAULU**



**WAKENYA  
TUFAULU.**



# FAULU PURPOSE: CHAMPIONING MUTUALLY POSITIVE FUTURES EVERYDAY



## VISION

To be our customers' most trusted lifetime partner, passionate about helping them achieve their financial goals.

And, by helping generations achieve those goals, help build the financial prosperity of the societies, businesses and shareholders we engage with.

## VALUES



The Lordship of Jesus Christ



Always Act with Integrity



Trust & Accountability



Champion the Customer



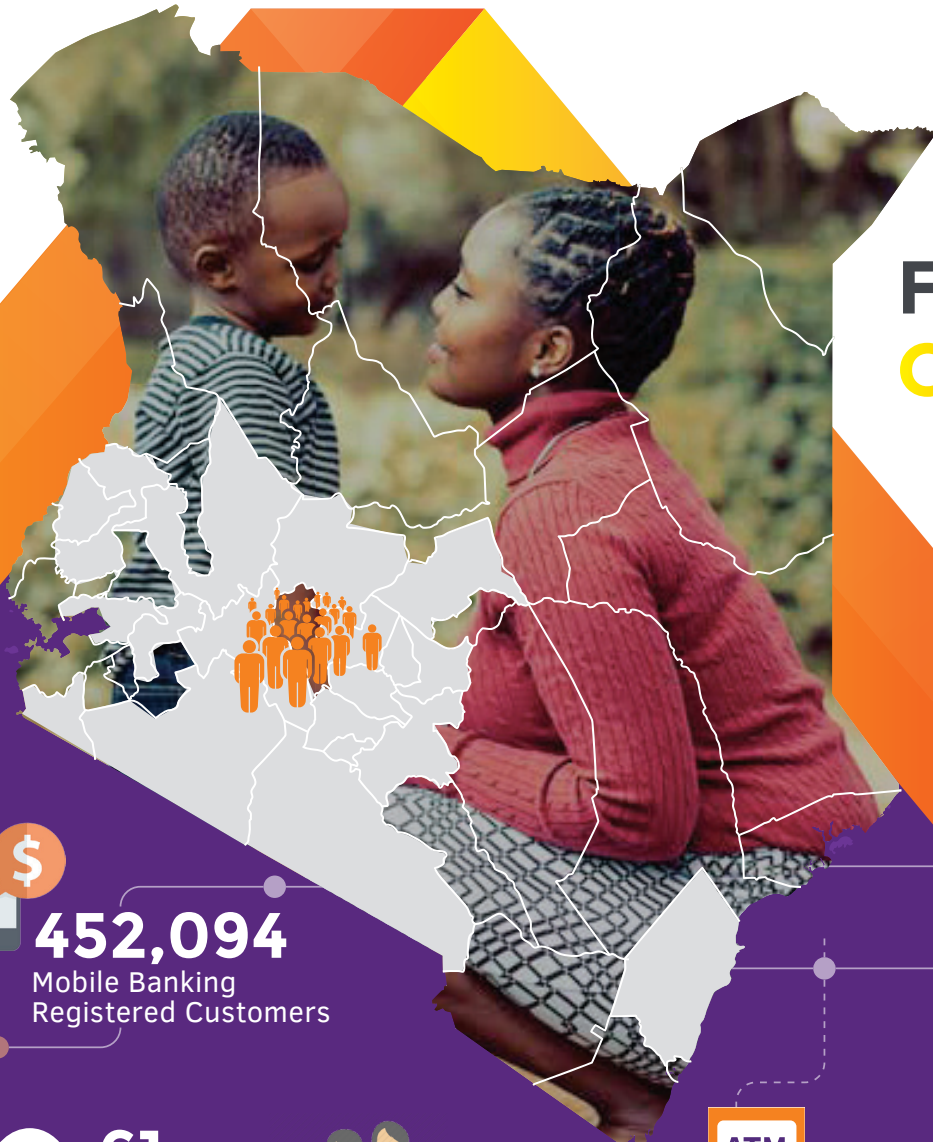
The Power of Diversity and Inclusion



Respect for Each Other & Communities  
We Serve



Agile Innovation That Makes a Difference



# FAULU AT A GLANCE



**452,094**  
Mobile Banking  
Registered Customers



**61**  
Banking  
Outlets



**1190**  
Employees



**28**  
ATMS



**300**  
Agents

- **Baringo County**  
Kabarnet
- **Bomet County**  
Bomet
- **Bungoma County**  
Bungoma  
Kimilili
- **Busia County**  
Busia
- **Elgeyo Marakwet County**  
Iten
- **Embu County**  
Embu
- **Homabay County**  
Homabay
- **Kajiado County**  
Rongai  
Kiserian  
Kitengela
- **Kakamega County**  
Kakamega  
Mumias
- **Kabarnet County**  
Kabarnet

- **Kericho County**  
Litein  
Kericho
- **Kiambu County**  
Thika  
Kiambu  
Limuru
- **Kilifi County**  
Kilifi  
Malindi
- **Kirinyaga County**  
Mwea
- **Kisumu County**  
Kisumu
- **Kitui County**  
Matuu  
Mwingi  
Kitui
- **Kwale County**  
Ukunda
- **Laikipia County**  
Nyahururu  
Nanyuki
- **Machakos County**  
Machakos

- **Makueni County**  
Emali
- **Meru County**  
Makutano  
Meru  
Maua
- **Migori County**  
Migori
- **Mombasa County**  
Changamwe  
Kengeleni  
Moi Avenue
- **Muranga County**  
Muranga
- **Nairobi County**  
Ngong Road  
Kawangware  
OTC  
Kibera  
Kimathi Street  
Jeevanjee  
Kariobangi  
Kayole  
Githurai  
Gikomba

- **Naivasha County**  
Naivasha
- **Nakuru County**  
Nakuru  
Molo  
Njoro
- **Narok County**  
Narok
- **Nyeri County**  
Nyeri  
Karatina
- **Siaya County**  
Bondo  
Ugunja
- **Transnzoia County**  
Kitale
- **Taita-Taveta County**  
Voi  
Taveta
- **Uasin Gishu County**  
Eldoret
- **West Pokot County**  
Kapenguria



**REPORTS AND FINANCIAL STATEMENTS**  
FOR THE YEAR ENDED 31 DECEMBER 2018

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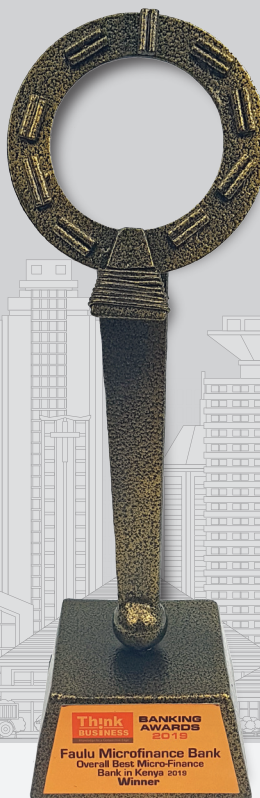
★ ★ ★  
**OVERALL**  
**BEST**  
**MICRO**  
**FINANCE**  
**BANK IN KENYA**



**THANKS TO YOU  
 OUR CUSTOMERS  
 WE ARE HONORED.**

**AWARDS:**

- Overall Best Microfinance Bank in Kenya
- Lifetime Achievement Award in Banking - Head of Retail Banking, Rose Kimani
- 2nd Best Microfinance Bank in Agriculture and Livestock Financing
- 3rd Best Bank in Product Marketing.



Regulated by the Central Bank of Kenya

*Wakenya Tufaulu*

[www.faulukenya.com](http://www.faulukenya.com)

[faulukenya](#) +254 711 074 000

**Faulu**

A MEMBER OF THE **OLDMUTUAL GROUP**



# CORPORATE INFORMATION

## Board of Directors

Dr. Peter Wanyaga Muthoka	Chairman	
Apollo N. Njoroge	Managing Director	
Peter J. Mogan*	Non- Executive Director	
Joshua S. Muiru	Non- Executive Director	
Peter K. Mwangi	Non- Executive Director	
George A. Maina	Non- Executive Director	
Peter N. Gachuba	Non-Executive Director	
Sophia A. Mukoba	Non- Executive Director	Appointed 14th February, 2018
Theunis Kruger **	Non- Executive Director	Resigned 28th February, 2018
Catherine Musakali	Non-Executive Director	Resigned 9th April, 2018
Dr. Catherine N. Kimura	Non- Executive Director	Appointed 14th February, 2018

Audit Committee	IT Committee	Risk and Compliance Committee
Joshua Muiru Sophia Mukoba Catherine Musakali	Joshua Muiru George Maina Peter Gachuba Apollo Njoroge	Joshua Muiru George Maina Peter K. Mwangi Catherine Musakali

Remuneration and Nominations Committee	Credit Committee
Dr. Peter W. Muthoka George Maina Peter K. Mwangi	Peter Gachuba Dr. Catherine Kimura Catherine Musakali Theunis Kruger

Registered office	Company Secretary	Principal Banker
Ngong Lane Off Ngong Road P O Box 60240 00200 - Nairobi	Nkirote K. Mworira UAP Old Mutual Towers Upperhill Road, P.O. Box 43013-00100 Nairobi, Kenya	Standard Chartered Bank Kenya Limited Yaya Centre Branch P O Box 40310 00100 - Nairobi

Auditors	Principal Lawyers
Deloitte & Touche Certified Public Accountants (Kenya) Deloitte Place, Waiyaki Way, Muthangari P O Box 40092 00100 - Nairobi	Daly & Inamdar Advocates 6th Floor, ABC Towers, ABC Place, Waiyaki Way P.O. Box 40034, Nairobi 00100 Kenya

\*Canadian

\*\*South African

# THE BOARD OF DIRECTORS

## From Right to Left

**Dr. Peter Wanyaga Muthoka** (Chairman), **Peter K. Mwangi** (Non Executive Director), **Peter N. Gachuba** (Non Executive Director), **Sophia A. Mukoba** (Non Executive Director), **Nkirote M. Njiru** (Company Secretary).



**From Left to Right**

**Apollo N. Njoroge** (Managing Director), **Dr. Catherine N. Kimura** (Non Executive Director), **George A. Maina** (Non Executive Director), **Peter J. Mogan** (Non Executive Director), **Joshua S. Muiru** (Non Executive Director).



## BOARD OF DIRECTORS (Continued)



### DR. PETER WANYAGA MUTHOKA

D.ML, MA(Ed), BA (Hons), EBS,  
MBS, FKIB, FKIM, MID

CHAIRMAN

#### Qualification:

- Honorary Degree of Doctor of Management and Leadership (D.ML) (Honoris Causa)
- The Management University of Africa (MUA) MA (Education), with special reference to UN Agencies
- University of California, Los Angeles (UCLA)
- BA Economics & History (Hons), University of East Africa, Nairobi Campus

**Year of Birth:** 1943

**Date of Appointment:** 26 March 2014

#### Experience:

Dr. Muthoka is the Chancellor of Masinde Muliro University of Science and Technology (MMUST). Previously, Dr. Muthoka has served as Group Chairman of Kenya Commercial Bank. He is now the current Chairperson of the Board of Directors Faulu Microfinance Bank Limited and the Board of Trustees UAP Old Mutual Foundation.

Through his illustrious career, Dr. Muthoka has been a corporate leader and an entrepreneur with long and varied experience in public and private sectors in the fields of Management, Education, Finance, Investment, Export Promotion, Agriculture, Real Estate, Corporate Governance, International Diplomacy, and Community Voluntary work.

In recognition of his exemplary service within the Kenyan public service and international organizations, the president of the Republic of Kenya awarded him with the medal of Moran of the Burning Spear (MBS) in 2004 and the Medal of Elder of the Burning Spear (EBS) in 2012.

**Qualification:**

- BSc. Electrical Engineering, University of Nairobi
- Certified Public Accountant CPA (K)
- Certified Financial Analyst - CFA Charter Holder
- Chartered Public Secretary CPS (K)

**Year of Birth:** 1969

**Date of Appointment:** 11 March 2015



**PETER K. MWANGI**  
NON EXECUTIVE DIRECTOR

**Experience:**

Peter joined Old Mutual Kenya as the Chief Executive Officer in October 2014 from Nairobi Securities Exchange and later became the Group CEO following the merger of UAP and Old Mutual. He now heads the UAP Old Mutual Group Business which also includes Faulu Microfinance Bank Limited.

At NSE, he served as the Chief Executive Officer for six (6) years, during his time Peter was credited with, amongst other things, the successful Demutualization and Self-Listing of the NSE.

Prior to this, Peter was the Managing Director of Centum Investments Limited which is one of the Kenya's largest publicly quoted investment company. Early in his career, Peter served in the Kenya Air force and held the rank of captain.

He sits on the UAP Old Mutual Group Board in; Kenya, Uganda, Tanzania, Rwanda, South Sudan, Boards as an Executive Director.



## BOARD OF DIRECTORS (Continued)



**GEORGE A. MAINA**  
NON EXECUTIVE DIRECTOR

### Qualification:

- B.Tech (Hons) Aeronautical Engineering and Design
- Loughborough University of Technology

**Year of Birth:** 1952

**Date of Appointment:** 2003

### Experience:

George began his career in aeronautical engineering and went on to serve in the capacity of deputy Managing Director and Marketing Manager for the Shell Company in Jamaica, Ghana and East Africa markets. Through his experience, George gained expertise in various sectors including: Strategy development and Implementation, Governance, Organization Development / Re-engineering and Capacity Building, Change Management, Risk Management, Finance and Investment Management, Mergers, Acquisitions and Exits as well as Investment Banking.

He joined the Faulu Board in 2003 and has been instrumental in leading the restructuring and divestiture of the bank. George is currently a Director at UAP Old Mutual Holdings Limited.

**Qualification:**

- MSc. International Business – Southern New Hampshire University, Manchester, NH, USA  
BSc. Accounting, Southern New Hampshire University, Manchester, NH, USA
- Executive Courses from Harvard Business School – USA and Wharton Business School USA

**Year of Birth:** 1964

**Date of Appointment:** 16 March 2015

**Experience:**

Peter is an investment banker with many years of business experience. He has worked in Commercial banking, Investment banking and Private Equity for nearly 20 years. He has served in the Board of Equity Bank and other Microfinance Banks outside Kenya such as Opportunity Bank in Malawi, Socremo in Mozambique, Pride in Uganda and Pride in Tanzania.

Earlier in his career, he was a Corporate Finance Manager at KPMG, Investment Officer at CDC Capital, General Manager of Kestrel Capital, Head of Investment & Merchant Banking in Cooperative Bank and also worked as a Consultant for the World Bank in Nairobi.

He is currently a Commissioner in the Commission of Revenue Allocation in Kenya.



**COMNR. PETER N. GACHUBA**  
NON EXECUTIVE DIRECTOR



## BOARD OF DIRECTORS (Continued)



**DR. HON. CATHERINE N.  
KIMURA**  
NON EXECUTIVE DIRECTOR

### Qualification:

- Bachelor of Arts Degree (Hons) from the University of Nairobi
- Diploma in Tourism and International Relations (University of Paris)
- Certificate in Public Finance (University of Connecticut)
- Certificate in Budgeting (Harvard Institute)

**Year of Birth:** 1943

**Date of Appointment:** 14 February 2018

### Experience:

Dr. Hon. Catherine Kimura is a specialist in Public Finance and Policy and Management with over 37 years' experience.

She has held enviable positions in the government and public service including Investment Secretary - Ministry of Finance as well as Member of Parliament - East African Legislative Assembly (EALA) and the first Chancellor of Multimedia University of Kenya.

She has previously served as a Director of KCB Bank Kenya and currently serves as a Director of Old Mutual Securities Limited. Her vast experience is beneficial to Faulu's overall strategic planning, management and finance.

**Qualification:**

- Master of Arts in Economics, University of Nairobi
- Bachelor of Arts in Economics, University of Nairobi
- Executive Courses in Corporate Governance, Debt Management, Financial Analysis and Policy and Public Finance

**Year of Birth:** 1950

**Date of Appointment:** 30 March 2015

**Experience:**

Joshua is an economist with extensive experience in the banking industry having worked with the Central Bank of Kenya for over 23 years. He has also worked with the Industrial and Commercial Development Corporation, Kenya Industrial Estates and has been a Director at KCB Rwanda and KCB Tanzania.

He also has vast training and experience in policy formulation and corporate governance. Consequently, he is a seasoned member of the Institute of Directors of Kenya and a Consultant for Kenya Institute of Bankers.



**JOSHUA S. MUIRU**  
NON EXECUTIVE DIRECTOR



## BOARD OF DIRECTORS (Continued)



**SOPHIA A. MUKOBA**  
NON EXECUTIVE DIRECTOR

### Qualification:

- Masters of Business Administration, University of Nairobi
- Bachelor of Commerce - Accounting Option
- Certified Public Accountant CPA (K)
- Member of the Chartered Institute of Management Accountants (CIMA)

**Year of Birth:** 1975

**Date of Appointment:** 14 February 2018

### Experience:

Sophia is a seasoned finance professional with over 18 years' experience spanning across Audit, Control Management Accounting and Commercial Finance. Sophia has held various Senior Finance roles and is currently the Finance Director for Unilever East Africa. Prior to joining Unilever, she worked at British American Tobacco Kenya Limited and Deloitte & Touche. Her expertise in financial and audit matters are of great value to the Faulu Board.

**Qualification:**

- Bachelor of Law – Osgoode Hall Law School
- Attorney of Law in Society of Columbia
- Member of Law Society of British Columbia

**Year of Birth:** 1952

**Date of Appointment:** 4 July 2014



**PETER J. MOGAN**  
NON EXECUTIVE DIRECTOR

**Experience:**

Peter has been an active lawyer, businessman and mediator in British Colombia and Ontario with a career spanning over 37 years.

He is highly skilled in mergers and acquisitions, contract negotiations, international trade, dealings with government, tax planning and securities compliance for both publicly listed and private companies.

Peter also has extensive experience in facilitating Leadership Development, Strategic Planning, Conflict Management and Community Building Workshops for Business, Government and Not-for-profit Organizations in six continents.

He currently serves as a Director on or Corporate Secretary to the Boards of several British Columbia companies as well as a number of charities. He is also actively involved with Global Mothers, a new social enterprise targeting poverty alleviation in the developing world through trade.



## BOARD OF DIRECTORS (Continued)



**APOLLO NJOROGE**  
MANAGING DIRECTOR

### Qualification:

- Graduate of IESE Business School in Spain
- Masters' Degree in International Business Administration (Finance Option), United States International University
- Executive Management- Strathmore Business School
- Bachelor of Science Degree (Hons) in Mathematics and Physics University of Nairobi

**Year of Birth:** 1970

**Date of Appointment:** 19 December 2016

### Experience:

Apollo is an experienced financial executive with over 24 years' experience in Retail, Micro, Small and Medium Enterprises Banking across East Africa joined Faulu Microfinance Bank Limited as the Managing Director and Chief Executive Officer.



Prior to his appointment, he was Acting Managing Director, Equity Bank in Uganda, where he also held the positions of Executive Director and Chief Operations Officer. He has held the following positions at Equity Bank in Kenya; General Manager in charge of Business Relationships and Head of Business Growth & Development. He has also worked in African Banking Corporation Limited and Investments & Mortgages Bank.

Apollo's achievements during his tenure at Equity, were commendable and include: Strategy formulation and implementation which led to the acquisition of a micro finance institution in Uganda and its eventual growth into a fully-fledged profitable bank in the top ten (10). He is also credited with leading the change process for the rollout of a new banking software, documentation of procedures and supporting the team to transition to a commercial bank.



**Qualification:**

- Global Executive Masters in Business Administration jointly offered by United States International University (Kenya) and Columbia Business School (New York, USA)
- Master of Laws in Commercial Law - University of Cape Town (Republic of South Africa)
- Bachelor of Laws Degree - University of Reading (United Kingdom)
- Higher National Diploma in Law (Kenya)
- Higher National Diploma in Human Resource Management (Kenya)

**Year of Birth:** 1973

**Date of Appointment:** 21 August 2017

**Experience:**

Nkirote is a certified public secretary and lawyer with a passion for corporate governance, standard setting and policy making. She is an Advocate of the High Court of Kenya, an active member of the Law Society of Kenya and a fellow of the Institute of Certified Public Secretaries of Kenya where she has been an elected member of the Council and is currently serving as the Chairperson of the Institute.

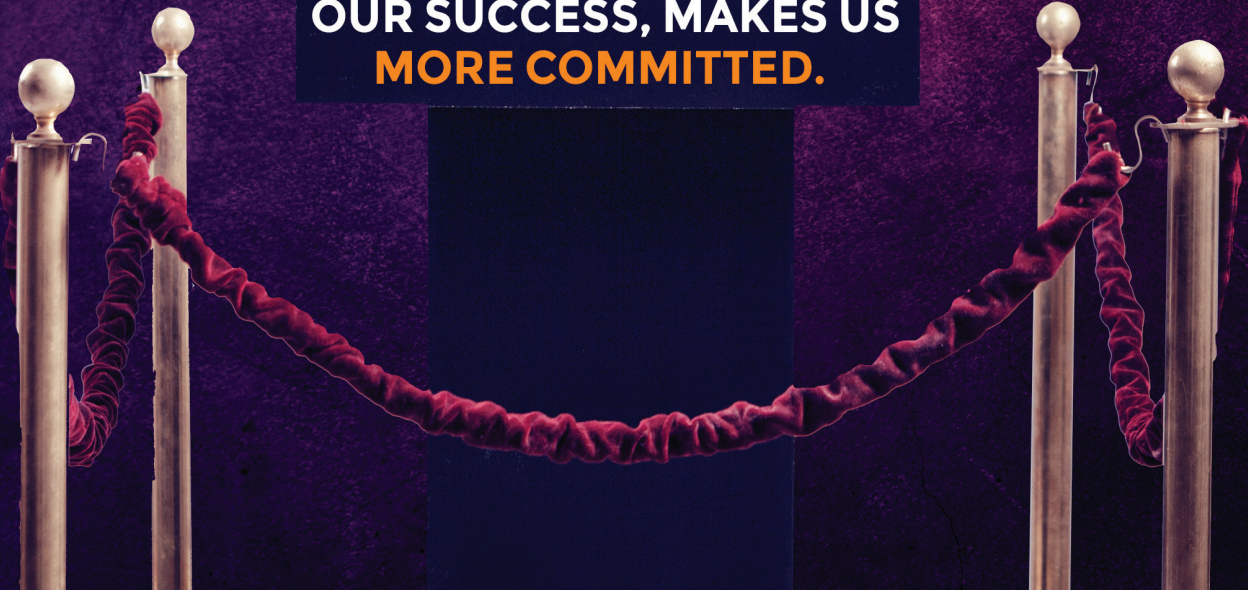
In her twenty years of practice, Nkirote has worked in both public and private sectors in Kenya in several sub-sectors including telecommunications, retirement benefits and insurance in a wide-range of activities involving setting-up of legal and governance structures, legal and regulatory risk analysis, monitoring developments in legal research, legal policy development, legislative drafting, industry supervision and capacity building.



**NKIROTE NJIRU**  
COMPANY SECRETARY



**OUR SUCCESS, MAKES US  
MORE COMMITTED.**





WAKENYA TUFALU



# SENIOR MANAGEMENT



<b>APOLLO NJOROGE</b>	<b>CAROLINE KIPSANAI</b>	<b>DAVID MUKARU</b>	<b>GRACE THIONG'O</b>	<b>JULIUS TALIANI</b>
Managing Director	Head of Marketing & Customer Experience	Head of Business Growth	Head of Risk & Compliance	Head of Finance & Strategy



<b>PAUL KAHORO</b>	<b>NAHASHON OJODE</b>	<b>MAUREEN MBORI</b>	<b>PETER IHA</b>	<b>MICHAEL KALII</b>
Head of Audit	Head of Credit	Head of Treasury	Head of Human Capital	Head of Operations



”

Coming together is a **beginning**.  
Keeping together is **progress**.  
Working together is **success**.

--Henry Ford



**From Left To Right (Standing)**

Nahashon Ojode, Michael Kalii, Julius Taliani, Maureen Mbori, Paul Kahoro, David Mukaru, Peter Iha.

**From Left To Right (Sitting)**

Grace Thiong'o, Apollo N. Njoroge, Caroline Kipsanai.





The Group posted pre-tax profits of Kshs 287 million up from Kshs. 178 million in 2017 mainly driven by the retail business.

DR. PETER WANYAGA MUTHOKA  
CHAIRMAN

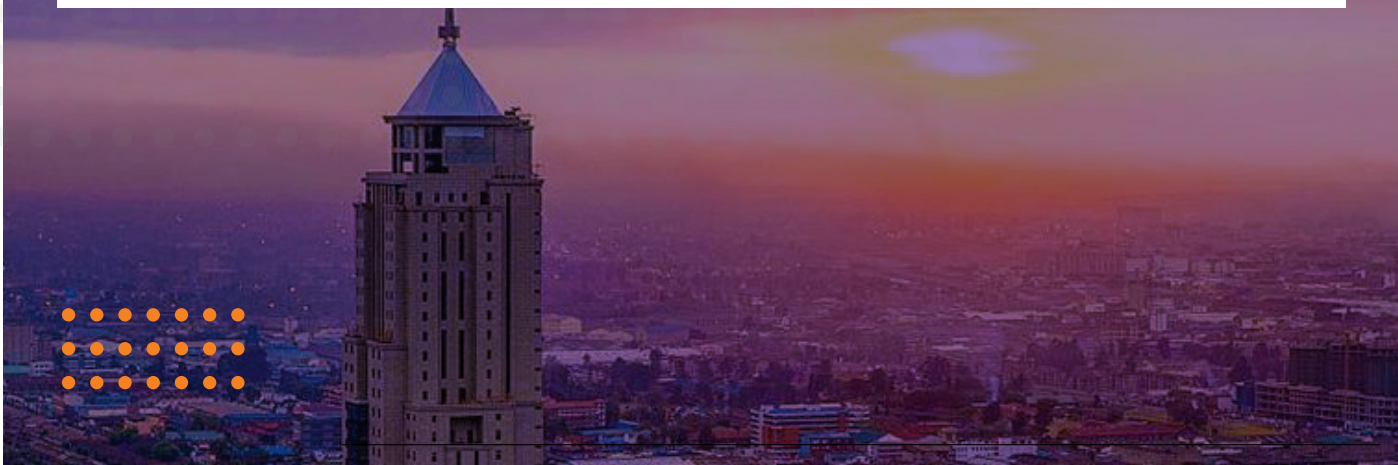
## CHAIRMAN'S STATEMENT

It is my pleasure to present to you the Faulu Microfinance Bank Limited (the "Bank") Annual Report and Financial Statements for the year ended 31st December 2018.

The financial statements include the consolidated financial statements of the Bank and its subsidiary (together, the "Group").

The year under review saw a remarkable growth in the Group, a testament of the commitment by the Board of Directors, Management and the wider Faulu fraternity in ensuring that the bank not only delivers its set targets but also provides relevant financial solutions to our customers.

In 2018 the Bank leveraged on the upgraded T24 system from R10 to R16, which improved our efficiencies and customer experience.



## Operating Environment

According to African Development Bank, Real GDP grew to an estimated 5.9% in 2018, from 4.9% in 2017, supported by good weather, eased political uncertainties, improved business confidence, and strong private consumption. Supply side, services accounted for 52.5% of the growth, agriculture for 23.7%, and industry for 23.8% and demand side, private consumption was the key driver of growth.

To stimulate growth, the Central Bank of Kenya, through the Monetary Policy Committee lowered the Central Bank Rate (CBR) twice, during the six meetings held in 2018 in order to support economic activity. The MPC later lowered the CBR to 9.0% from 10% that had been set in September 2016.

Kenya continues to face the challenges of inadequate infrastructure, high-income inequality, and high poverty exacerbated by high unemployment, which varies across locations and communities. Kenya is exposed to risks related to external shocks, climate change, and security.

Kenya's Big Four (B4) economic plan, introduced in 2017 by the President, focuses on manufacturing, affordable housing, universal health care coverage, and food and nutrition security. It envisages enhancing structural transformation, addressing deep-seated social and economic challenges, and accelerating economic growth to at least 7% a year. By implementing the B4 strategy, Kenya hopes to reduce poverty rapidly and create decent jobs.

The overall year on year inflation stood at 5.04% in December 2018, compared to 7.99% in December 2017, which is within the Central Bank of Kenya preferred range of 2.5% - 7.5%.

The Kenyan Shilling gained by 1.4% against the US Dollar to close at Ksh101.8 / USD in 2018 compared to Kshs. 103.2/USD at the end 2017; being the only major African currency to have appreciated against the dollar in 2018.

## Financial Results

During the year under review, the Group posted pre-tax profits of Kshs 287 million up from Kshs. 178 million in 2017 mainly driven by the retail business.

The non-performing loans ratio decreased from 16.50% in December 2017 to 13.07% in December 2018. This was mainly attributed to aggressive collection that netted off with growth in loan book.

Total Group assets grew by 8% from Kshs. 25.3 billion in December 2017 to Kshs 27.3 Billion in 2018 driven mainly by the growth of the loan book by 10%.

The gross loans and advances to customer increased from Kshs. 17.2 billion in 2017 to Kshs. 19.1 Billion in 2018.

## Risk Management

The bank performs a detailed assessment of its risk profile and capital requirements on a regular basis. We remain alert against the present risk of cybercrime to both the bank and our customers.

The Bank is adequately capitalized for its business model and the risk appetite as defined by the Board of Directors.

The Bank's capital ratios are higher than the minimum requirements prescribed under CBK Prudential Requirements.

The Bank is adequately capitalized for its business model and the risk appetite as defined by the Board of Directors. The Bank's capital ratios are higher than the minimum requirements prescribed under CBK Prudential Requirements.

## CHAIRMAN'S STATEMENT (Continued)

### Developments in the Banking Sector

For the year ended 31st December 2018, the banking sector saw a number of developments as detailed below:-

#### Adoption of IFRS 9

The initial application of IFRS 9 as from 1st January 2018 led to increased impairment loss allowances. The day one adjustment, which was Kshs. 1.9 Billion, had a negative impact on the Bank's capital. The Central Bank of Kenya (CBK) established a five-year window for commercial banks and other financial institutions to stagger the recognition of the additional impairment losses under IFRS 9.

The IFRS 9 adds another major challenge to banks that has seen lending margins drop significantly following the introduction of interest rate controls. The twin challenge of more stringent accounting rules and narrower lending margins will force banks to retain more of the profit, and reduce the cash available for distribution to shareholders.

Those that choose to raise their dividends risk tapping their shareholders for new capital in the coming years, re-introducing a wave of rights issue.

#### Technology Leverage

There has been need to leverage technology to drive efficiencies in industry operations in order to serve customers better with relevant products that meet their expectations. The banking industry has moved deeper into financial technology space.

#### Chase Bank Kenya Limited ("Chase Bank") and Imperial Bank Limited (Imperial Bank) sale:

The Central Bank of Kenya (CBK) and Competition Authority of Kenya (CAK) authorised acquisition of Chase Bank in October 2018 by SBM Holdings. CBK also appointed Kenya Commercial Bank (KCB) as an agent to take over Imperial Bank.

### Looking forward

As the Group continues to expand, increased adoption of technology will reduce operational cost and improve efficiency. Some of the measures include integration with the mobile application platforms and internet banking to facilitate increased collection of deposits and disbursement of loans with lower operating cost.

Diversification into different revenue streams will also increase non-funded income given the introduction of interest rate cap, which has negatively affected funded income to the banks.

Our focus will remain acquiring entry-level customers as well as offering transformative products to Retail, Micro, Small and Medium Enterprises.

### Acknowledgement

I take this opportunity to thank the Management and Staff for their hard work and dedication as they execute their different role. I affirm that your effort counts.

My gratitude goes out to my fellow Directors whose wisdom and stewardship in providing strategic direction for this organisation is unparalleled.

Finally, I wish to recognize and extend my sincere gratitude to our esteemed customers and shareholders for their continued belief in our financial solutions and brand. We appreciate your loyalty and remain committed to keeping your best interests at heart, as we innovate and continue to execute for you


Thank you and God Bless You.



**Dr. Peter Wanyaga Muthoka - Chairman**  
**D.ML, M.A (Ed.) B.A (Hons), EBS, MBS,**  
**FKIB, FKIM, MID**

BANKING MADE EASY

**MOBILE BANKING.**  
**ACCESS YOUR MONEY**  
ANYTIME, ANYWHERE.



The bank managed to perform significantly well albeit the challenges that come with reorganisations and met 93% of the set target for the year 2018 in Profitability.

APOLLO N. NJOROGE - MD

## MANAGING DIRECTOR'S STATEMENT

Faulu Microfinance bank's overall ambition is to become the Leading Retail and MSME Bank and Bancassurance Champion.

With this in mind and with the help of our over 400,000 customers across the country, together with our staff and stakeholders, I am proud to say that we are spearheading the business to the right direction.

It is my pleasure to present the 2018 Annual Report and Financial Statements. 2018 had its fair share of challenges for the business especially with the staff restructuring that took place in April and May. The bank managed to perform significantly well albeit the challenges that come with reorganisations and met 93% of the set target for the year 2018 in Profitability. 2018 saw us make remarkable steps towards attaining our set objectives to our customers, staff and esteemed shareholders. I am proud to say that Faulu was the best Microfinance bank in deposits and profitability in Kenya in the year 2018.

### Overview of the Operating Environment

The Kenyan economy was on a recovery and growth path in 2018 supported by good weather, eased political uncertainty and strong private consumption.

Real GDP growth was estimated at 5.9% in 2018, up from 4.9% in 2017. This growth was supported by an uptake in accommodation and food services, electricity and water supply and construction activities.

The macroeconomic environment remained stable, with low and stable interest rates and competitive exchange rate to support exports. Month on month overall inflation remained stable averaging 4.7% in 2018 down from 8.0% in 2017, owing to a decline in food and energy prices.

To stimulate growth, the Central Bank of Kenya reduced the Central Bank Rate to 9% in July 2018 from 9.5%. This resulted in increased borrowing by the households. However, this was not adequate to spur rapid economic activity. Banks still face the challenges brought about by the capping of interest rates done in September 2016. There is a need to review this law in a bid to enable commercial banks price-in the credit risk for different customers in the different sectors of the economy.

**Regulatory Environment**

In 2018, the regulator introduced Cyber Security Guidelines for Payment Service Providers (PSPs). The Guidelines set the minimum standards that PSPs should adopt to develop effective cybersecurity governance and risk management frameworks in order to maintain a sound, secure and efficient National Payment System.

Following the introduction of Mortgage Refinance Companies (MRCs) in the Finance Act 2018, the Central Bank introduced the draft MRC Regulations, 2019 intended to provide a framework for licensing, capital adequacy, liquidity management, corporate governance, risk management, and reporting requirements of MRCs. MRCs will refinance primary mortgage lenders such as Commercial banks, Microfinance banks and Saccos using funds from the Capital Markets so as to provide affordable mortgages to eligible members of the public. This will avail immense business growth opportunities in the mortgage segment.

Anti-Money Laundering and Countering Financing of Terrorism continued to take centre stage especially in the renewed fight against corruption in the public sector. Conducting customer due diligence, a thorough review of supporting documentations and reporting of large and/or

suspicious transactions, and those by politically exposed persons cannot be over-emphasized as some of the key risks that needed to be keenly mitigated.

Faulu continues to strengthen its anti-money laundering and countering of financing of terrorism (AML/CFT) frameworks and commits to address the identified lapses and be fully compliant with all aspects of the law.

**Performance Overview**

The Faulu 2018 Group performance was as follows:

**Profit Before Tax**

 **61%**

increased by Kshs.109 million to Kshs.287 million in **2018**.

The impressive performance was driven by growth in disbursements, lower Opex, repositioning of bonds portfolio through money market trades to supplement interest income and aggressive growth of non-interest revenue.

**Customer Deposits**

 **Kshs. 2.1B**

**grew to Kshs.18.5 billion in 2018**

due to aggressive sale, daily monitoring of achievements against targets, deposit mobilization through marketing and media campaigns and launch of current and savings accounts ( CASA) drive.

**Gross Loans and Advances to Customers**

 **Kshs. 2.0B**

**grew from Kshs. 17.2billion in 2017 to Kshs.19.2 billion in 2018.**

This was largely fueled by customer loyalty as well as marketing campaigns.

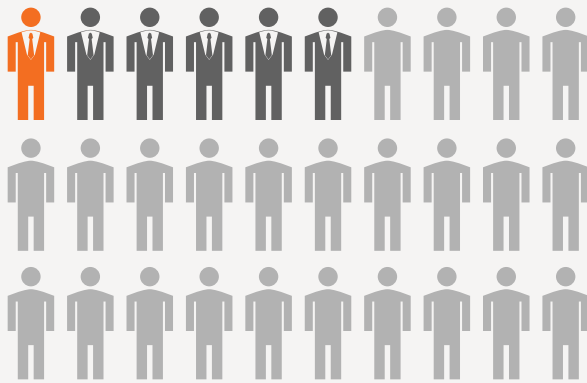
## MANAGING DIRECTOR'S STATEMENT (Continued)

### Total Assets

 **8%**

grew to **Kshs. 27 Billion** in 2018, mainly attributed to growth in loan book as a result of more disbursements.

### Customer Numbers



Growth in customer base is attributed to the banks aggressive and committed sales force, excellent customer experience, new innovations and vast products that addresses the customer's needs.

### The Quality of the Loan Book

The quality of the book improved to a **PAR of 13.07%** with an **NPL of Kshs.2.5B** in December 2018, down from a **PAR of 16.59%** and an **NPL of Kshs2.87B** in December 2017, mainly on account of aggressive collection and enhanced credit underwriting.

### Looking ahead

We are pleased with our progress in 2018 and we look forward to greater performance in the days ahead.

Our future focus as a customer led retail and traders bank is to continue evolving digitally by offering our customers relevant financial solution.

### Acknowledgement

I would like to sincerely thank our customers, Board of Directors and staff for their dedicated contribution in driving the Banks strategic objectives in 2018. I look forward to your support in making Faulu great again in 2019.

Thank you.



**Apollo N. Njoroge**  
Managing Director



TRANSACT CONVENIENTLY



WE ARE WHERE YOU ARE,  
WITH OUR ATMS SPREAD COUNTRYWIDE  
AND, THROUGH ANY VISA ATM.



# SUSTAINABILITY REVIEW

Our sustainability agenda is to enhance financial inclusion and help Kenyans achieve their ambitions by fulfilling their financial services needs in a responsible and sustainable manner. We enable people, businesses and society to grow in a way that is sustainable in the long-term.

As a member of the Old Mutual Group Kenya, part of our commitment to Social responsibility is to actively support our company-wide global strategy. Responsible business practices are core components of the Old Mutual Group risk management strategy which is underpinned by the Group's four values of Integrity, Respect, Accountability and Pushing beyond boundaries.

By managing our finances responsibly, we build trust and strong profitable relationships. We also achieve great success by upholding responsible business.

Our sustainability approach aims to balance Social, Economic and Environmental Risks and Opportunities through the deliberate use of our products and services, collaboration and partnerships and by managing our own impact.

## ECONOMIC

### Local Economic Impact

Credit is the fuel of the economic engine. Over the last five years our net loans and advances to customers has grown at Compounded Annual Growth Rate (CAGR) of 5.5%; as at December 2018, to Kshs.19.2Billion which was outstanding as net loans and advances to public and private enterprises.

As the **leading microfinance bank in profitability and deposits in 2018**, we pride ourselves in offering financial transformation through provision of financial education and integrated financial services that includes Banking, Savings, Investments and Insurance solutions through our various channels.

### Our Accolades Include:

- Think Business Award 2016 as the fastest growing Microfinance Bank in Kenya
- Top Employer Award
- 5 Wins of the Financial Reporting (FiRe) Award

Faulu has over **300** service providers and Ten (10) Foreign Service providers. In 2018, the bank paid **over Kshs. 894 million** to our suppliers with 90% of the total revenue paid to local suppliers.

The following policies and manuals guide procurement and Facilities management.

- Procurement and Facilities management Manual,
- Procurement and Facilities Management Policy,
- Risk Policy,
- Accounting Manual & Operations Manual.

**Through partnership development**, finance is required for long-term investment and economic growth. We had a long term borrowing of up to Kshs 4.4 Billion.

### Taxes

We contribute to the creation of prosperity and to the stability of our country by remitting our taxes on time.

Taxes provide essential public revenues for governments to meet economic and social objectives. We view taxation as a mainstream part of our corporate social responsibilities.

Faulu is also KRA's appointed agent to assist the taxman in collection of various taxes across the country.





**SOCIAL  
SUSTAINABILITY  
INITIATIVES**

**Employee Welfare**

We are determined to make Faulu a great place to work in, to encourage staff to bring out the best in themselves at work and by helping one another realize their full potential. We view one another as part of one big family and each member's welfare as our collective responsibility.

Our Staff Welfare Club participates and contributes to the welfare of the members in times of need and during celebrations. We stand with one another when we:

- Welcome newborns
- Celebrate marriages or weddings
- When our staff are hospitalized
- When bereavement.

We invest in out-of-office staff activities such as sports events, team building and Corporate Social Responsibilities to help staff reflect bond.

Our staff engagement initiatives were:

**Purposeful Casual Fridays:** During this day staff are challenged to follow a dress theme on every first Friday of the month in support of a social cause.

**Staff wellness** is aimed at encouraging a healthy lifestyle. Some of the activities realised included annual free medical check-up, Go plus app to ensure staff stay healthy and at the same time earn points which can earn them awards from to time.

**Bring Your Child to Work day** - This was initiated by the Old Mutual Womens' Network (OWN - EA) which promotes diversity in the workplace. In 2018 children visited their parent's work place and spent the day participating in fun-filled activities

## SOCIAL SUSTAINABILITY INITIATIVES (Continued)

### HR Policies Framework

We have proactive HR Policies, procedures and manuals that guide us on HR related issues. These include:

- Disciplinary, Grievance Policy and Procedures
- Sexual Harassment Policy
- HIV/Aids Policy
- Occupational Health & Safety Policy
- Code of Conduct & Ethics
- Loan Policy
- Whistle blowing policy
- Leave policy
- Promotion policy
- Recruitment policy
- Performance Management policy
- Performance Improvement Policy
- Dress Code Policy
- On job training procedure and work rotation policy

### Whistle-blowing Policy

The Whistle blowing policy is intended to encourage and enable employees to raise serious concerns within the bank rather than overlooking a problem or simply reporting it outside of the defined channels within the Bank.

The policy provides avenues for staff to raise concerns and receive feedback on any action taken.

This reassures staff that they are protected from reprisals or victimization for “whistle blowing” in good faith.

The policy provides that staff may report an issue if it is unlawful; fraudulent; contrary to the bank’s policies and procedures; falls below established standards of practice; amounts to improper conduct and breach the Bank’s code of Conduct.

The bank has put in place systems to encourage staff to raise concerns in a structured and protected way. The bank respects the confidentiality of staff raising concerns and sets out arrangements that include the opportunity to raise concerns outside the management structure.

### Labour Standards

We appreciate the need for work-life balance for our staff and we have created an inclusive and conducive environment to cater for their different requirements. We support staff in child rearing responsibilities by providing time off work for male and female staff in line with existing labour laws and best practice for enhanced productivity and employee engagement.

The bank has a designated a mothers room equipped with the necessary facilities to support mothers after their maternity leave.

Our bank maintains cordial relations with the staff union and we continue to foster partnership to ensure that staff interests are addressed on time. There is a Collective Bargaining Agreement that provides guidelines on the management and policies around the unionised employees.

## ENVIRONMENTAL SUSTAINABILITY INITIATIVES

As part of improving the way we manage our direct environmental impacts we have developed a robust environmental sustainability programme that revolves around reforestation and seeks to ensure we conserve our environment by increasing forest cover as well as keeping the environment around us clean. This has led the bank to organise for tree planting days and clean up days every year.

The bank through the staff has actively participated in tree planting activities over the years at the slopes of Ndakaini in Ndeka and at Aberdares National Park.

Staff have also taken part in clean up activities in Upper Hill.

# A summary of our **RESPONSIBLE BUSINESS AGENDA** priority areas:

1

## Responsible to our customers

We treat our customers fairly, equipping them with financing skills and develop products that meet the needs of our customers. This ensures that they access affordable and transparent financial services.



2

## Responsible investment

We ensure our investments, work practices and buildings are geared towards reducing our direct and indirect impact on the environment.



3

## Responsible to our employees

We ensure we treat our employees fairly, meeting their needs as our internal customers and community members, and giving them an opportunity to give back to society. The Bank does this by:

- Promoting equality in the workplace
- Developing talent to be future fit



4

## Responsible to our communities

We work with our community and other partners to build a better world-contributing to education, skills development and local economic development.



5

## Responsible environment management

We ensure our investments, work practices are geared towards reducing our direct and indirect impact on the environment. Faulu does this by:

- Promoting access to education and health care in the communities we serve
- Conserving the environment and driving sustainable consumption of natural resources



# WELCOME TO FAULU AGENCY BANKING



**AGENT**  
KARIBU



TOA



TUMA/POKEA

HUDUMA  
ZETU



WEKA



LIPA



## SERVICES

- ✓ Account Opening
- ✓ Cash Deposit
- ✓ Cash Withdrawal
- ✓ Third Party Payments ( School Fees etc)
- ✓ Bill Payments ( KPLC, DSTV, Water Etc)
- ✓ Balance Inquiry

[www.faulukenya.com](http://www.faulukenya.com)

faulukenya +254 711 074 000

**Faulu**

A MEMBER OF THE OLD MUTUAL GROUP



## OUR CORPORATE SOCIAL RESPONSIBILITIES

Faulu Corporate Social Responsibility is strongly engrained in the staff culture.



### AS A MEMBER OF THE OLD MUTUAL GROUP AND AN INTEGRAL PART OF UAP OLD MUTUAL FOUNDATION



which is the social investment arm of UAP Old Mutual Group, Faulu is committed to enabling Kenyans realize their dreams with a focus on Healthcare, Environment, Education and Risk Awareness in order to form sustainable community partnerships and development.

Throughout the year, Faulu Kenya participated in numerous projects around the country in various categories as outlined below.



# ABOUT UAP OLD MUTUAL AND FAULU FOUNDATION

## How Faulu Invests in the Communities we serve across Kenya

**70%** IMPACT  
Kenyatta National Hospital  
Accident and Emergency  
wing improved services for  
**180,000** patients

Uasin Gishu County  
Hospital improved  
lab and maternity  
services for over  
**108,000**  
patients annually

**14%** IMPACT  
**50,000** trees  
planted towards  
support environmental  
conservation

**7%** IMPACT  
600 visually impaired pupils  
supported

**5%** IMPACT  
2000 people attended to  
through medical camps

**4%** IMPACT  
600 staff volunteers





## EDUCATION

### Bible Translation and Literacy Run for the Bibleless

The annual run was dedicated towards the translation of the Bible into minority language groups in Kenya. Through this, the minority communities get to access basic literacy programs for them to be able to read their bible in their mother tongue.

Through the foundation Faulu continues to support free financial education initiatives to empower communities to be self-reliant and to end the cycle of poverty. The sessions provide robust conversations on financial management through practical solutions.

Other activities held to support education included the visit to Kijana Wamalwa Memorial High School to donate equipment including printers, computers and cabinets.

Meru Medical Camp



Faulu staff pose for a photo at 'Run for the Bibleless'.



Kijana Wamalwa School Visit to donate equipment to aid in education



The visit to Kijana Wamalwa Memorial High School to donate equipment including printers, computers and cabinets.

Financial Education Sessions Ongoing



Customers happy to be equipped with financial skills in Meru

ENVIRONMENT



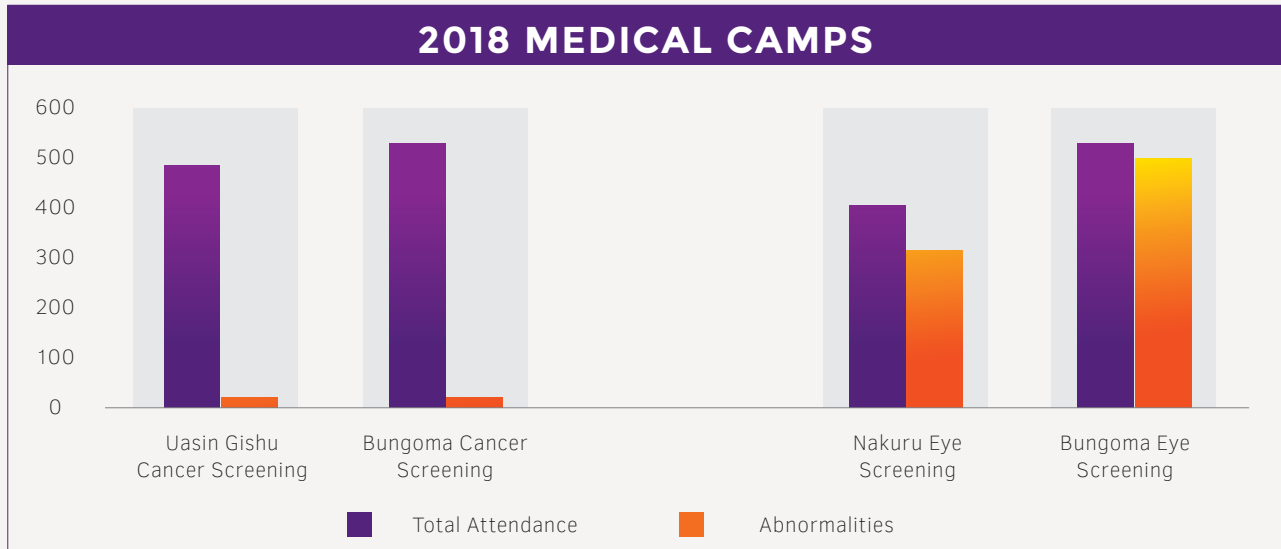
Faulu also participated in planting trees at their Head Office and promoted staff to buy trees to plant at home as well.



## HEALTHCARE

The foundation renovated the Uasin Gishu County Hospital that serves up to 300 patients daily by investing Kshs. 10.9 M to this project

The table below outlines a report about the Medical Camps held in 2018.



The renovation focused on remodeling the entire laboratory and maternity building for space optimization. The renovation served to improve the services at the hospital and to decongest other county labs

### Meru Medical Camp

Faulu together with the wider UAP Old Mutual team held a Medical Camp in Meru to offer free eye check up, cancer screening services and financial education.



Supported the Prevention of Non Communicable Diseases



The Foundation also sponsored free medical camps in Eldoret, Nakuru, Meru and Bungoma Counties in 2018 to support the prevention or early detection of noncommunicable diseases. Thanks to the partnership with the Africa Cancer Foundation, Kenya Society of the Blind, hospitals and County Governments we have supported over **2000** people with free screening services for; prostate, cervical, breast, eye as well as Blood Pressure, BMI and Blood sugar screening.



Customers at the Medical Camp getting checked





Faulu launches the Women's Network

## CUSTOMER AND STAFF ENGAGEMENT PROGRAMS

Staff took part in the bring your children to work exercise that saw parents bring their children to work in order for the children to get to appreciate where their parents work, to socialize and break the monotony of everyday work.

The leadership team had an opportunity to attend the **Aspire Leadership Program** that was done at Strathmore University. The Advanced Management program and Senior Management Leadership program was insightful and has seen the leaders cascade their learnings down to improve staff productivity.



Management staff happy to graduate from Stathmore University after attending the Aspire Leadership Program.

## CUSTOMER DRIVEN

Faulu upgraded several branches in **Kakamega, Malindi, Ukunda, Mwingi** and **Kitui** to ensure customers access Banking, Investments, Savings and Insurance solutions which includes competitive General and Life insurance products for both individuals and SMEs with ease.

Faulu did this to remain committed to the organisations Financial Inclusion agenda as well as our vision of being our customers' most trusted lifetime partner, passionate about helping them achieve their financial goals and, by helping generations achieve those goals, help build the financial prosperity of the societies, businesses and stakeholders we engage with.



Hon Charity K. Ngilu cuts the ribbon together with Faulu Board Director – Dr. Hon. Catherine Kimura, Kitui Branch Manager – Josephine Makau (2nd right) and Faulu MD – Apollo Njoroge (far right) as they unveil Faulu Kitui Branch.

**SUSTAINABLE AND SOCIAL RESPONSIBILITY (Continued)**

**Faulu Officially Launches Agency banking in Murang'a**



**Faulu opens Malindi Branch**



Staff At The Agency launch



Faulu engages customers during their roadshows

Faulu opens Mwingi Branch



**HUDUMA ZETU**

-  TOA
-  WEKA
-  TUMA POKEA
-  LIPA

TRANSACT CONVENIENTLY



**WE ARE WHERE YOU ARE,  
WITH OVER 300 AGENTS  
COUNTRYWIDE.**



# REPORT OF THE DIRECTORS

The directors present their report together with the audited financial statements (the “company” or Bank” or “Faulu”) and its subsidiary (together, the “Group”) for the year ended 31 December 2018, which disclose its state of affairs in accordance with the Kenyan Companies Act, 2015 and Microfinance Act, 2006.

## PRINCIPAL ACTIVITIES

THE PRINCIPAL ACTIVITY OF THE BANK IS THE TRANSFORMATION OF LIVES THROUGH THE PROVISION OF LOANS TO MICRO AND SMALL ENTREPRENEURS AND DEPOSIT TAKING FROM THE PUBLIC.



## REPORT OF THE DIRECTORS (Continued)

### OPERATING RESULTS FOR THE YEAR

	Group		Bank	
	2018	2017	2018	2017
	Shs '000	Shs '000	Shs '000	Shs '000
Profit before tax	287,360	177,996	273,615	163,486
Taxation charge	(96,916)	(73,780)	(92,709)	(69,427)
<b>Profit for the year transferred to retained earnings</b>	<b>190,444</b>	<b>104,216</b>	<b>180,906</b>	<b>94,059</b>

### BUSINESS REVIEW

#### Operating Environment

The average inflation for year 2018 was 5.04% down from inflation rate of 7.99 % that was experienced the previous year.

Kenya has made significant political, structural and economic reforms that have largely driven sustained economic growth, social development and political gains over the past decade. However, its key development challenges still include poverty, inequality, climate change and the vulnerability of the economy to internal and external shocks. A stable macroeconomic environment, low oil prices, rebound in tourism, strong remittance inflows, has boosted the economic expansion and a government led infrastructure development initiative.

Kenya's real gross domestic product (GDP) growth is projected to rise to 5.7% in 2018—up from 4.9% in 2017—and continue to increase steadily to 5.8% in 2019, and 6.0% in 2020, according to the World Bank's 18th Kenya Economic Update.

The performance of the Group has been detailed in the Chairman's Statement.

#### Market Description and Branch Networks

The Bank has 48 banking branches, 22 marketing offices and over 300 appointed agents. These hubs and branches currently serve over 400,000 customers. The bulk of the Bank's customers are

engaged in commercial activity of a retail nature, with a reasonable number engaged in service businesses, agriculture and manufacturing. The Bank closed two banking branches and 14 marketing hubs during the year through consolidation to drive efficiency and serve customers better.

#### Products and Services

Over the years, Faulu has developed several products in response to the needs of its clients. These needs are dynamic and keep changing according to social economic trends, Faulu commits to remain relevant to its clientele through offering products and services which are relevant to customers ranging from savings accounts, term accounts, loans as well as insurance products.

#### Risk Management

The Bank has put in place a robust risk management and corporate governance framework that scopes and explains the components of business risks, financial risks, operational risks as well as detailing the mitigation and response plans for each category of risk. The year ended 31st December 2018 was characterized by a myriad of risks ranging from uncertainties in the political environment, tough operating environment which led to tight liquidity stances as well as drought which hampered productivity in the agricultural sector. The Bank will continue to monitor all risks affecting its business to ensure appropriate actions are taken to reduce potential impact.

Refer to note 3 of the financial statements for a description of the Bank's financial risks and how they are mitigated.

#### Conclusion

The Bank has continued to position itself through customer empowerment by offering meaningful financial education, proactively addressing customer needs, community empowerment, offering under one roof integrated financial services. This also includes establishing sufficient presence in brick and mortar, agency banking, point of sale services, ATMs and digital channels in the form of mobile banking.

### DIVIDEND

The directors did not recommend the payment of a dividend in respect of the year (2017: Shs nil).

### DIRECTORS

The directors who held office during the year and up to the date of approval of these financial statements are disclosed on page 2.

### AUDITORS

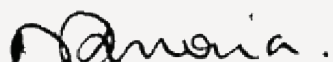
The auditors, Deloitte & Touche, having expressed their willingness, continue in office in accordance with the Kenyan Companies Act, 2015 and subject to approval by the Central Bank of Kenya under section 29(1) of the Kenyan Microfinance Act (2006). The directors monitor the effectiveness, objectively and independence of the auditor. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders,

### DIRECTORS' STATEMENT AS TO THE INFORMATION GIVEN TO THE AUDITORS

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

BY ORDER OF THE BOARD



SECRETARY  
Nairobi  
8th March 2019



# CORPORATE GOVERNANCE STATEMENT

Faulu Microfinance Bank Limited received its Deposit Taking License from the Central Bank of Kenya on 21 May 2009, becoming the first institution in Kenya to be licensed to receive deposits from the public under the Micro Finance Act (2006).

The Board of Directors of Faulu are responsible for ensuring that the organisation complies with the Laws of Kenya and the prudential guidelines issued by the Central Bank of Kenya.

The Board of Directors of Faulu Microfinance Bank Limited are also responsible for ensuring that the Bank complies with the highest standards of corporate governance and universally accepted business ethics. The Board has developed, adopted and benchmarked a framework of internationally recognized principles of good corporate governance, which it endeavours to adhere to in the pursuit and maintenance of the highest possible standards.

The Board of Faulu further upholds the values of uncompromised integrity, while conforming to the highest standards of ethics, honesty, trust, fairness, quality and pursuit for excellence.

## **Board size, Composition and Appointments**

The Board comprises a balanced mix of proficient individuals. This takes into account a balance of executive, non-executive and independent Directors, various skills and competencies, differing experiences and team roles, balance gender and age factors. This ensures ability to add value while ensuring that there is an appropriate balance of power on the Board such that no individuals/interests has unfettered power or can dominate the Board's decision making process.

There is a formal and transparent process for all appointments to the Board. On an annual basis, the Board reviews and assesses the composition and performance of the Board to ensure that:

- (a) the mix of membership is appropriate and compatible with the requirements of both the Board and the company;
- (b) Non-executive Directors commit adequate time and contribute effectively to the Board.

The Board is directly involved in the sourcing and appointment of new Directors and appointments are based on merit and against objective criteria.

# BOARD RESPONSIBILITIES

The Board is responsible for setting the direction of the company, corporate values and standards, and ensures that its obligations to shareholders are understood and met. In particular, their responsibilities include the following:

- Providing entrepreneurial leadership to the company within a framework of prudent and effective controls which enable risk to be assessed and managed;
- Strategy formulation (including company vision, mission and values) and ensuring that there are adequate policies systems and structures to successfully implement the company's strategies;
- Elaborating duty of care and confidentiality, including establishing responsibility and obligations of individual Board members;
- Reviewing and approving the strategic plans and annual budgets, financial statements; and
- Monitoring the company's performance against strategic plans and objectives on an ongoing basis, as well as through mandatory quarterly meetings.

## CORPORATE GOVERNANCE STATEMENT (Continued)

### Chairman and Managing Director

The roles and responsibilities of the Chairman of the Board and the Managing Director remain distinct and separate. The Chairman provides overall leadership to the Board without limiting the principles of collective responsibility for Board decisions. The Managing Director is responsible to the Board and takes responsibility for the effective and efficient running of the institution on a day-to-day basis.

### Board Committees

The committees of the Board consist of a balanced mix of non-executive and executive Directors. The Board has constituted the following five (5) main Board committees:

1. The Audit Committee
2. The Risk and Compliance Committee
3. The Credit Committee
4. The Remuneration and Nominating Committee
5. The IT Committee

Other ad hoc committees are set up as and when the need arises. The committees regularly reports to the Board on their activities and decisions.

### Board and Board Committee Meetings

The Board and its committees meet regularly in accordance with business requirements. Adequate notice was given for each meeting and directors received in good time detailed papers on the issues to be discussed. The Board and Board committees attendance during the year was as follows:

Board of Directors attendance	
Dr. Peter W. Muthoka	75%
George A. Maina	100%
Joshua Muiru	100%
Catherine Musakali	100%
Peter J. Mogan	100%
Peter K. Mwangi	75%
Peter Gachuba	100%
Theunis Kruger	100%
Apollo Njoroge	100%
Dr Catherine N. Kimura	100%
Sophia Mukoba	75%

## CORPORATE GOVERNANCE STATEMENT (Continued)

### Board Sub-committees

Risk and Compliance Committee		Audit Committee		Remuneration and Nominating Committee	
George A. Maina	100%	Joshua Muiru	100%	Dr. Peter W. Muthoka	75%
Peter Mwangi	100%	Catherine Musakali	100%	George Maina	100%
Joshua Muiru	100%	Sophia Mukoba	75%	Peter K Mwangi	75%
Catherine Musakali	100%				

Credit Committee		IT Committee	
Peter Gachuba	100%	George Maina	100%
Theunis Kruger	100%	Joshua Muiru	100%
Catherine Musakali	100%	Peter Gachuba	75%
Dr. Catherine N. Kimura	100%	Apollo Njoroge	100%

### The Audit Committee

The Audit Committee has been established by the Board to assist in raising the standards of corporate governance and internal controls in the following areas:

- Assisting the board in oversight of preparation and presentation of Financial Statements;
- Recommending and reviewing adherences to accounting policies and internal controls;
- Assisting the Board in ensuring the company's compliance with applicable laws and regulations as well as the company's charter, by laws and other internal regulations;
- Acting as Board's central coordination point for investigation of complaints relating to financial statements, compliance, and internal controls; and
- Oversee independence of external auditors.

### The Risk and Compliance Committee

The committee currently comprises of two Board members and has been established by the board to assist in the following responsibilities:

- Establishing the company's risk policies, including risk tolerances, consistent with the Risk Management Program and ensuring that senior management takes steps necessary to identify, measure, monitor and control risk;
- Reviewing the adequacy of the company's capital and allocations to various business units considering the types and sizes of risks at those business units; and
- Establishing an enterprise-wide risk management framework for all functions in the company and at all levels.

### The Credit Committee

The Committee is a Board Committee established by and among the Board of Directors to assist in discharging their corporate governance duties by:

- a. Reviewing and recommending for approval of the Board policies with respect to credit risk of the Bank's operations;
- b. Reviewing and monitoring the application and effectiveness of such policies;
- c. Review lending practices and quality of loan portfolio;
- d. Ensure that there are effective procedures and adequate resources to identify and mitigate credit risk;
- e. Monitor and evaluate all issues that may materially impact on the present and future quality of the loan portfolio and credit risk management;
- f. Delegate and review lending limits to the sanctioning arms of the institution; and
- g. Ensure adequate provisions for loans and advances, bad and doubtful debts and write off policy.

### The Remuneration and Nominating Committee

The committee has been established to assist the board with the following responsibilities;

- a. Guiding and directing the implementation of remuneration strategy, policies, group-wide remuneration principles, related proposals and structure, whilst taking into consideration local conditions; and
- b. Monitoring and controlling the remuneration and benefit structures and their costs.

### The IT Committee

The Information Technology (IT) Board Committee was established by the board of the Bank as part of its mandate to drive transformation, governance and business growth for the bank. The committees mandate includes the following:

1. Develop and sustain the IT plan for the Bank and ensure approval by the Board. This include:
  - a. Responsibility of managing strategic IT related projects like the core banking upgrade/ replacement; and
  - b. Coordinating components of the IT plans

from all units across the Bank;

2. Develop and recommend the Bank's IT policy;
3. Review and recommend IT project development plans in the context of IT strategic and transformation agenda;
4. Create ad hoc committees to address strategic ICT issues, when required; and
5. Review, coordinate and arbitrate major ICT activities across the Bank
6. Provide an update to the Board, Regulators and the relevant Old Mutual board on the progress made in the identified IT strategic projects and the transformation agenda.

### Management Committees

#### i) The Assets and Liabilities Management Committee (ALCO)

This committee meets every month or more frequently when necessary. ALCO, a risk management committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposit withdrawals can be met as and when they fall due, and the company does not encounter difficulties in meeting its obligations or financial liabilities as they fall due. This includes management of operational risks, interest rate, market and exchange rate risks and ensuring compliance with statutory requirements governing liquidity.

#### ii) The Management Credit Risk Committee

This committee meets regularly to approve new credit applications and renewals within the delegated limits set by the Board. The committee also regularly makes recommendations to the Board Credit Committee on the revision of limits. All approvals are independent of the originating business unit.

### Monitoring and Evaluation

The Board assesses its own performance and that of management in the discharge of their duties and responsibilities and develops and submits to the Central Bank of Kenya an annual self-assessment of the Board performance.

**Reckless and Fraudulent Activities**

The Board of Directors ensures that the institution and management do not;

- a. Allow a credit facility or guarantee to remain outstanding;
- b. Incur any liability;
- c. Enter into any contract or transaction; or
- d. Conduct its business or part thereof in a fraudulent or reckless manner detrimental to the institution's interest or the interest of depositors or the general public, as directed in the Microfinance Act 2006 (s.32).

**Scheme of Arrangement**

The Board of Directors ensures that the institution does not enter into any scheme of arrangement with its creditors.

**Restriction on Trading and Investment**

The Board of Directors certifies that Faulu Microfinance Bank Limited:

- a. Has not acquired or held, directly or indirectly, any part of the share capital of; or
- b. Have a beneficial interest in any financial, commercial, agricultural, industrial or other undertaking, where the value of the institution's interest exceeds 25% in the aggregate of the institution's core capital, except in an undertaking in fulfilment of a debt due to the institution.

**Single Borrower Limit**

The institution did not extend loans exceeding 5% of its core capital to any single end-user borrower. The Board of Directors ensures that loans or credit facilities equivalent to the maximum limit are extended only to those borrowers who have the capacity or have an established track record of satisfactory repayment. Faulu Microfinance Bank Limited has well-defined credit policies and procedures covering the maximum lending limits and approval levels, rate to be charged, repayment period, loan tracking and collateral. The institution granted loans to 2 single end users that exceeded

2% of its core capital. The aggregate amount of loans was not more than 70% of the Bank's total loan portfolio.

**KYC Requirements**

The Board of Directors ensures that Management obtains and maintains proper identification of customers wishing to open accounts or make transactions or enter into an engagement with the institution whether directly or indirectly through proxy; and maintains adequate and accurate records for a minimum of seven years regarding its customers, sources of funds and transactions, as required by the Microfinance Act 2006.



.....  
**Dr. Peter Wanyaga Muthoka- D.ML, M.A(Ed.)**  
**B.A (Hons), EBS, MBS, FKIB, FKIM, DID**  
**Chairman**



.....  
**Apollo N. Njoroge**  
**Managing Director**

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

- i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;
- ii) selecting suitable accounting policies and then applying them consistently; and
- iii) making accounting estimates and judgements that are reasonable in the circumstances.

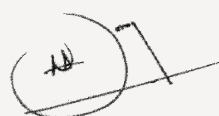
Having made an assessment of the Group's and the Bank's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the Group and Bank's ability to continue as a going concern.

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

Approved by the board of directors on 8th March 2019 and signed on its behalf by:



.....  
**Dr. Peter Wanyaga Muthoka**  
**D.ML, M.A(Ed.) B.A (Hons), EBS, MBS, FKIB, FKIM, DID**  
**Chairman**



.....  
**Apollo N. Njoroge**  
**Managing Director**

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF  
FAULU MICROFINANCE BANK LIMITED  
(Continued)**

## REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

### Opinion

We have audited the accompanying financial statements of Faulu Microfinance Bank Limited (the "bank") and its subsidiary (together, the "group"), set out on pages 16 to 75, which comprise the group and bank statement of financial position as at 31 December 2018, and the group and bank statements of profit or loss and other comprehensive income, the group and bank statement of changes in equity and the group and bank statements of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the group and bank financial statements give a true and fair view of the group and bank financial position as at 31 December 2018 and of their group and bank financial performance and group and bank cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") and the requirements of the Kenyan Companies Act, 2015.

### Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), which is consistent with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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, which comprises corporate information, chairman's statement, report of the directors, corporate governance statement and the statement of director's responsibilities. The other information does not include the financial statements and our auditor's report thereon.

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

In connection with our audit of the group and bank financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the group and bank financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

### Responsibilities of the Directors and Those Charged with Governance

The directors are responsible for the preparation of the group and bank financial statements that give a true and fair view in accordance with IFRS and the requirements of the Kenyan companies Act, and for such internal controls as directors determine are necessary to enable the preparation of group and bank financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the group and bank financial statements, the directors are responsible for

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FAULU MICROFINANCE BANK LIMITED (Continued)

### REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS (Continued)

assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group and bank or to cease operations, or have no realistic alternative but to do so. Those charged with governance are responsible for overseeing the Group financial reporting process.

#### **Auditor's Responsibilities for the Audit of the group and bank financial statements**

Our objectives are to obtain reasonable assurance about whether the group and bank 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 consolidated 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 group and bank financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery,

intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated and separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the group and bank financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the group and bank financial information of the entities or business activities

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF  
FAULU MICROFINANCE BANK LIMITED  
(Continued)**

within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with 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 matters prescribed by the Kenyan Companies Act, 2015**

In our opinion, the information given in the report of the directors is consistent with the consolidated and separate financial statements.

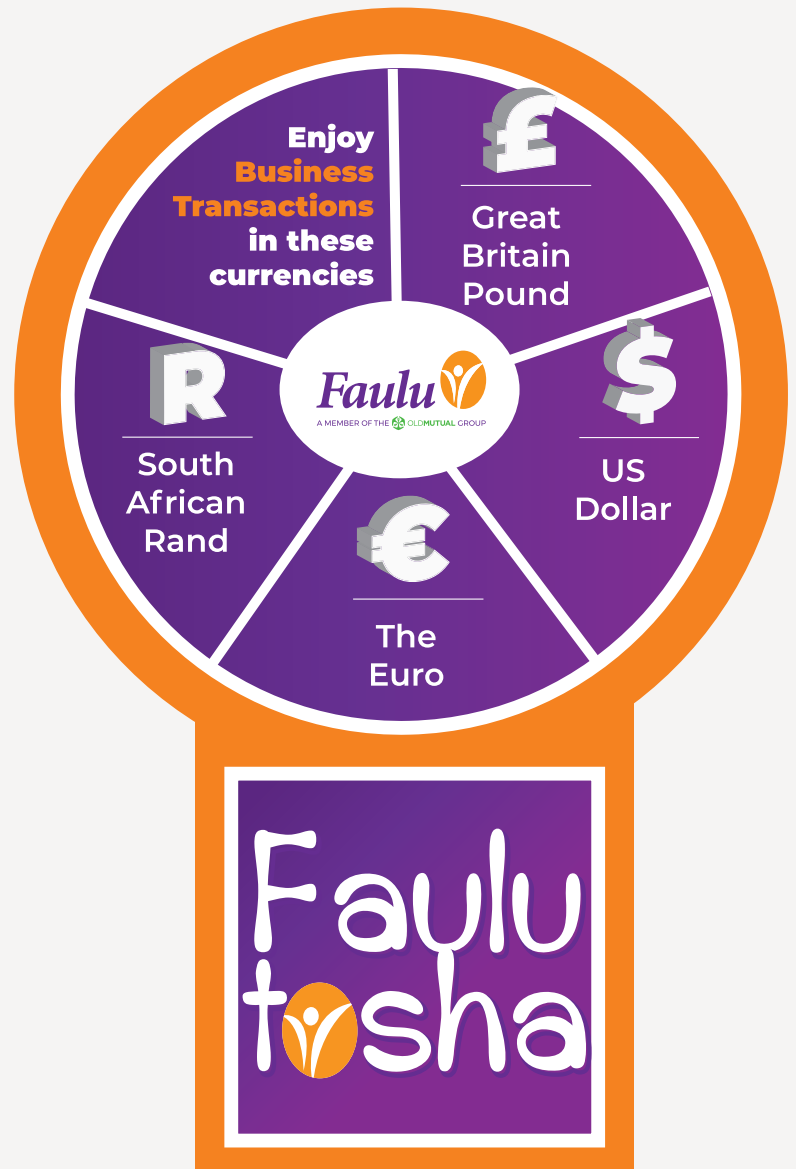
**Certified Public Accountants (Kenya)  
Nairobi, Kenya**

**27th March 2019**



**CPA Anne Muraya,**

Practising certificate No. 1697.  
Signing partner responsible for the independent audit



## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	Group		Bank	
		2018	2017	2018	2017
		Shs '000	Shs '000	Shs '000	Shs '000
Interest income	5	4,045,629	4,046,500	4,045,629	4,046,500
Interest expense	6	(2,114,353)	(1,960,152)	(2,114,353)	(1,960,152)
<b>Net interest income</b>		<b>1,931,276</b>	<b>2,086,348</b>	<b>1,931,276</b>	<b>2,086,348</b>
Fees and commissions	7	566,994	416,847	539,596	391,977
Foreign exchange loss		(521)	(5,339)	(521)	(5,339)
Other operating income	8	22,896	24,793	19,015	22,747
<b>Operating income</b>		<b>2,520,645</b>	<b>2,522,649</b>	<b>2,489,366</b>	<b>2,495,733</b>
Administration and operating expenses	9	(2,128,510)	(1,957,460)	(2,112,528)	(1,945,054)
Impairment losses on loans and receivables	11	(109,407)	(232,402)	(107,855)	(232,402)
Impairment losses on deposit and intangible assets		-	(158,710)	-	(158,710)
		(2,237,917)	(2,348,572)	(2,220,383)	(2,336,166)
<b>Operating profit</b>		<b>282,728</b>	<b>174,077</b>	<b>268,983</b>	<b>159,567</b>
Share of associate company's profit	18	4,632	3,919	4,632	3,919
Profit before tax		287,360	177,996	273,615	163,486
Taxation charge	12(a)	(96,916)	(73,780)	(92,709)	(69,427)
<b>Profit for the year</b>		<b>190,444</b>	<b>104,216</b>	<b>180,906</b>	<b>94,059</b>
<b>Other comprehensive income</b>					
Items that will not be reclassified subsequently to profit or loss					
Gain on revaluation of property	20	-	58,871	-	58,871
Deferred tax thereon	19	-	(10,123)	-	(10,123)
		-	48,748	-	48,748
<b>Total comprehensive income for the year</b>		<b>190,444</b>	<b>152,964</b>	<b>180,906</b>	<b>142,807</b>

## STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2018

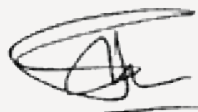
	Note	Group		Bank	
		2018	2017	2018	2017
		Shs '000	Shs '000	Shs '000	Shs '000
<b>ASSETS</b>					
Local currency cash		349,311	297,185	349,311	297,185
Balances due from banks and financial institutions		677,882	122,300	677,882	122,300
Short term deposits with banks	13	1,963,446	985,000	1,963,446	985,000
Cash balances with Central Bank of Kenya	14	1,029,099	782,985	1,029,099	782,985
Loans to customers	15	16,934,754	16,957,894	16,934,754	16,957,894
Government securities	16	1,879,900	2,500,000	1,879,900	2,500,000
Other assets	17	1,370,821	906,475	1,363,704	900,171
Tax recoverable	12(c)	167,935	237,739	167,935	237,739
Due from related companies	29(a)	41,514	54,194	54,037	54,194
Investment in associate companies	18(a)	51,424	48,181	51,424	48,181
Investment in Faulu Insurance Agency	18(b)	-	-	1,000	1,000
Deferred tax asset	19	461,163	-	460,713	-
Property and equipment	20	1,414,662	1,418,502	1,414,170	1,418,083
Intangible assets	21	877,561	1,020,425	877,561	1,020,425
<b>TOTAL ASSETS</b>		<b>27,219,472</b>	<b>25,330,880</b>	<b>27,224,936</b>	<b>25,325,157</b>
<b>LIABILITIES AND EQUITY</b>					
<b>LIABILITIES</b>					
Cash collaterals	22	588,844	711,957	588,844	711,957
Customer deposits	23	17,891,042	15,698,740	17,940,968	15,738,146
Borrowings	24	4,430,520	3,571,774	4,430,520	3,571,774
Deferred tax liability	19	-	134,856	-	134,856
Other liabilities	25	740,923	663,637	727,121	638,945
Tax payable	12(c)	1,301	616	-	-
Due to related companies	29(b)	73,604	44,597	73,604	44,597
		23,726,234	20,826,177	23,761,057	20,840,275
<b>EQUITY</b>					
Share capital	26	480,000	480,000	480,000	480,000
Share premium		2,899,759	2,899,759	2,899,759	2,899,759
(Accumulated deficit) / retained earnings		(142,025)	313,954	(171,384)	294,133
Revaluation surplus		255,504	259,915	255,504	259,915
Statutory reserve		-	551,075	-	551,075
		3,493,238	4,504,703	3,463,879	4,484,882
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>27,219,472</b>	<b>25,330,880</b>	<b>27,224,936</b>	<b>25,325,157</b>

**STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2018  
(Continued)**

The financial statements on pages 16 to 75 were approved and authorised for issue by the board of directors on 8th March 2019 and were signed on its behalf by:



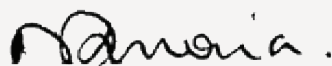
**Dr. Peter W. Muthoka**  
EBS MBS FKIM FKIB  
Chairman



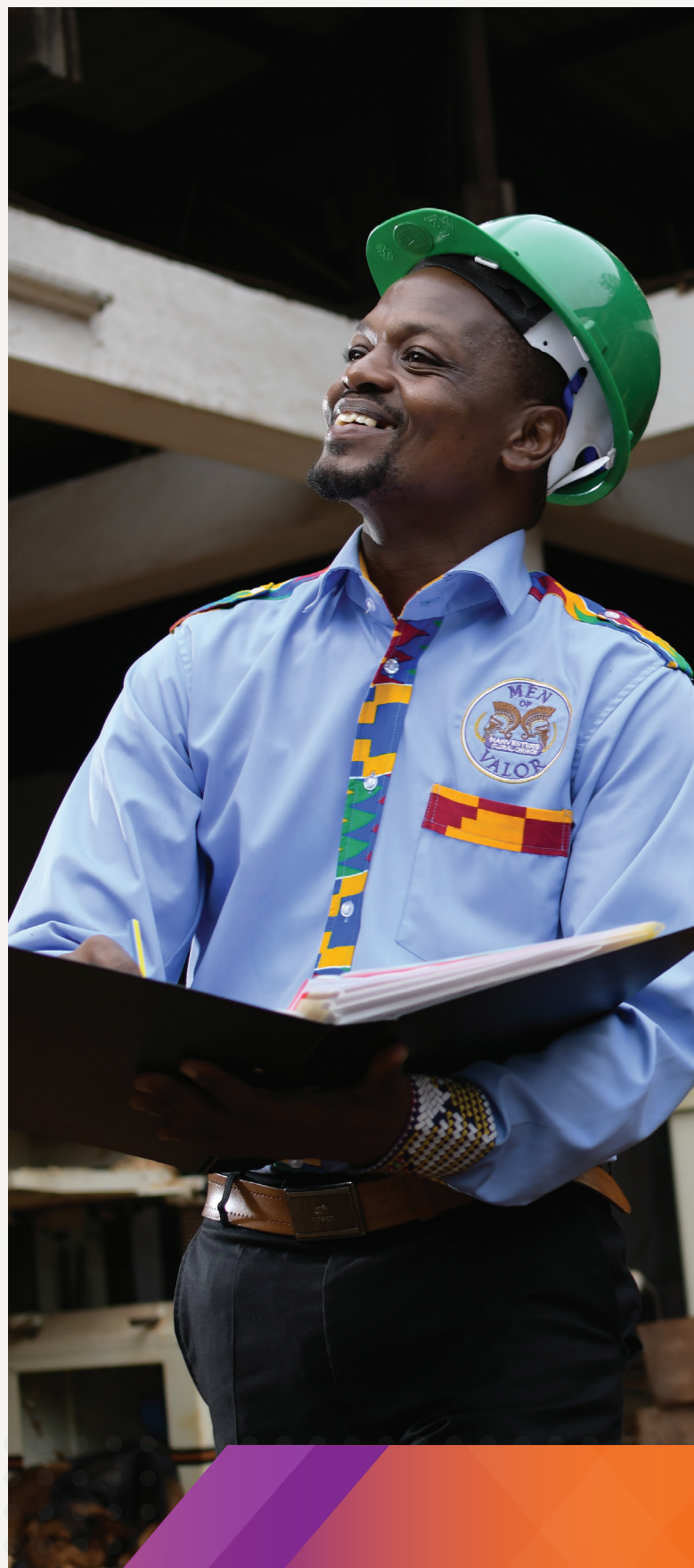
**Joshua Muiru**  
Director



**Apollo N. Njoroge**  
Managing Director



**Nkirote K. Mworira**  
Company Secretary



## STATEMENT OF CHANGES IN EQUITY

### FOR THE YEAR ENDED 31 DECEMBER 2018

Group						
	Share capital	Share Premium	(Accumulated deficit)/ Retained earnings	Revaluation surplus	Statutory reserve	Total
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
At 1 January 2017	480,000	2,899,759	257,445	211,962	502,573	4,351,739
Profit for the year	-	-	104,216	-	-	104,216
Other comprehensive income	-	-	-	48,748	-	48,748
Total comprehensive income for the year	-	-	104,216	48,748	-	152,964
Transfer to statutory reserve	-	-	(48,502)	-	48,502	-
Transfer of excess depreciation net of deferred tax	-	-	795	(795)	-	-
<b>At 31 December 2017</b>	<b>480,000</b>	<b>2,899,759</b>	<b>313,954</b>	<b>259,915</b>	<b>551,075</b>	<b>4,504,703</b>
At 1 January 2018 - As previously reported	480,000	2,899,759	313,954	259,915	551,075	4,504,703
Transfer from statutory reserve	-	-	551,075	-	(551,075)	-
IFRS 9 transition adjustment net of tax* (Note 1(e))	-	-	(1,341,995)	-	-	(1,341,995)
Prior year adjustment (Note 28)	-	-	140,086	-	-	140,086
Adjusted balance at beginning of period	480,000	2,899,759	(336,880)	259,915	-	3,302,794
Total comprehensive income for the year	-	-	190,444	-	-	190,444
Transfer of excess depreciation net of deferred tax	-	-	4,411	(4,411)	-	-
<b>At 31 December 2018</b>	<b>480,000</b>	<b>2,899,759</b>	<b>(142,025)</b>	<b>255,504</b>	<b>-</b>	<b>3,493,238</b>

\*The transition adjustment is due change in accounting policy as result of initial application of IFRS 9, as shown in note 2

## STATEMENT OF CHANGES IN EQUITY

### FOR THE YEAR ENDED 31 DECEMBER 2018

Bank						
	Share capital	Share Premium	(Accumulated deficit)/ Retained earnings	Revaluation surplus	Statutory reserve	Total
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
At 1 January 2017	480,000	2,899,759	247,781	211,962	502,573	4,342,075
Profit for the year	-	-	94,059	-	-	94,059
Other comprehensive income	-	-	-	48,748	-	48,748
Total comprehensive income for the year	-	-	94,059	48,748	-	142,807
Transfer to statutory reserve	-	-	(48,502)	-	48,502	-
Transfer of excess depreciation net of deferred tax	-	-	795	(795)	-	-
<b>At 31 December 2017</b>	<b>480,000</b>	<b>2,899,759</b>	<b>294,133</b>	<b>259,915</b>	<b>551,075</b>	<b>4,484,882</b>
At 1 January 2018 - As previously reported	480,000	2,899,759	294,133	259,915	551,075	4,484,882
Transfer from statutory reserve	-	-	551,075	-	(551,075)	-
IFRS 9 transition adjustment net of tax* (Note 1(e))	-	-	(1,341,995)	-	-	(1,341,995)
Prior year adjustment (Note 28)	-	-	140,086	-	-	140,086
At 1 January 2018 - Restated	480,000	2,899,759	(356,701)	259,915	-	3,282,973
Total comprehensive income for the year	-	-	180,906	-	-	180,906
Transfer of excess depreciation net of deferred tax	-	-	4,411	(4,411)	-	-
<b>At 31 December 2018</b>	<b>480,000</b>	<b>2,899,759</b>	<b>(171,384)</b>	<b>255,504</b>	<b>-</b>	<b>3,463,879</b>

\*The transition adjustment is due change in accounting policy as result of initial application of IFRS 9, as shown in note 2

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*Faulu* 

A MEMBER OF THE  **OLDMUTUAL** GROUP

Regulated by the Central Bank of Kenya. Terms and conditions apply

## STATEMENT OF CASH FLOWS

### FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	Group		Bank	
		2018	2017	2018	2017
		Shs '000	Shs '000	Shs '000	Shs '000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Cash used in operations	27(a)	962,765	(173,661)	958,598	(144,742)
Taxation paid	12(c)	(45,916)	(65,506)	(41,944)	(56,127)
Net cash generated from / (used in) operating activities		916,849	(239,167)	916,654	(200,869)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Purchase of property and equipment	20	(149,057)	(469,839)	(148,862)	(469,839)
Purchase of intangible asset	21	(40,384)	(13,219)	(40,384)	(13,219)
Net cash used in investing activities		(189,441)	(483,058)	(189,246)	(483,058)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>					
Borrowings received	27(c)	2,551,174	1,200,000	2,551,174	1,200,000
Borrowings repaid	27(c)	(1,692,428)	(1,981,099)	(1,692,428)	(1,981,099)
Net cash generated from / (used in) financing activities		858,746	(781,099)	858,746	(781,099)
INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS		1,586,154	(1,503,324)	1,586,154	(1,465,026)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		1,404,485	2,907,809	1,404,485	2,869,511
CASH AND CASH EQUIVALENTS AT END OF YEAR	27(b)	2,990,639	1,404,485	2,990,639	1,404,485

# NOTES TO THE FINANCIAL STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2018

## 1. ACCOUNTING POLICIES

### Statement of compliance

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

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

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


#### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018

The following new and revised IFRSs were effective in the current year but had no material impact on the amounts reported in these financial statements.

#### Impact of initial application of IFRS 9 Financial Instruments

During the year, the Group adopted IFRS 9 Financial Instruments. As a result of the application of IFRS 9, there was a change in the accounting policies and these new policies were applicable from 1 January 2018. As permitted by the transition provisions of IFRS 9, the Group elected not to restate comparative period results; accordingly, all comparative period information is presented in accordance with the previous accounting policies, as indicated below. Adjustments to carrying amounts of financial assets and liabilities at the date of initial application (1 January 2018) were recognized in opening Retained earnings and Statutory credit risk reserves in the current period.

New or amended disclosures have been provided for the current period, where applicable, and comparative period disclosures are consistent with those made in the prior year.



Additionally, the Group adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that were applied to the disclosures for 2018 and to the comparative period.

IFRS 9 introduced new requirements for:

- 1) The classification and measurement of financial assets and financial liabilities,
- 2) Impairment of financial assets, and
- 3) General hedge accounting.

Details of these new requirements as well as their impact on the Group's consolidated financial statements are described below.

The Group has applied IFRS 9 in accordance with the transition provisions set out in IFRS 9.

### **(a) Classification and measurement of financial assets**

The date of initial application (i.e. the date on which the Group has assessed its existing financial assets and financial liabilities in terms of the requirements of IFRS 9) is 1 January 2018. Accordingly, the Group has applied the requirements of IFRS 9 to instruments that continue to be recognised as at 1st January 2018 and has not applied the requirements to instruments that have already been derecognised as at 1st January 2018. Comparative amounts in relation to instruments that continue to be recognised as at 1 January 2018 have been restated where appropriate.

All recognised financial assets that are within the scope of IFRS 9 are required to be measured subsequently at amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

##### Impact of initial application of IFRS 9 Financial Instruments (Continued)

Specifically, debt instruments that are held within the business model of Faulu whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are measured subsequently at amortised cost.

The directors of the Group reviewed and assessed the Group's existing financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date and concluded that with the initial application of IFRS 9 the financial assets classified as held-to-maturity and loans and receivables under IAS 39 that were measured at amortised cost continue to be measured at amortised cost under IFRS 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding has had the following impact on the Group's financial assets as regards their classification and measurement:

##### (b) Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires the Group to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

In particular, IFRS 9 requires the Bank to measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses (ECL) if the credit risk on that financial instrument has increased significantly since initial recognition, or if the financial instrument is a purchased or originated credit-impaired financial

asset.

However, if the credit risk on a financial instrument has not increased significantly since initial recognition (except for a purchased or originated credit-impaired financial asset), the Bank is required to measure the loss allowance for that financial instrument at an amount equal to 12-months ECL. IFRS 9 also requires a simplified approach for measuring the loss allowance at an amount equal to lifetime ECL for trade receivables, contract assets and lease receivables in certain circumstances.

##### (c) Classification and measurement of financial liabilities

A significant change introduced by IFRS 9 in the classification and measurement of financial liabilities relates to the accounting for changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of the issuer.

Specifically, IFRS 9 requires that the changes in the fair value of the financial liability that is attributable to changes in the credit risk of that liability be presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss, but are instead transferred to retained earnings when the financial liability is de recognised. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at FVTPL was presented in profit or loss.

The application of IFRS 9 has had no impact on the classification and measurement of the Group's financial liabilities.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

#### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

#### Impact of initial application of IFRS 9 Financial Instruments (Continued)

#### (c) Classification and measurement of financial liabilities (Continued)

### Mandatory reclassifications

There has been no change in the classification of the financial assets. This is tabulated below:

Sh'000	1 January 2018		Previous measurement 31 December 2017	
	Measurement category	Carrying amount Sh'000	Category	Carrying amount Sh'000
<b>Financial assets:</b>				
<b>Loans and advances</b> - amortised cost (note 15)	Amortized cost	19,180,523	<b>Loans and advances</b> - amortised cost	17,278,035
<b>Cash &amp; Cash equivalents</b> - amortised cost	Amortized cost	4,025,104	<b>Cash &amp; Cash equivalents</b> - amortised cost	2,187,469
<b>Government securities</b> - (note 14)	Amortized cost	1,900,000	<b>Government securities</b> - held to maturity	2,500,000
<b>Other assets</b> - amortised cost (note 18)	Amortized cost	1,617,186	<b>Other assets</b> - amortised cost	900,171

#### (d) General hedge accounting

The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about the Group's risk management activities have also been introduced.

The application of the IFRS 9 hedge accounting requirements has had no impact on the results and financial position of the Group for the current and/or prior years as the Group has no hedging relationships and therefore no hedge accounting is required as per IFRS 9.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

##### Impact of initial application of IFRS 9 Financial Instruments (Continued)

##### (e) Transition disclosures in relation to the initial application of IFRS 9

There were no financial assets or financial liabilities which the Group had previously designated as at FVTPL under IAS 39 that were subject to reclassification or which the Group has elected to reclassify upon the application of IFRS 9. There were no financial assets or financial liabilities which the Group has elected to designate as at FVTPL at the date of initial application of IFRS 9.

##### Impairment allowance reconciliations

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

Sh'000	IAS 39 as at 31 December 2017			Transition Adjustments	IFRS 9 as at 1 January 2018			
	Collectively assessed	Individually assessed	Total		Stage 1	Stage 2	Stage 3	Total
Loans at amortized cost	-	319,966	319,966	1,869,570	457,589	568,436	1,163,687	2,189,711
Debt securities at amortized cost	-	-	-	29,085	29,085	-	-	29,085
Cash and cash equivalents	-	-	-	18,439	2,071	16,368	-	18,439
Other assets at amortized cost	-	175	175	42	42	-	-	42
Off-balance sheet loan commitments	-	-	-	-	-	-	-	-
<b>Total allowance for credit losses</b>	-	<b>320,141</b>	<b>320,141</b>	<b>1,917,136</b>	<b>488,787</b>	<b>584,804</b>	<b>1,163,687</b>	<b>2,237,277</b>
<b>Deferred tax @ 30%</b>				<b>(575,141)</b>				
<b>IFRS 9 transition adjustment net of deferred tax</b>			<b>1,341,995</b>					
31 December 2018				31 December 2017				
Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000	Total Sh'000		
Grade 1: Normal	13,902,359	153,242	62,986	-	14,118,587	11,681,948		
Grade 2: Watch	2,163,541	344,323	46,868	-	2,554,732	2,633,934		
Grade 3: Substandard	-	377,035	10,727	-	387,762	743,298		
Grade 4: Doubtful	-	168,593	16,443	-	185,036	373,170		
Grade 5: Loss	-	-	1,934,406	-	1,934,406	1,845,510		
<b>Total gross carrying amount</b>	<b>16,065,900</b>	<b>1,043,193</b>	<b>2,071,430</b>	<b>-</b>	<b>19,180,523</b>	<b>17,277,860</b>		
Loss allowance	(549,750)	(257,459)	(1,438,560)	-	(2,245,769)	(319,966)		
<b>Carrying amount</b>	<b>15,516,150</b>	<b>785,734</b>	<b>632,870</b>	<b>-</b>	<b>16,934,754</b>	<b>16,957,894</b>		

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

##### Impact of initial application of IFRS 9 Financial Instruments (Continued)

In the current year, the Group and Bank has applied IFRS 15 Revenue from Contracts with Customers (as amended in April 2016) which is effective for an annual period that begins on or after 1 January 2018. IFRS 15 introduced a 5-step approach to revenue recognition. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios.

IFRS 15 uses the terms 'contract asset' and 'contract liability' to describe what might more commonly be known as 'accrued revenue' and 'deferred revenue', however the Standard does not prohibit an entity from using alternative descriptions in the statement of financial position. The Group and Bank have adopted the terminology used in IFRS 15 to describe such balances.

The application of IFRS 15 has not had a significant impact on the financial position and/or financial performance of the Group and Bank.

##### IFRS 2 (amendments) Classification and Measurement of Share-based Payment Transactions

The amendments clarify the following:

1. In estimating the fair value of a cash-settled share-based payment, the accounting for the effects of vesting and non-vesting conditions should follow the same approach as for equity-settled share-based payments.
2. Where tax law or regulation requires an entity to withhold a specified number of equity instruments equal to the monetary value of the employee's tax obligation to meet the employee's tax liability which is then remitted to the tax authority (typically in cash), i.e. the share-based payment arrangement has a 'net settlement feature', such an arrangement should be classified as equity-settled in its entirety, provided that the share-based payment would have been classified as equity-settled had it not included the net settlement feature.
3. A modification of a share-based payment that changes the transaction from cash-settled to equity-settled should be accounted for as follows:
  - (a) the original liability is de recognised;
  - (b) the equity-settled share-based payment is recognised at the modification date fair value of the equity instrument granted to the extent that services have been rendered up to the modification date; and
  - (c) any difference between the carrying amount of the liability at the modification date and the amount recognised in equity should be recognised in profit or loss immediately.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### Application of new and revised International Financial Reporting Standards (IFRSs) (Continued)

##### (i) Relevant new standards and amendments to published standards effective for the year ended 31 December 2018 (Continued)

<p><b>IFRIC 22 Foreign Currency Transactions and Advance Consideration</b></p>	<p>IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a nonmonetary asset or nonmonetary liability (for example, a non-refundable deposit or deferred revenue).</p> <p>The Interpretation specifies that the date of transaction is the date on which the entity initially recognises the nonmonetary asset or nonmonetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the Interpretation requires an entity to determine the date of transaction for each payment or receipt of advance consideration.</p>
<p><b>IAS 40 (amendments) Transfers of Investment Property</b></p>	<p>The amendments clarify that a transfer to, or from, investment property necessitates an assessment of whether a property meets, or has ceased to meet, the definition of investment property, supported by observable evidence that a change in use has occurred. The amendments further clarify that the situations listed in IAS 40 are not exhaustive and that a change in use is possible for properties under construction (i.e. a change in use is not limited to completed properties).</p>
<p><b>Annual Improvements to IFRS Standards 2014 – 2016 Cycle Amendments to IAS 28 Investments in Associates and Joint Ventures</b></p>	<p>The amendments clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at FVTPL is available separately for each associate or joint venture, and that election should be made at initial recognition.</p> <p>In respect of the option for an entity that is not an investment entity (IE) to retain the fair value measurement applied by its associates and joint ventures that are IEs when applying the equity method, the amendments make a similar clarification that this choice is available for each IE associate or IE joint venture.</p>

In the current year, the Group has applied a number of amendments to IFRS Standards and Interpretations issued by the International Accounting Standards Board (IASB) that are effective for an annual period that begins on or after 1 January 2018. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### (ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2018

At the date of authorisation of these financial statements, The Group has not applied the following new and revised IFRS Standards that have been issued but are not yet effective.

New and Amendments to standards	Effective for annual periods beginning on or after
IFRS 16-Leases	1 January 2019, with earlier application permitted
Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures	1 January 2019, with earlier application permitted
Annual Improvements to IFRS Standards 2015–2017 Cycle- Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements IAS 12 Income Taxes and IAS 23 Borrowing Costs	1 January 2019, with earlier application permitted
Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement	1 January 2019, with earlier application permitted
IFRS 10 Consolidated Financial Statements and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint	1 January 2019, with earlier application permitted
IFRIC 23 Uncertainty over Income Tax Treatments	Effective for annual periods beginning on or after 1 January 2019

#### IFRS 16 Leases

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

The directors of the company anticipate that the application of IFRS 16 in the future may have a significant impact on amounts reported in respect of the company's financial assets and financial liabilities. However, it is not practicable to provide the company has completed a reasonable estimate of the effect of IFRS 16 until a detailed review.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### (ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2018

##### **Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures**

The amendment clarifies that IFRS 9, including its impairment requirements, applies to long-term interests.

Furthermore, in applying IFRS 9 to long-term interests, an entity does not take into account adjustments to their carrying amount required by IAS 28 (i.e., adjustments to the carrying amount of long-term interests arising from the allocation of losses of the investee or assessment of impairment in accordance with IAS 28).

The amendments apply retrospectively to annual reporting periods beginning on or after 1 January 2019.

Earlier application is permitted. Specific transition provisions apply depending on whether the first-time application of the amendments coincides with that of IFRS 9.

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

##### **Annual Improvements to IFRS Standards 2015–2017 Cycle Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs**

The Annual Improvements include amendments to four Standards.

##### **IAS 12 Income Taxes**

The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that

generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

##### **IAS 23 Borrowing Costs**

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

##### **IFRS 3 Business Combinations**

The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including re-measuring its previously held interest (PHI) in the joint operation at fair value. The PHI to be re-measured includes any unrecognised assets, liabilities and goodwill relating to the joint operation.

##### **IFRS 11 Joint Arrangements**

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

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

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

**1. ACCOUNTING POLICIES** (Continued)

**(ii) Relevant new and amended standards and interpretations in issue but not yet effective in the year ended 31 December 2018**

**Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement**

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this re-measurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as re-measured under IAS 19.99 with the discount rate used in the re-measurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied. The amendments to IAS 19 must be applied to annual periods beginning on or after 1 January 2019, but they can be applied earlier if an entity elects to do so.

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

**IFRS 10 Consolidated Financial Statements and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture**

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the re-measurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted. The directors of the Bank anticipate that the application of these amendments may have an impact on the Group's consolidated financial statements in future periods should such transactions arise.

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### **IFRIC 23 Uncertainty over Income Tax Treatments**

IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires an entity to:

- determine whether uncertain tax positions are assessed separately or as a group; and
- assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:
  - o If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
  - o If no, the entity should reflect the effect of uncertainty in determining its accounting tax position.

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Entities can apply the Interpretation with either full retrospective application or modified retrospective application without restatement of comparatives retrospectively or prospectively.

The directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Group's consolidated financial statements.

#### **iii) Early adoption of standards**

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

#### **(a) Basis of preparation**

The consolidated financial statements are prepared under the historical cost convention, as

modified to include revaluation of certain assets at fair value.

#### **Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary Faulu Insurance Agency Limited for the year ended 31 December 2018. Subsidiaries are those companies in which the bank has power to exercise control over the operations of the entities. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the group. Intra-group balances and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

#### **(b) Interest income and expense**

Interest income and expense for all interest bearing financial instruments are recognised within the profit or loss on accrual basis using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instruments (or, where appropriate, a shorter period) to the carrying amount of the financial instruments. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all fees and points paid or received transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability. Fair value changes on other derivatives held for risk management purposes, and other financial

**1. ACCOUNTING POLICIES** (Continued)

assets and liabilities carried at fair value through profit or loss, are presented in net income on other financial instruments carried at fair value in the profit or loss.

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

**(c) Investment in associate company**

An associate is an entity over which the company has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the statement of financial position at cost as adjusted for post-acquisition changes in the company's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the company's interest in that associate are recognised only to the extent that the company has incurred legal or constructive obligations or made payments on behalf of the associate.

**(d) Taxation**

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

**(i) Current tax**

The tax currently payable is based on taxable

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

**(ii) Deferred tax**

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

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

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

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

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

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

#### (e) Fees and commission

In the normal course of business, the company earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, are recognised as the related services are performed.

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

#### (f) Property and equipment

Property and equipment are stated at cost or as professionally revalued less accumulated depreciation and any impairment charge. Professional valuations are carried out in accordance with the company's policy of revaluing freehold land and buildings. Revaluations are performed with sufficient regularity such that the carrying amounts do not differ materially from those that would be determined using fair values at the end of each reporting period and at least once in every three years.

Any revaluation increase arising on revaluation of such property, plant and equipment is recognised in other comprehensive income, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on revaluation of such property, plant and equipment is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the revaluation surplus reserve relating to a previous revaluation of that asset.

#### (g) Depreciation

Depreciation on property and equipment is calculated on the reducing balance at the following annual rates:

Motor vehicles	25.0%
Computers and equipment	30.0%
Electronic office equipment	25.0%
Durable non-electrical equipment	12.5%
Buildings on freehold land	2.5%
Freehold land	nil

Depreciation is recognised in profit or loss. On subsequent sale or retirement of a revalued

**1. ACCOUNTING POLICIES** (Continued)

property and equipment, the attributable revaluation surplus remaining in the revaluation reserve is transferred directly to equity. Each year, the difference between depreciation based on the revalued carrying amount of an asset (the depreciation charged to the profit or loss) and the depreciation based on the assets' original cost is transferred from the revaluation surplus to revenue reserves, net of related deferred taxation.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

**(h) Work in progress**

Work in progress relates to construction of the banking halls for the branches. Cost includes materials, direct labour and any other direct expenses incurred in respect of the project. The amounts are transferred to property and equipment once is completed and commissioned. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

**(i) Intangible assets - computer software development costs**

Costs incurred on computer software are initially accounted for at cost as intangible assets and subsequently at cost less any accumulated amortisation and accumulated impairment losses. Amortisation is calculated on a straight line basis over the estimated useful lives.

**(j) Leases**

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

Rentals payable under operating leases are amortised on the straight line basis over the term of the relevant lease.

**(k) Impairment of tangible and intangible assets other than goodwill**

At the end of each reporting period, the company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

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

#### (l) Retirement benefit obligations

##### i) Company's defined contribution pension scheme

The company operates a defined contribution pension scheme for its permanent employees. The assets of the scheme are held and administered independently of the company's assets. The scheme is funded by contributions from both the company and employees. The company's contribution to the scheme is limited to 10 per cent of the employees' basic salary while employees contribute 5 per cent of their basic salary. The company's contribution is charged to the profit or loss in the year to which it relates.

##### ii) Statutory defined contribution pension scheme

The company also contributes to the statutory National Social Security Fund. This is a defined contribution scheme to which the company's

obligation is limited to a specified contribution per employee per month and is charged to the profit or loss in the year to which it relates.

##### iii) Other employee entitlements

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

#### (m) Foreign currencies

Transactions in foreign currencies are translated at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting period. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses on exchange of monetary items are dealt with in the profit or loss in the period in which they arise.

#### (n) Financial instruments

The Group applies IFRS 9 Financial Instruments to the recognition, classification and **measurement, and derecognition of financial assets and financial liabilities and the impairment of financial assets.**

##### Recognition

The Group recognises financial assets and liabilities when it becomes a party to the terms of the contract. Trade date or settlement date accounting is applied depending on the classification of the financial asset.

1. ACCOUNTING POLICIES (Continued)

**Classification and measurement**

Financial assets are classified on the basis of two criteria:

- i) the business model within which financial assets are managed, and
- ii) their contractual cash flow characteristics (whether the cash flows represent 'solely payments of principal and interest' (SPPI)).

The Group assesses the business model criteria at a portfolio level. Information that is considered in determining the applicable business model includes (i) policies and objectives for the relevant portfolio, (ii) how the performance and risks of the portfolio are managed, evaluated and reported to management, and (iii) the frequency, volume and timing of sales in prior periods, sales expectation for future periods, and the reasons for such sales.

The contractual cash flow characteristics of financial assets are assessed with reference to whether the cash flows represent SPPI. In assessing whether contractual cash flows are SPPI compliant, interest is defined as consideration primarily for the time value of money and the credit risk of the principal outstanding. The time value of money is defined as the element of interest that provides consideration only for the passage of time and not consideration for other risks or costs associated with holding the financial asset. Terms that could change the contractual cash flows so that it would not meet the condition for SPPI are considered, including: (i) contingent and leverage features, (ii) non-recourse arrangements and (iii) features that could modify the time value of money.

Financial assets will be measured at amortised cost if they are held within a business model whose objective is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent SPPI.

Financial assets will be measured at fair value through other comprehensive income if they are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and their contractual cash flows represent SPPI.

Other financial assets are measured at fair value through profit and loss. There is an option to make an irrevocable election on initial recognition for non traded equity investments to be measured at fair value through other comprehensive income, in which case dividends are recognised in profit or loss, but gains or losses are not reclassified to profit or loss upon derecognition, and impairment is not recognised in the income statement.

**Accounting for loans and advances and deposits held at amortised cost under IFRS 9 effective from 1 January 2018**

Loans and advances to customers and banks, customer accounts and most financial liabilities, are held at amortised cost. That is, the initial fair value (which is normally the amount advanced or borrowed) is adjusted for repayments and the amortisation of coupon, fees and expenses to represent the effective interest rate of the asset or liability. Balances deferred on-balance sheet as effective interest rate adjustments are amortised to interest income over the life of the financial instrument to which they relate. Financial assets that are held in a business model to collect the contractual cash flows and that contain contractual terms that give rise on specified dates to cash flows that are SPPI, are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transaction costs.

In determining whether the business model is a 'hold to collect' model, the objective of the business model must be to hold the financial asset

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### (n) Financial instruments (Continued)

to collect contractual cash flows rather than holding the financial asset for trading or short-term profit taking purposes. While the objective of the business model must be to hold the financial asset to collect contractual cash flows this does not mean the Group is required to hold the financial assets until maturity. When determining if the business model objective is to collect contractual cash flows the Group will consider past sales and expectations about future sales.

#### **Accounting for loans and advances and deposits held at amortised cost under IAS 39 for 2017 and 2016**

Loans and advances to customers and banks, customer accounts, debt securities and most financial liabilities, are held at amortised cost. That is, the initial fair value (which is normally the amount advanced or borrowed) is adjusted for repayments and the amortisation of coupon, fees and expenses to represent the effective interest rate of the asset or liability. Balances deferred on-balance sheet as effective interest rate adjustments are amortised to interest income over the life of the financial instrument to which they relate. In accordance with IAS 39, where the Group no longer intends to trade in financial assets it may transfer them out of the held for trading classification and measure them at amortised cost if they meet the definition of a loan. The initial value used for the purposes of establishing amortised cost is fair value on the date of the transfer.

#### **(i) Significant increase in credit risk**

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Bank compares the risk of a default occurring on the financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment,

the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort. Forward-looking information considered includes the future prospects of the industries in which the Banks's borrowers operate, obtained from economic expert reports, financial analysts, governmental bodies, relevant think-tanks and other similar organisations, as well as consideration of various external sources of actual and forecast economic information that relate to the Group's core operations.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- an actual or expected significant deterioration in the financial instrument's external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk for a particular financial instrument, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor, or the length of time or the extent to which the fair value of a financial asset has been less than its amortised cost;
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the borrower;
- significant increases in credit risk on other financial instruments of the same borrower;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant decrease in the borrower's ability to meet its debt obligations.

**1. ACCOUNTING POLICIES** (Continued)

**(n) Financial instruments** (Continued)

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

Despite the foregoing, the Bank assumes that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date. A financial instrument is determined to have low credit risk if:

- The financial instrument has a low risk of default,
- The borrower has a strong capacity to meet its contractual cash flow obligations in the near term,
- Adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

The Bank considers a financial asset to have low credit risk when the asset has external credit rating of 'investment grade' in accordance with the globally understood definition or if an external rating is not available, the asset has an internal rating of 'performing'. Performing means that the counterparty has a strong financial position and there is no past due amounts.

**(ii) Definition of default**

The Bank considers the following as constituting an event of default for internal credit risk management purposes as historical experience indicates that financial assets that meet either of the following criteria are generally not recoverable:

- when there is a breach of financial covenants by the borrower; or

- information developed internally or obtained from external sources indicates that the borrower is unlikely to pay its lenders and or creditors, including the Bank, in full (without taking into account any collateral held by the Bank).

Irrespective of the above analysis, the Bank considers that default has occurred when a financial asset is more than 90 days past due unless the Bank has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

**(iii) Credit-impaired financial assets**

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:

- (a) significant financial difficulty of the issuer or the borrower;
- (b) a breach of contract, such as a default or past due event (see (ii) above);
- (c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- (d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- (e) the disappearance of an active market for that financial asset because of financial difficulties.

**(iv) Write-off policy**

The Bank writes off a financial asset when there is information indicating that the borrower is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the borrower has been placed under liquidation or has entered into

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 1. ACCOUNTING POLICIES (Continued)

#### (n) Financial instruments (Continued)

bankruptcy proceedings, or, when the amounts are over two years past due, whichever occurs sooner. Financial assets written off may still be subject to enforcement activities under the Bank's recovery procedures, taking into account legal advice where appropriate. Any recoveries made are recognised in profit or loss.

#### (v) Measurement and recognition of expected credit losses

The measurement of expected credit losses is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default. The assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information as described above. As for the exposure at default, for financial assets, this is represented by the assets' gross carrying amount at the reporting date; for financial guarantee contracts, the exposure includes the amount drawn down as at the reporting date, together with any additional amounts expected to be drawn down in the future by default date determined based on historical trend, the Bank's understanding of the specific future financing needs of the borrower, and other relevant forward-looking information.

For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to the Bank in accordance with the contract and all the cash flows that the Bank expects to receive, discounted at the original effective interest rate.

If the Bank has measured the loss allowance for a financial instrument at an amount equal to lifetime ECL in the previous reporting period, but determines at the current reporting date that the conditions for lifetime ECL are no longer met, the Bank measures the loss allowance at an amount equal to 12-month ECL at the current reporting date.

#### Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Bank retains substantially all the risks and rewards of ownership of a transferred financial asset, the Bank continues to recognise the financial asset and recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset measured at amortised cost, the difference between the asset's carrying amount and the sum of the consideration received and receivable is recognised in profit or loss. In addition, on derecognition of an investment in a debt instrument classified as at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss. In contrast, on derecognition of an investment in equity instrument, which the Bank has elected on initial recognition to measure at FVTOCI, the cumulative gain or loss previously accumulated in the investments revaluation reserve is not reclassified to profit or loss, but is transferred to retained earnings.

#### Financial liabilities

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

**1. ACCOUNTING POLICIES** (Continued)

**Derecognition of financial liabilities**

Financial liabilities are derecognised when and only when the company obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

**Borrowings**

Borrowings are recorded at the proceeds received. Finance charges, including premiums payable on settlement or redemption, are accounted for on the accruals basis and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

**(o) Offsetting financial instruments**

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

**(p) Cash and cash equivalents**

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

**q) Statutory reserve**

Where impairment losses required by the microfinance (Deposit Taking Institutions) Regulation 2008 issued by the Central Bank of Kenya exceed those computed under International Financial Reporting Standards (IFRS), the excess is

recognised as a statutory reserve and accounted for as an appropriation from revenue reserves. The reserve is not available for distribution.

**(r) Revaluation reserve**

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

**(s) Comparatives**

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year

**2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES**

In the process of applying the entity's accounting policies, management has made estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES (Continued)

i) Critical accounting judgements in applying the company's policies

Business model assessment

Classification and measurement of financial assets depends on the results of the SPPI and the business model test. The Bank determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Bank monitors financial assets measured at amortised cost that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Bank's continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets. No such changes were required during the periods presented.

Significant increase in credit risk

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

and supportable forward-looking information.

Establishing groups of assets with similar credit risk characteristics

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

Models and assumptions used

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

ii) Key sources of estimation uncertainty

Establishing the number and relative weightings of forward-looking scenarios for each type of product and determining the forward-looking information relevant to each scenario:

**2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING THE ENTITY'S ACCOUNTING POLICIES** (Continued)

When measuring ECL the Bank uses reasonable and supportable forward-looking information, which is based on assumptions for the future movement of different economic drivers and how these drivers will affect each other.

**Probability of default:**

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

**Loss Given Default:**

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

**Property and equipment**

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

**Fair value measurement and valuation**

Some of the company's assets and liabilities are measured at fair value for financial reporting process. In estimating the fair value of an asset or liabilities, the company uses market – observable data to the extent it is available. Where level 1 inputs are not available, the company engages third party qualified valuers to perform the valuation.

**3. FINANCIAL RISK MANAGEMENT**

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

- **Credit risk**
- **Liquidity risk**
- **Market risks**

**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 loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the company considers and consolidates all elements of credit risk exposure.

**Credit risk management**

The Banks's Risk Compliance and Credit committee is responsible for managing the Group's credit risk by:

- Ensuring that the Bank has appropriate credit risk practices, including an effective system of internal control, to consistently determine adequate allowances in accordance with the Bank's stated policies and procedures, IFRS and relevant supervisory guidance.
- Identifying, assessing and measuring credit risk across the Bank, from an individual instrument to a portfolio level.
- Creating credit policies to protect the Bank against the identified risks including the requirements to obtain collateral from

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

borrowers, to perform robust ongoing credit assessment of borrowers and to continually monitor exposures against internal risk limits.

- Limiting concentrations of exposure by type of asset, counterparties, industry, credit rating, geographic location etc.
- Establishing a robust control framework regarding the authorisation structure for the approval and renewal of credit facilities.
- Developing and maintaining the Bank's risk grading to categorise exposures according to the degree of risk of default. Risk grades are subject to regular reviews.
- Developing and maintaining the Bank's processes for measuring ECL including monitoring of credit risk, incorporation of forward-looking information and the method used to measure ECL.
- Ensuring that the Bank has policies and procedures in place to appropriately maintain and validate models used to assess and measure ECL.
- Establishing a sound credit risk accounting assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess credit risk and to account for ECL. Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

The internal audit function performs regular audits making sure that the established controls and procedures are adequately designed and implemented.

#### Significant increase in credit risk

As explained in note 1 the Bank monitors all financial assets that are subject to impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant

increase in credit risk the Bank will measure the loss allowance based on lifetime rather than 12-month ECL.

#### Internal credit risk ratings

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

The credit risk grades are designed and calibrated to reflect the risk of default as credit risk deteriorates. As the credit risk increases the difference in risk of default between grades changes.

Each exposure is allocated to a credit risk grade at initial recognition, based on the available information about the counterparty. All exposures are monitored and the credit risk grade is updated to reflect current information. The monitoring procedures followed are both general and tailored to the type of exposure.

The following data are typically used to monitor the Bank's exposures:

- Payment record, including payment ratios and ageing analysis;
- Extent of utilisation of granted limit;
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies;

**3. FINANCIAL RISK MANAGEMENT** (Continued)

**a) Credit risk** (Continued)

**Significant increase in credit risk** (Continued)

- For retail exposures: internally generated data of customer behaviour, affordability metrics etc.; and
- For corporate exposures: information obtained by periodic review of customer files including audited financial statements review, changes in the financial sector the customer operates etc.

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

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

The Bank uses different criteria to determine whether credit risk has increased significantly per portfolio of assets. The criteria used are both quantitative changes in PDs as well as qualitative.

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

information that demonstrates otherwise.

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

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

**Incorporation of forward-looking information**

The Bank uses forward-looking information that is available without undue cost or effort in its assessment of significant increase of credit risk as well as in its measurement of ECL. The Bank uses internal experts who use external and internal information to generate a 'base case' scenario of future forecast of relevant economic variables along with a representative range of other possible forecast scenarios. The external information used includes economic data and forecasts published by governmental bodies and monetary authorities.

The Bank uses multiple scenarios to model the non-linear impact of assumptions about macroeconomic factors on ECL. The Bank applies probabilities to the forecast scenarios identified. The base case scenario is the single most-likely outcome and consists of information used by the

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

Bank for strategic planning and budgeting. The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using a statistical analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. The Bank has not made changes in the estimation techniques or significant assumptions made during the reporting period.

The bank carried out an impact assessment of the forward-looking information on the ECL. Based on its findings, there was no correlation between forward-looking and impairment loss.

#### Measurement of ECL

The key inputs used for measuring ECL are:

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

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

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

LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross collateralisation and seniority of claim, cost of realisation of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original EIR of the loan.

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

The Bank measures ECL considering the risk of default over the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if contact extension or renewal is common business practice. For such financial instruments the Bank measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. These financial instruments do not have a fixed term or repayment structure

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

and have a short contractual cancellation period. However, the Bank does not enforce in the normal day-to-day management the contractual right to cancel these financial instruments. This is because these financial instruments are managed on a collective basis and are cancelled only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment.

The measurement of ECL is based on probability weighted average credit loss. As a result, the measurement of the loss allowance should be the same regardless of whether it is measured on an individual basis or a collective basis (although measurement on a collective basis is more practical for large portfolios of items). In relation to the assessment of whether there has been a significant increase in credit risk it can be necessary to perform the assessment on a collective basis as noted below on Groupings based on shared risks characteristics.

#### Groupings based on shared risks characteristics

When ECL are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics, such as:

- instrument type;
- credit risk grade;
- collateral type;
- date of initial recognition;
- remaining term to maturity;
- industry;
- geographic location of the borrower;
- income bracket of the borrower; and

The groupings are reviewed on a regular basis to ensure that each group is comprised of homogenous exposures.

#### Credit quality

The Bank monitors credit risk per class of financial instrument. An analysis of the Bank's credit risk concentrations per class of financial asset is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

#### (i) Management of credit risk

#### Concentrations of assets and off balance sheet items:

Details of significant concentrations of the company's financial assets and liabilities by industry groups are as detailed below:

Gross loans to customers	2018	%	2017	%
	Shs '000		Shs '000	
Agriculture	668,452	4%	3,209	0.02%
Trade	7,319,109	38%	6,540,916	38.57%
Consumer	11,192,961	58%	10,413,769	61.41%
	<b>19,180,522</b>	<b>100%</b>	<b>16,957,894</b>	<b>100%</b>
Cash Collaterals				
Agriculture	26,775	5%	52,081	7%
Trade	549,195	93%	487,714	69%
Consumer	12,873	2%	172,162	24%
	<b>588,843</b>	<b>100%</b>	<b>711,957</b>	<b>100%</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

#### (ii) Maximum exposure to credit risk before collateral held

	2018	%	2017	%
	Shs '000		Shs '000	
<b>Credit exposure on balance sheet items:</b>				
Short term deposits with banks	1,968,670	8%	985,000	4%
Loans to customers	19,180,523	79%	17,278,035	80%
Government securities	1,900,000	8%	2,500,000	11%
Bank balances	677,926	1%	122,300	1%
Cash reserve requirement	1,029,133	4%	782,985	4%
Total gross carrying amount	24,756,252	100%	21,668,320	100%
Loss allowance	(2,286,639)		(320,141)	
<b>Carrying amount</b>	<b>22,469,613</b>		<b>21,348,179</b>	

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

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

31 December 2018						31 December 2017
Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000	Total Sh'000
Grade 1: Normal	13,902,359	153,242	62,986	-	14,118,587	11,681,948
Grade 2: Watch	2,163,541	344,323	46,868	-	2,554,732	2,633,934
Grade 3: Substandard	-	377,035	10,727	-	387,762	743,298
Grade 4: Doubtful	-	168,593	16,443	-	185,036	373,170
Grade 5: Loss	-	-	1,934,406	-	1,934,406	1,845,684
<b>Total gross carrying amount</b>	<b>16,065,900</b>	<b>1,043,193</b>	<b>2,071,429</b>	<b>-</b>	<b>19,180,523</b>	<b>17,278,034</b>
Loss allowance	(549,750)	(257,459)	(1,438,560)	-	(2,245,769)	(320,141)
<b>Carrying amount</b>	<b>15,516,150</b>	<b>785,734</b>	<b>632,870</b>	<b>-</b>	<b>16,934,754</b>	<b>16,957,893</b>

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

Financial statement line	31 December 2018	31 December 2017
	IFRS 9	IAS 39
	Sh'000	Sh'000
Loans at amortized cost	2,245,769	319,966
Other assets at amortised cost	34	175
Cash and cash equivalents	5,224	-
Government securities	20,100	-
Other assets	15,512	-
<b>Total allowance for credit losses</b>	<b>2,286,639</b>	<b>320,141</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

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

Loans and advances to customers at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000
Loss allowance as at 1 January 2018- restated	457,589	568,436	1,163,687	-	2,189,712
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	247,901	(174,087)	(73,814)		-
- Transfer to stage 2	(38,543)	61,427	(22,883)		-
- Transfer to stage 3	(25,432)	(147,012)	172,444		-
- Increases due to change in credit risk	-	-	-		-
-Decreases due to change in credit risk	-	-	-		-
- Write-offs	-	-	(58,493)		(58,493)
New financial assets originated or purchased	528,613	-	-		528,613
Financial assets that have been derecognised	(620,377)	(51,304)	257,619		(414,062)
<b>Loss allowance as at 31 December 2018</b>	<b>549,751</b>	<b>257,460</b>	<b>1,438,560</b>	<b>-</b>	<b>2,245,771</b>

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

Loss allowance - Other financial assets at amortised cost	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000
Loss allowance as at 1 January 2018- restated	30,198	16,368	-	-	47,566
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	16,368	(16,368)	-		-
- Transfer to stage 2	-	-	-		-
- Transfer to stage 3	-	-	-		-
- Increases due to change in credit risk	-	-	-		-
-Decreases due to change in credit risk	-	-	-		-
- Write-offs	-	-	-		-
New financial assets originated or purchased	15,892	-	15,029		30,921
Financial assets that have been derecognised	(36,617)	-	-		(36,617)
<b>Loss allowance as at 31 December 2018</b>	<b>25,841</b>	<b>-</b>	<b>15,029</b>	<b>-</b>	<b>41,870</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

The tables below analyse the movement of the gross carrying amount during the year per class of assets.

<b>Banking</b>	<b>Stage 1 12-month ECL Sh'000</b>	<b>Stage 2 Lifetime ECL Sh'000</b>	<b>Stage 3 Lifetime ECL Sh'000</b>	<b>POCI Sh'000</b>	<b>Total Sh'000</b>
<b>Gross carrying amounts- Loans and advances to customers at amortised cost</b>					
Gross carrying as at 1 January 2018	13,425,491	1,865,012	1,865,012	-	17,278,035
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	1,005,048	(729,795)	(275,253)	-	-
- Transfer to stage 2	(695,332)	754,305	(58,973)	-	-
- Transfer to stage 3	(526,806)	(448,895)	975,701	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	(58,493)	-	(58,493)
New financial assets originated or purchased	10,679,363	-	-	-	10,679,363
Financial assets that have been derecognised	(7,821,864)	(397,434)	(499,084)	-	(8,718,382)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>16,065,900</b>	<b>1,043,193</b>	<b>1,948,910</b>	<b>-</b>	<b>19,180,523</b>
<b>Other financial assets</b>					
<b>Gross carrying amounts- - Other financial assets at amortised cost</b>					
Gross carrying as at 1 January 2018	3,939,498	450,787	-	-	4,390,285
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	450,787	(450,787)	-	-	-
- Transfer to stage 2	(7,375)	7,375	-	-	-
- Transfer to stage 3	(11,647)	-	11,647	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	-	-	-
New financial assets originated or purchased	1,468,670	473,274	-	-	1,941,944
Financial assets that have been derecognised	(1,085,000)	-	-	-	(1,085,000)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>4,754,933</b>	<b>480,649</b>	<b>11,647</b>	<b>-</b>	<b>5,247,229</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

#### Credit quality (Continued)

The tables below analyse the movement of the gross carrying amount during the year per product.

SME	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000
Gross carrying amounts- Loans and advances to customers at amortized cost					
Gross carrying as at 1 January 2018	2,881,063	1,017,069	1,277,507	-	5,175,639
- Transfer to stage 1	389,838	(279,063)	(110,775)	-	-
- Transfer to stage 2	(463,349)	498,995	(35,646)	-	-
- Transfer to stage 3	(367,468)	(366,445)	733,914	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	46,951	-	46,951
New financial assets originated or purchased	1,429,036	-	-	-	1,429,036
Financial assets that have been derecognised	(1,497,398)	(385,653)	(673,835)	-	(2,556,886)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>2,371,722</b>	<b>484,902</b>	<b>1,238,116</b>	<b>-</b>	<b>4,094,740</b>
<b>Community</b>					
Gross carrying as at 1 January 2018	989,823	292,881	261,339	-	1,544,043
- Transfer to stage 1	218,566	(158,570)	(59,997)	-	-
- Transfer to stage 2	(19,019)	31,672	(12,653)	-	-
- Transfer to stage 3	(3,702)	(3,065)	6,767	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	-	-	-
New financial assets originated or purchased	543,935	45,084	338,686	-	927,705
Financial assets that have been derecognised	(401,327)	(18,034)	(135,475)	-	(554,835)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>1,328,276</b>	<b>189,969</b>	<b>398,668</b>	<b>-</b>	<b>1,916,913</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

##### Credit quality (Continued)

Retail					
Gross carrying as at 1 January 2018	9,525,872	583,794	448,687	-	10,558,353
- Transfer to stage 1	396,644	(292,162)	(104,482)	-	-
- Transfer to stage 2	(212,964)	223,638	(10,674)	-	-
- Transfer to stage 3	(155,636)	(79,385)	235,021	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	11,542	-	11,542
New financial assets originated or purchased	8,322,621	-	-	-	8,322,621
Financial assets that have been derecognised	(5,510,634)	(67,563)	(145,450)	-	(5,723,647)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>12,365,903</b>	<b>368,322</b>	<b>434,644</b>	<b>-</b>	<b>13,168,869</b>

SME	Stage 1 12-month ECL Sh'000	Stage 2 Lifetime ECL Sh'000	Stage 3 Lifetime ECL Sh'000	POCI Sh'000	Total Sh'000
Loss allowance as at 1 January 2018- restated	113,842	247,556	607,068	-	968,466
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	64,011	(43,998)	(20,014)	-	-
- Transfer to stage 2	(13,994)	26,604	(12,610)	-	-
- Transfer to stage 3	(7,071)	(61,651)	68,721	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	(46,951)	-	(46,951)
New financial assets originated or purchased	70,735	-	-	-	70,735
Financial assets that have been derecognised	(185,194)	(86,164)	141,572	-	(129,786)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>42,330</b>	<b>82,347</b>	<b>737,787</b>	<b>-</b>	<b>862,464</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

##### Credit quality (Continued)

<b>Community</b> Loss allowance- Loans and advances to customers at amortised cost	<b>Stage 1</b> 12-month ECL Sh'000	<b>Stage 2</b> Lifetime ECL Sh'000	<b>Stage 3</b> Lifetime ECL Sh'000	<b>POCI</b> Sh'000	<b>Total</b> Sh'000
Loss allowance as at 1 January 2018- restated	49,659	37,017	78,332	-	165,008
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	29,947	(20,295)	(9,652)	-	-
- Transfer to stage 2	(1,303)	4,206	(2,904)	-	-
- Transfer to stage 3	(82)	(54)	136	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	-	-	-
New financial assets originated or purchased	26,924	2,232	16,764	-	45,920
Financial assets that have been derecognised	(7,524)	3,678	140,645	-	136,800
<b>Gross carrying amounts as at 31 December 2018</b>	<b>97,622</b>	<b>26,785</b>	<b>223,321</b>	<b>-</b>	<b>347,728</b>
<b>Retail</b> Loss allowance- Loans and advances to customers at amortised cost	<b>Stage 1</b> 12-month ECL Sh'000	<b>Stage 2</b> Lifetime ECL Sh'000	<b>Stage 3</b> Lifetime ECL Sh'000	<b>POCI</b> Sh'000	<b>Total</b> Sh'000
Loss allowance as at 1 January 2018- restated	294,088	283,863	478,286	-	1,056,237
<b>Changes in the loss allowance</b>					
- Transfer to stage 1	153,942	(109,794)	(44,148)	-	-
- Transfer to stage 2	(23,246)	30,616	(7,370)	-	-
- Transfer to stage 3	(18,279)	(85,307)	103,587	-	-
- Increases due to change in credit risk	-	-	-	-	-
-Decreases due to change in credit risk	-	-	-	-	-
- Write-offs	-	-	(11,542)	-	(11,542)
New financial assets originated or purchased	411,958	-	-	-	411,958
Financial assets that have been derecognised	(408,664)	28,949	(41,362)	-	(421,078)
<b>Gross carrying amounts as at 31 December 2018</b>	<b>409,798</b>	<b>148,326</b>	<b>477,451</b>	<b>-</b>	<b>1,035,575</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### a) Credit risk (Continued)

##### Credit quality (Continued)

As discussed above in the significant increase in credit risk section, under the Bank's monitoring procedures a significant increase in credit risk is identified before the exposure has defaulted, and at the latest when the exposure becomes 30 days past due. The table below provides an analysis of the gross carrying amount of loans and advances to customers by past due status.

##### Loans to customers

	Gross Shs '000	Net Shs '000
31 December 2018		
IFRS 9 Stage 1 (0- 30 days)	16,065,900	15,516,149
IFRS 9 Stage 2 (31- 90 days)	1,043,193	790,994
IFRS 9 Stage 3 (Over 90 days)	2,071,429	836,824
	<b>19,180,522</b>	<b>17,143,967</b>
31 December 2017		
Neither past due nor impaired (0-30 days)	11,740,158	11,740,158
Past due but not impaired (31-90 days)	2,688,677	2,688,677
Impaired (Over 90 days)	2,849,200	2,529,059
	<b>17,278,035</b>	<b>16,957,894</b>

##### Cash Collateral held

The Bank's cash collateral consists of collateral held against loans and receivables to group customers (note 22). The fair value of cash collateral is Shs 588,844,000 (2017: Shs 711,956,000). The value of non-cash collateral held is Sh 3,217,831,000 (2017: Shs 3,270,838,000)

#### b) Liquidity risk

The company is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

##### (i) 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 Risk Compliance and Credit Committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties meeting financial liabilities as they fall due is encountered.

A portfolio of short-term liquid assets largely made up of short-term liquid investment securities and bank facilities ensure that sufficient liquidity is maintained within the company as a whole. The liquidity ratio as at 31 December 2018 was 26.6% (2017:26.4%).

##### (ii) Source of funding

The company has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base of customers. The company also borrows from the banks for short term liquidity requirements.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### b) Liquidity risk (Continued)

As at December 2018	Maturing in less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Total Shs '000
<b>FINANCIAL LIABILITIES</b>								
Cash collateral held	27,472	49,964	43,681	22,179	126,548	59,062	259,937	<b>588,844</b>
Borrowings	115,464	272,467	329,413	886,264	1,637,651	1,189,261	-	<b>4,430,520</b>
Customer deposits	7,118,140	5,767,346	3,100,121	1,920,685	34,677	-	-	<b>17,940,968</b>
Total liabilities (contractual maturity dates)	<b>7,261,076</b>	<b>6,089,777</b>	<b>3,473,215</b>	<b>2,829,128</b>	<b>1,798,876</b>	<b>1,248,323</b>	<b>259,937</b>	<b>22,960,332</b>
<b>FINANCIAL ASSETS</b>								
Cash and bank balances	349,311	-	-	-	-	-	-	<b>349,311</b>
Short term deposits	900,000	900,000	-	14,028	149,418	-	-	<b>1,963,446</b>
Cash reserve requirement	1,029,099	-	-	-	-	-	-	<b>1,029,099</b>
Government securities	-	-	200,000	300,000	-	300,000	1,079,900	<b>1,879,900</b>
Loans to customers (net)	973,027	1,561,721	1,320,221	2,252,277	5,723,107	3,329,270	1,775,131	<b>16,934,754</b>
<b>Total assets (expected maturity dates)</b>	<b>3,251,437</b>	<b>2,461,721</b>	<b>1,520,221</b>	<b>2,566,305</b>	<b>5,872,525</b>	<b>3,629,270</b>	<b>2,855,031</b>	<b>22,156,510</b>
<b>NET LIQUIDITY GAP</b>	<b>(4,009,639)</b>	<b>(3,628,056)</b>	<b>(1,952,994)</b>	<b>(262,823)</b>	<b>4,073,649</b>	<b>2,380,947</b>	<b>2,595,094</b>	<b>(803,822)</b>
<b>As at 31 December 2017</b>								
Total liabilities (contractual maturity dates)	8,731,467	5,526,227	2,480,660	2,167,738	594,437	474,994	46,354	<b>20,021,877</b>
<b>Total assets (expected maturity dates)</b>	<b>3,231,255</b>	<b>2,742,927</b>	<b>561,963</b>	<b>944,024</b>	<b>5,742,415</b>	<b>5,483,764</b>	<b>2,939,016</b>	<b>21,645,364</b>
<b>NET LIQUIDITY GAP</b>	<b>(5,500,212)</b>	<b>(2,783,300)</b>	<b>(1,918,697)</b>	<b>(1,223,714)</b>	<b>5,147,978</b>	<b>5,008,770</b>	<b>2,892,662</b>	<b>1,623,487</b>

3. FINANCIAL RISK MANAGEMENT (Continued)

c) Market Risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads 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.

Management of market risks

Overall authority for market risk is vested in the Risk Compliance and Credit Committee which is responsible for the development of detailed risk management policies. The policies are subject to review and approval by the board.

Exposure to interest rate risk

The company is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on financial position and cash flows. The risk committee closely monitors the interest rates trends to minimize the potential adverse impact of interest rate changes. The table overleaf summarizes the exposure of interest rate risk at the end of reporting period. The company maintains an appropriate mix of fixed and floating rates deposit base. Interest rates on advances to customers and other risk assets are either pegged to the company's lending rate or the company's rates are adjusted from time to time to reflect the cost of deposits.

Interest rates on cash collateral held are determined by the company with the company retaining the discretion to adjust the rates in line with changes in market trends. The interest rates, therefore, may fluctuate depending on the movement in the market interest rates. The company also invests in fixed interest rate instruments issued by the Government of Kenya through the Central Bank of Kenya.

The matching and controlled mismatching of the maturities and interest rate of assets and liabilities is fundamental to the management of the company. It is unusual for a company's assets and liabilities to be completely matched due to the nature of business terms and types.

Included in the table overleaf are financial assets and liabilities at carrying amounts categorized by the earlier of contractual repricing or maturity dates.

The table below summarises the exposure to interest rate risks. Included in the table are the company's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The company does not bear an interest rate risk on off statement of financial position items. (All figures are in Kenya Shillings).



## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### c) Market risks (Continued)

	Less than 1 month Shs '000	1 month less than 3 month Shs '000	3 month less than 6 month Shs '000	6 month less than 1 year Shs '000	1 year less than 3 year Shs '000	3 year less than 5 year Shs '000	Over 5 years Shs '000	Non-interest bearing Shs '000	Total Shs '000
<b>A. FINANCIAL ASSETS</b>									
Cash and bank balances	1,027,193	-	-	-	-	-	-	-	<b>1,027,193</b>
Short term deposits	900,000	900,000	-	14,028	149,418	-	-	-	<b>1,963,446</b>
Cash reserve ratio (CBK)	-	-	-	-	-	-	-	1,029,133	<b>1,029,133</b>
Government securities	-	-	200,000	300,000	-	300,000	1,079,900	-	1,879,900
Loans to customers (net)	797,949	1,451,252	1,268,740	644,206	3,466,462	1,715,501	7,590,644	-	16,934,754
<b>Total financial assets</b>	<b>2,725,142</b>	<b>2,351,252</b>	<b>1,468,740</b>	<b>958,234</b>	<b>3,615,880</b>	<b>2,015,501</b>	<b>8,670,544</b>	<b>1,029,133</b>	<b>22,834,426</b>
<b>B. FINANCIAL LIABILITIES</b>									
Borrowings	115,464	272,467	329,413	886,264	1,637,651	1,189,261	-	-	<b>4,430,520</b>
Customer deposits	7,118,140	5,767,346	3,100,121	1,920,685	34,676	-	-	-	<b>17,940,968</b>
Cash collateral held	-	-	-	-	-	-	-	588,843	<b>588,843</b>
<b>Total financial liabilities</b>	<b>7,233,604</b>	<b>6,039,813</b>	<b>3,429,534</b>	<b>2,806,949</b>	<b>1,672,327</b>	<b>1,189,261</b>	<b>-</b>	<b>588,843</b>	<b>22,960,331</b>
<b>C. On statement of financial position-interest sensitivity gap</b>	<b>(4,508,462)</b>	<b>(3,688,561)</b>	<b>(1,960,794)</b>	<b>(1,848,715)</b>	<b>1,943,553</b>	<b>826,240</b>	<b>8,670,544</b>	<b>440,290</b>	<b>(125,905)</b>
<b>D. As at 31 December 2017</b>									
Total financial assets	3,224,240	1,766,509	440,443	847,345	5,741,614	5,483,627	2,939,016	1,202,470	<b>21,645,364</b>
Total financial liabilities	4,299,989	5,638,415	3,875,904	4,056,246	800,160	506,068	133,138	711,957	<b>20,021,877</b>
<b>E. On statement of financial position-interest sensitivity gap</b>	<b>705,871</b>	<b>(5,571,631)</b>	<b>(3,260,790)</b>	<b>(4,077,392)</b>	<b>1,089,076</b>	<b>7,227,706</b>	<b>(5,420,812)</b>	<b>332,848</b>	<b>(1,866,495)</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### c) Market risks (Continued)

##### Interest rate risk stress test

The impact that an immediate hypothetical increase or decrease in interest rates of 3% applied at the beginning of the year would have on the profit for the year assuming a growing balance sheet and current interest rate risk profile would be as follows:

	2018		2017	
	Shs'000		Shs'000	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
3% increase in interest rates	56,533	39,573	62,716	43,901
3% decrease in interest rates	(56,533)	(39,573)	(62,716)	(43,901)

The model does not take into account any corrective action in response to interest rate movements, particularly in adverse situations.

##### Currency risk

The company operates wholly within Kenya and its assets and liabilities are reported in the local currency. The company's currency position is as follows and all amounts are stated in Shs

	Shs '000	USD	Euro	GBP	Total (Shs '000)
<b>A. ASSETS</b>					
Cash and bank balances	972,202	2,789	81,481	440,000	1,496,472
Short term deposits with banks	1,968,670	-	-	-	1,968,670
Cash reserve ratio (CBK)	1,029,133	-	-	-	1,029,133
Government securities	1,900,000	-	-	-	1,900,000
Loans to customers (net)	17,143,967	-	-	-	17,143,967
<b>Total financial assets</b>	<b>23,013,972</b>	<b>2,789</b>	<b>81,481</b>	<b>440,000</b>	<b>23,076,005</b>
<b>B. LIABILITIES</b>					
Cash collateral held	588,844	-	-	-	588,844
Borrowings	4,430,520	-	-	-	4,430,520
Customer deposits	17,940,968	-	-	-	17,940,968
<b>Total financial liabilities</b>	<b>22,960,332</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>22,960,332</b>
<b>C NET BALANCE SHEET POSITION</b>					
	<b>53,640</b>	<b>2,789</b>	<b>81,481</b>	<b>440,000</b>	<b>(913,460)</b>
As at 31 December 2017	21,633,933	5,110,977	100,972	-	27,798,862
A Total financial assets	21,633,933	5,110,977	100,972	-	27,798,862
B Total financial liabilities	20,021,877	-	-	-	20,021,877
<b>NET BALANCE SHEET POSITION</b>	<b>1,612,056</b>	<b>5,110,977</b>	<b>100,972</b>	<b>-</b>	<b>6,824,005</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 3. FINANCIAL RISK MANAGEMENT (Continued)

#### c) Market risks (Continued)

The table below summarizes the estimated impact of a 10% decline/appreciation of the Kenya Shilling against the two major currencies traded by the company i.e. the US Dollar and the Euro.

	2018 Shs '000 Effect on profit	2017 Shs '000 Effect on profit
<b>Currency - Euro</b>		
+ 10% Shs movement	(949)	(9,231)
- 10% Shs movement	949	9,231
<b>Currency - US dollars</b>		
+ 10% Shs movement	(28)	(21)
- 10% Shs movement	28	21
<b>Currency - GBP</b>		
+ 10% Shs movement	(5,677)	-
- 10% Shs movement	5,677	-

relating to items that are included in equity but are treated differently for capital adequacy purposes.

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

Various limits are applied to elements of the capital base. Qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 % of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of Microfinance bank and certain other regulatory items.

Risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-statement of financial position exposures.

### 4. CAPITAL RISK MANAGEMENT

The Central Bank of Kenya sets and monitors capital requirements for microfinance banks.

The Microfinance bank regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings after deductions for intangible assets, and other regulatory adjustments

The institution's aim is to build a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Microfinance bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 4. CAPITAL RISK MANAGEMENT (Continued)

In implementing current capital requirements, the Central Bank of Kenya requires each microfinance bank to maintain;

- A minimum level of regulatory capital of Shs 60 million.
- A ratio of core capital to the risk-weighted assets plus risk-weighted off-statement of financial position assets at or above the required minimum of 10%.
- Core capital of not less than 8% of total deposit liabilities.
- Supplementary capital of not less than 12% of risk-weighted assets plus risk-weighted off-statement of financial position items.

Faulu Microfinance Bank Limited has complied with all externally imposed capital requirements throughout the year.

The capital position at 31 December was as follows;

	BANK	
	2018	2017
	Shs'000	Shs'000
<b>Tier 1 capital</b>		
Share capital	480,000	480,000
Share premium	2,899,759	2,899,759
Retained earnings	(171,384)	294,133
	<b>3,208,375</b>	<b>3,673,892</b>
<b>Tier 2 capital</b>		
Collective allowances for impairment	-	251,065
Revaluation reserve	63,876	65,177
	<b>63,876</b>	<b>316,243</b>
Regulatory capital	<b>3,272,251</b>	<b>3,990,135</b>
Total risk-weighted assets	<b>20,462,843</b>	<b>20,085,217</b>
Borrowings	4,430,520	3,571,774
<b>Capital ratios</b>		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum -12%)	16.9%	19.9%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum -10%)	16.6%	18.4%

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 4. CAPITAL RISK 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 and Compliance and Credit, and is subject to review by the Board Credit Committee or ALCO as appropriate.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Microfinance bank 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 Microfinance Bank's longer term strategic objectives. The Microfinance bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

### 5. INTEREST INCOME

GROUP AND BANK		
	2018 Shs '000	2017 Shs '000
Loans and receivables	3,570,948	3,565,692
Short term bank deposits	163,237	258,392
Held to maturity investments- treasury bonds	-	222,416
Fair value through profit and loss	311,444	-
	<b>4,045,629</b>	<b>4,046,500</b>

### 6. INTEREST EXPENSE

GROUP AND BANK		
	2018 Shs '000	2017 Shs '000
Savings accounts	1,626,553	1,461,173
Borrowed funds	487,800	498,979
	<b>2,114,353</b>	<b>1,960,152</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 7. FEES AND COMMISSIONS

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Registration fees	389	475	389	475
Loan set up fees	370,639	263,159	368,635	263,159
Commission (net)	183,899	142,587	158,505	117,717
Chattels mortgage fees	12,067	10,626	12,067	10,626
	<b>566,994</b>	<b>416,847</b>	<b>539,596</b>	<b>391,977</b>

### 8. OTHER OPERATING INCOME

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Bad debts recovered	1,644	14,013	1,644	14,013
Other income	21,252	10,780	17,371	8,734
	<b>22,896</b>	<b>24,793</b>	<b>19,015</b>	<b>22,747</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 9. ADMINISTRATION AND OPERATING EXPENSES

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Staff costs (note 10)	968,567	1,042,652	957,806	1,031,648
Office operations and supplies	518,336	390,488	517,412	390,399
Training and evaluation	7,988	3,501	7,988	3,501
Office rent and repairs	181,194	172,382	181,194	172,382
Travelling expenses	41,794	39,007	41,794	39,007
Depreciation of property and equipment	144,297	158,363	144,297	158,363
Audit fees	5,200	4,971	4,795	4,587
Loss on disposal of assets	3,147	-	3,147	-
Amortisation of intangible assets	188,579	63,272	188,579	63,272
Directors' fees	14,487	15,137	13,490	15,137
Other expenses	54,921	67,657	52,026	66,758
	<b>2,128,510</b>	<b>1,957,430</b>	2,112,528	<b>1,945,054</b>

The administration and operating expenses have been prepared and presented as per IAS 1 as per the nature of expense.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 10. STAFF COSTS

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Staff salaries and wages	808,220	820,368	798,122	809,365
Medical expenses	112,405	88,965	112,404	88,965
Defined contribution pension scheme	63,150	73,033	62,487	73,033
Temporary labour	1,356	2,647	1,356	2,647
Staff awards	1,041	1,169	1,041	1,169
Staff uniforms	41	159	41	159
Statutory pension contribution (NSSF)	1,407	1,248	1,407	1,248
Recruitment	967	2,505	967	2,505
Health & safety	15	100	15	100
Staff welfare & entertainment	7,137	6,657	7,137	6,657
Staff bonus	(33,488)	35,000	(33,488)	35,000
Health awareness	-	871	-	871
Provision for accumulated leave	5,964	8,757	5,964	8,757
Staff related surveys	352	1,173	352	1,172
	<b>968,567</b>	<b>1,042,652</b>	<b>957,806</b>	<b>1,031,648</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 11. IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
At 1 January as previously reported	320,141	429,064	320,141	429,064
IFRS 9 transition adjustment (Note 1(e))	1,917,136	-	1,917,136	-
<b>At 1 January-restated</b>	<b>2,237,277</b>	<b>429,064</b>	<b>2,237,277</b>	<b>429,064</b>
Additional provision during the year	109,407	232,402	107,855	232,402
Write offs	(58,493)	(341,325)	(58,493)	(341,325)
<b>At 31 December</b>	<b>2,288,191</b>	<b>320,141</b>	<b>2,286,639</b>	<b>320,141</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 12. TAXATION

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
<b>(a) TAXATION CHARGE</b>				
<b>Current tax expense</b>				
Based on the adjusted profit for the year at 30%	116,405	21,230	111,748	16,877
Share of associate company taxation (note 18)	1,389	1,176	1,389	1,176
Prior year over provision for current tax	-	(712)	-	(712)
<b>Deferred taxation (note 26)</b>	117,794	21,694	113,137	17,341
Current year (credit)/ charge	(20,878)	52,086	(20,428)	52,086
	<b>96,916</b>	<b>73,780</b>	<b>92,709</b>	<b>69,427</b>
<b>(b) RECONCILIATION OF EXPECTED TAX BASED ON ACCOUNTING PROFIT TO TAX CHARGE</b>				
Accounting profit before taxation	287,360	177,996	273,615	163,486
Tax at the applicable rate of 30%	86,208	53,399	82,085	49,046
Tax effect of expenses not deductible for tax purposes	9,319	19,917	9,235	19,917
Prior year over provision- current tax	-	(712)	-	(712)
	95,527	72,604	91,320	68,251
Share of associate company taxation (note 18)	1,139	1,176	1,139	1,176
	<b>96,966</b>	<b>73,780</b>	<b>92,709</b>	<b>69,427</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 12. TAXATION (Continued)

#### (c) TAX (RECOVERABLE)/PAYABLE

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Balance at 1 January	(237,123)	(192,135)	(237,739)	(197,777)
Charge for the year	116,405	21,230	111,748	16,877
Paid in the year	(45,916)	(65,506)	(41,944)	(56,127)
Prior year (over) / under provision	-	(712)	-	(712)
Balance at 31 December	(166,634)	(237,123)	(167,935)	(237,739)
Tax recoverable	(167,935)	(237,739)	(167,935)	(237,739)
Tax payable	1,301	616	-	-
	<b>(166,634)</b>	<b>(237,123)</b>	<b>(167,935)</b>	<b>(237,739)</b>

### 13. SHORT TERM DEPOSITS WITH BANKS

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
<b>Held to maturity</b>		
Commercial Bank of Africa Limited	-	100,000
The Co-operative Bank of Kenya Limited	500,000	300,000
Kenya Commercial Bank PLC	700,000	-
Equity Bank PLC	100,000	200,000
NIC Bank PLC	-	300,000
Credit Bank Limited	-	85,000
Stanbic Bank Kenya Limited	500,000	-
SBM Bank Limited	168,670	-
	1,968,670	985,000
Less: impairment loss allowance (Note (3 a (ii)))	(5,224)	-
	<b>1,963,446</b>	<b>985,000</b>

Effective interest rate average 8.8% in 2018 and 13% in 2017. All the deposits except those held by SBM Bank mature within 90 days from the balance sheet date.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 14. CASH BALANCES WITH CENTRAL BANK OF KENYA

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
Gross Cash reserve requirement	1,029,133	782,985
Less: impairment loss allowance (Note (3 a (ii)))	(34)	-
	1,029,099	782,985

As at 31 December 2018, the cash ratio requirement was 5.25% (2017: 5.25%) of eligible deposits. These funds are not available for the day to day operations of the Bank and are non-interest bearing.

### 15. LOANS TO CUSTOMERS

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
Gross loans to customers	19,180,523	17,278,035
Less: Impairment loss allowance (Note (3 a (ii)))	(2,245,769)	(320,141)
	16,934,754	16,957,894

The effective interest rate on customer advances at 31 December 2018 was 19.7% (2017 – 20%). Advances to customers are secured by cash collaterals (note 22) and chattels mortgages. Other forms of collateral include land, buildings, and motor vehicles.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 16. GOVERNMENT SECURITIES

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
<b>Treasury bonds - Available for Sale</b>		
Maturing within 1 year	200,000	-
Maturing between 1 and 3 years	-	550,000
Maturing over 3 Years	1,400,000	1,850,000
	1,600,000	2,400,000
<b>Treasury bills - Available for Sale</b>	300,000	100,000
	1,900,000	2,500,000
Less: impairment loss allowance (Note (3 a (ii)))	(20,100)	-
	1,879,900	2,500,000

The effective interest rate on treasury bonds during the year ended 31 December 2018 was 13% (2017 – 12%) and that of treasury bills was 10.5% (2017 – 10.3%).

Treasury bonds worth Shs 903 million are pledged as security; Shs 303 million for the Standard Chartered Bank Limited, Shs 300 million Stanbic Bank Limited and Shs 300 million Barclays Bank of Kenya Limited borrowing shown on note 24. Ksh 903 million held as security is not available for use by the group

### 17. OTHER ASSETS

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Staff receivables	10,236	1,706	10,236	1,706
Prepaid expenses	112,416	89,929	112,416	89,929
Interest receivable	1,038,934	540,275	1,038,934	540,275
Deposits and sundry receivables	217,229	268,261	217,229	268,261
Commission receivable	8,669	6,304	-	-
	1,387,484	906,475	1,378,815	900,171
Less: impairment loss allowances (Note (3 a (ii)))	(16,663)	-	(15,111)	-
	<b>1,370,821</b>	<b>906,475</b>	<b>1,363,704</b>	<b>900,171</b>

## 18. INVESTMENTS IN SUBSIDIARY AND ASSOCIATE COMPANY

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
<b>Faulu Advisory Services Limited:</b>	1,029,133	782,985
At 1 January	48,181	45,439
Share of profit for the year	4,632	3,919
Share of taxation (note 12(a))	(1,389)	(1,176)
	51,424	48,181

The reporting date of Faulu Advisory Services Limited is 31 December. The company is incorporated in Kenya which is also its principal place of business. The company holds 25% ownership interest in the associate company. Its principal activity is guaranteeing loans advanced by Faulu Microfinance Bank Limited and training beneficiaries of microfinance loans on business related courses.

The associate company is a private company and there are no quoted market prices available for its shares.

There were no contingent liabilities relating to the company's interest in the associate.

Summarised financial information below represents amounts shown in the associate's unaudited financial statements (adjusted by the company for equity accounting purposes) as of 31 December 2018:

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
Non-current assets	7,696	2,752
Current assets	189,194	251,818
<b>Total assets</b>	<b>196,890</b>	<b>254,570</b>
Current liabilities	(112,915)	(57,290)
Revenue	64,116	61,860
Profit from continuing operations before tax	18,530	15,675
Other comprehensive income	-	-

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 19. DEFERRED TAX (ASSET)/ LIABILITY

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000

The net deferred tax asset is attributable to the following items:

Excess depreciation of capital allowances	68,928	64,151	68,913	64,151
Deferred tax on revaluation surplus	97,724	97,323	97,724	97,323
Bonus provision	(4,507)	(14,553)	(4,507)	(14,553)
Provision for staff leave pay	(7,307)	(7,753)	(7,307)	(7,753)
Impairment loss allowance	(607,961)	-	(607,496)	-
Other provisions	(6,040)	(4,312)	(6,040)	(4,312)
	(461,163)	134,856	(460,713)	134,856

The movements in the deferred tax account during the year were as follows:

At 1 January as previously report	134,856	72,647	134,856	72,647
Deferred tax asset on IFRS 9 transition adjustment	(575,141)	-	(575,141)	-
At 1 January as restated	(440,285)	72,647	(440,285)	72,647
(Credit)/ charge to profit or loss (note 11(a))	(20,878)	52,086	(20,428)	52,086
Charge to equity on revaluation of property	-	10,123	-	10,123
At 31 December	(461,163)	134,856	(460,713)	134,856

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 20. PROPERTY AND EQUIPMENT – GROUP

	Freehold land and buildings	Motor vehicles	Computers and equipment	Electronic office equipment	Durable non-electrical equipment	Work in progress (WIP)	Total
	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000	Shs '000
<b>COST/VALUATION</b>							
At 1 January 2017	355,297	25,308	170,451	152,140	1,509,306	410,588	2,623,090
Additions	-	-	2,436	5,108	26,471	432,635	466,650
Transfer to/(from) WIP	-	-	-	-	25,283	(810,902)	(785,619)
Assets written off	(9,168)	-	(45)	(6,615)	-	-	(15,828)
Revaluation increase	58,871	-	-	-	-	-	58,871
At 31 December 2017	405,000	25,308	172,842	150,633	1,561,060	32,321	2,347,164
Transfers	-	-	-	18,807	54,586	(77,081)	(3,688)
Assets written off	-	-	(15,500)	-	(8,457)	-	(23,957)
Transfer to intangible assets	-	-	-	-	-	(5,331)	(5,331)
At 31 December 2018	405,000	25,308	172,842	150,633	1,561,060	32,321	2,347,164
<b>DEPRECIATION</b>							
At 1 January 2017	7,867	16,717	118,527	70,238	566,213	-	779,562
Charge for the year	1,301	2,148	15,104	19,421	120,469	-	158,433
Elimination on revaluation	(9,168)	-	-	-	-	-	(9,168)
Eliminated on write off	-	-	(125)	(2)	(48)	-	(175)
At 31 December 2017	-	18,865	133,506	89,657	686,634	-	928,662
At 1 January 2018	-	18,865	133,506	89,657	686,634	-	928,662
Charge for the year	6,302	1,611	10,037	15,989	110,480	-	144,419
Eliminated on write off	-	-	(14,901)	-	(5,909)	-	(20,810)
At 31 December 2018	6,302	20,476	128,642	105,646	791,205	-	1,052,271
<b>NET BOOK VALUE</b>							
At 31 December 2018	398,698	4,832	32,813	65,716	831,327	81,276	1,414,662
At 31 December 2017	405,000	6,443	39,336	60,976	874,426	32,321	1,418,502

Land and buildings were revalued at Shs 405,000,000 as at 31 December 2017 by Gimco Limited, registered valuers.

At 31 December 2018, the net book value of the freehold land and building based on original cost was Shs 48,562,884 (2017: Shs 48,564,184).

The Group property and equipment 2018 balance of Shs. 1,414,662,000 (2017: Shs 1,418,502,000) includes the subsidiary's assets with a net book value of Ksh 492,000 (2017: Ksh 419,000).

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 20. PROPERTY AND EQUIPMENT (Continued)

#### Fair value measurement of the company's freehold land and buildings

The company's land and buildings are stated at their revalued amounts, being the fair values at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value measurements of the company's leasehold land and buildings as at 31 December 2017 were performed by Gimco Limited, registered and independent valuers (i.e. not related to the company). Gimco Limited are members of the Institute of Surveyors of Kenya and they have appropriate qualifications and relevant and recent experience in the fair value measurement of properties in the various locations in Kenya.

The fair value of land was determined by reference to market evidence of recent transactions for similar properties. The fair value of the building was based on the cost approach. Under this approach, the fair value is estimated at the cost of erecting a building adjusted to take into account the physical state of the actual structure.

Details of the company's freehold land and buildings and information about fair value hierarchy as at 31 December 2018 are as follows:

	Level 1	Level 2	Level 3	FAIR VALUE As at 31 December
	Shs '000	Shs '000	Shs '000	Shs'000
31 December 2018				
Land	-	350,000	-	350,000
Building	-	-	55,000	55,000
31 December 2017				
Land	-	350,000	-	300,000
Building	-	-	55,000	47,430

There were no transfers between level 1 and level 2 during the year.

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
<b>COST</b>		
At 1 January	1,290,171	564,535
Additions	40,384	13,219
Impairment losses	-	(75,182)
Transfer from WIP (Note 20)	5,331	787,867
At 31 December	1,335,886	1,290,439
<b>AMORTISATION</b>		
At 1 January	269,746	235,662
Charge for the year	188,579	63,272
Elimination on impairment	-	(29,188)
At 31 December	458,325	269,746
<b>NET BOOK VALUE</b>		
<b>At 31 December</b>	<b>877,561</b>	<b>1,020,693</b>

## 22. CASH COLLATERALS HELD

Cash collaterals represent payments made by loanees as security for loans taken. In accordance with the loan agreements, the amounts are refundable upon the successful repayment of loans by loanees and at the time a loanee leaves the loan scheme. The amounts are utilised to cover loans in the event of default.

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
0 - 30 days	500,249	610,935
31 - 90 days	16,491	48,439
91 - 180 days	12,107	26,617
Over 180 days	59,997	25,966
	<b>588,844</b>	<b>711,957</b>

The effective interest rate on the cash collaterals held at 31 December 2018 was nil (2017: nil).

## 23. CUSTOMER DEPOSITS

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Savings account	2,377,332	2,125,957	2,384,728	2,125,957
Fixed account	15,514,240	13,572,783	15,556,240	13,612,189
	<b>17,891,572</b>	<b>15,698,740</b>	<b>17,940,968</b>	<b>15,738,146</b>

The effective interest rate on customer deposits as at 31 December 2018 is 11% (2017: 11%).

## 24. BORROWINGS

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
Loans:		
Standard Chartered Bank Kenya Limited	527,778	694,444
Symbiotics SA	712,774	1,221,222
European Investment Bank	473,200	709,800
Oiko	600,000	750,000
IFAD	157,046	196,308
Barclays Bank of Kenya Limited	959,722	-
Stanbic Bank Kenya Limited	1,000,000	-
	<b>4,430,520</b>	<b>3,571,774</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 24. BORROWINGS (Continued)

GROUP AND BANK		
	2018 Shs '000	2017 Shs '000
<b>The borrowings are repayable as follows:</b>		
Within 1 year	2,430,520	1,059,623
After 1 year within 3 years	2,000,000	2,315,844
After 3 years and within 5 years	-	196,307
	<b>4,430,520</b>	<b>3,571,774</b>

During the year, additional debts were acquired from the following:

Shs 1 billion from Stanbic Bank Limited with interest rate pegged to the Central Bank Rate (CBR) plus a margin of 2.5% repayable in 3 years as a bullet, shs 1 billion from Barclays Bank Limited payable Shs 250 million in 3 year and shs 750 million with a maximum repayment period of 1 year and repayment is through direct monthly debits from the account. They are secured by government securities (note 14) with a value of Shs. 600 million.

The Bank overdraft was held at Standard Chartered Bank Kenya Limited ("SCB") for working capital requirements the SCB overdraft was undrawn with a limit of Shs. 250 million. The interest rates are pegged to the Central Bank Rate (CBR) plus a margin of 2.1%.

IFAD (International Fund for Agricultural Development) loan of Shs 200.2 million ( Current

balance Shs 157million) was granted by the Government of Kenya through Profit Fund in February 2012. It is aimed at promoting financial deepening in rural financial sector by availing access to credit for agricultural related projects. The loan period is 10 years with four-year grace period all-inclusive at an interest rate of 5% on reducing balance.

The effective interest rate on the other borrowings for 2018 and 2017 are as follows: SCB (11.5% ) Symbiotics (12.63%); European Investment Bank (9.2%); Oiko (10%); IFAD (5%).

#### Covenant Breaches

Faulu Microfinance Bank Limited has existing covenants with its lenders which require the Bank to maintain its non-performing loan ("NPL") ratio below the limits of; 8% for Oiko Credit, 10% for European Investment Bank (EIB), 10% for Symbiotics and 9% for Standard Chartered Bank.

Contract Changes done to some of the covenants effective December 2018 included Standard Chartered bank 90 day NPL at 11%, Oiko Credit 30 day NPL to Uncovered Capital Ratio (UCR) of 25%. In addition there was existing covenant waiver approval for EIB 30 day NPL at 15%.

In reference to the above, the Bank's management team took proactive approach in engaging with the various lenders on the quality of the Loan book. Following various engagements, the lenders approved waiver requests and contract amendments that the bank proposed. The bank also adopted a proactive approach of managing the non-performing book, segment target initiatives were put in place and this saw an improvement of the Non-performing loans ratio.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 25. OTHER LIABILITIES

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Accrued expenses	147,263	216,706	141,673	216,705
Staff leave provision	24,355	25,844	24,355	25,844
Bonus provision	39,974	35,000	39,974	35,000
Sundry liabilities	529,331	386,087	521,119	361,396
	<b>740,923</b>	<b>663,637</b>	<b>727,121</b>	<b>638,945</b>

### 26. a ) SHARE CAPITAL

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Authorised: 60,000,000 ordinary shares of Shs 10 each	600,000	600,000	600,000	600,000
Authorised, issued and fully paid: 48,000,000 (2017: 48,000,000) ordinary shares of Shs 10 each	480,000	480,000	480,000	480,000

#### b) Revaluation reserve

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

#### c) Retained earnings

This reserve includes accumulated profits over the years. The retained earnings are distributable to the shareholders

#### c) Statutory reserve

Where impairment losses required by legislation or regulations exceed those computed under International Financial Reporting Standards (IFRS), the excess is recognized as a statutory reserve and accounted for as an appropriation of retained earnings. This reserve is not distributable.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 27. NOTES TO THE STATEMENT OF CASH FLOWS

(a) RECONCILIATION OF PROFIT BEFORE TAXATION TO CASH GENERATED FROM OPERATIONS

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
Profit before taxation	287,360	177,996	273,615	163,486
Adjustment for:				
Depreciation	144,419	158,363	144,297	158,363
Amortisation of computer software	188,579	63,272	188,579	63,272
Write off of assets	3,147	6,485	3,147	6,485
Share of associate company's profit	(4,632)	(3,919)	(4,632)	(3,919)
Impairment of intangible asset	-	45,994	-	45,994
	618,873	448,191	605,006	433,681

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 27. NOTES TO THE STATEMENT OF CASH FLOWS (Continued)

#### (a) Reconciliation of profit before taxation to cash generated from operations (Continued)

	GROUP		BANK	
	2018 Shs '000	2017 Shs '000	2018 Shs '000	2018 Shs '000
<b>Working capital changes:</b>				
Increase in loans to customers	23,140	997,085	23,140	997,085
IFRS 9 transition adjustment (Note (e))	(1,917,136)	-	(1,917,136)	-
Prior year adjustment relating to prior years' suspended interest (Note 28)	140,086	-	140,086	-
Net movement in related party balances	30,684	(70,608)	29,164	(27,743)
(Decrease) / increase in other assets	(464,346)	450,194	(463,533)	429,031
Increase in cash collaterals held	(123,113)	(268,845)	(123,113)	(268,845)
Increase/ (decrease) in customer deposits	2,199,698	(666,684)	2,202,822	(652,278)
Increase/(decrease) in other liabilities	88,289	(546,113)	88,176	(538,792)
Decrease/ (increase) in government securities	620,100	(750,000)	620,100	(750,000)
(Decrease) / increase in cash reserve ratio-CBK	(246,114)	233,119	(246,114)	233,119
	<b>351,288</b>	<b>(621,852)</b>	<b>353,592</b>	<b>(578,423)</b>

#### (b) ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS

Cash and bank balances	1,027,193	419,485	1,027,193	419,485
Short term deposits with banks (note 13)	1,963,446	985,000	1,963,446	985,000
	<b>2,990,639</b>	<b>1,404,485</b>	<b>2,990,639</b>	<b>1,404,485</b>

#### (c) MOVEMENT IN BORROWINGS

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
At 1 January	3,571,774	4,386,811
Received in the year	2,551,174	1,200,000
Paid in the year	(1,692,428)	(2,015,037)
	<b>4,430,520</b>	<b>3,571,774</b>

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 28. PRIOR YEAR ADJUSTMENT

The prior year adjustment relates to interest income on non-performing loans that was previously suspended in line with Central Bank of Kenya (CBK) requirements. IFRS 9 requirements on interest income on non-performing loans have now been applied.

The effect of this adjustment is summarised below:

	Sh'000
<b>Liabilities</b>	
Other liabilities	140,086
<b>Reserves</b>	
Retained earnings	(140,086)

### 29. RELATED PARTY TRANSACTIONS

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

Old Mutual Holdings Limited is the principal shareholder of Faulu Microfinance Bank Limited.

Old Mutual Holdings Limited, Faulu Kenya Trust and Food for the Hungry Association (FH) are shareholders in Faulu Microfinance Bank Limited.

Faulu Microfinance Bank Limited, Faulu Advisory Services Limited and Faulu Kenya Trust are also related by virtue of common control.

Related company balances:

	GROUP		BANK	
	2018	2017	2018	2017
	Shs	Shs	Shs	Shs
	'000	'000	'000	'000

#### (a) From related parties:

UAP Holdings Limited	41,514	54,194	41,514	54,194
Faulu MFB Insurance Agency Limited	-	-	12,523	-
	<b>41,514</b>	<b>54,194</b>	<b>54,037</b>	<b>54,194</b>

#### (b) Due to related parties:

UAP Insurance Limited	(16,472)	-	(16,472)	-
Old Mutual Life Assurance Limited	(57,132)	(44,597)	(57,132)	(44,597)
	<b>(73,604)</b>	<b>(44,597)</b>	<b>(73,604)</b>	<b>(44,597)</b>

Transactions with related parties are at arm's length in the normal course of business, and on terms and conditions similar to those applicable to other customers. Amounts not settled as at the end of each reporting period in respect of transactions with related parties are disclosed under note 29.

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 29. RELATED PARTY TRANSACTIONS (Continued)

Directors and companies associated to directors make deposits in the Bank.

The advances to staff and directors are secured by property and are repayable in less than 25 years. Minimal impairment losses have been recorded against balances outstanding during the period as per IFRS 9 provisioning methodology.

The staff and directors are currently in-service for the bank and recoveries are made directly through payroll.

Advances to customers at 31 December 2018 include advances and loans to staff and directors as indicated below:

BANK		
	2018 Shs '000	2017 Shs '000
<b>(a) Advances to customers:</b>		
- Directors	24,006	14,452
- Employees	232,611	333,416
	<b>256,617</b>	<b>347,868</b>
<b>b) Customer deposits:</b>		
- Directors	98,859	83,360
- Employees	234,978	180,112
	<b>333,837</b>	<b>263,472</b>
<b>c) Related party transactions</b>		
Group recharges from Old Mutual Holdings Limited	<b>84,070</b>	<b>44,597</b>

#### Key management compensation

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

GROUP AND BANK		
	2018 Shs '000	2017 Shs '000
Salaries and other benefits	118,006	128,426
Directors' remuneration Fees for services as directors	13,490	15,137

GROUP AND BANK		
Average Number of Employees	2018 number	2017 number
Senior management	11	13
Number of staff	531	635
Total employees	<b>542</b>	<b>648</b>

### 30. CONTINGENT LIABILITIES

The company is a defendant in various legal suits with an estimated liability of Shs 94 million (2017 - Shs 122 million). In the opinion of the directors, after obtaining appropriate legal advice, the outcome of such actions will not give rise to any significant loss.

### 31. CAPITAL COMMITMENTS

The company had commitments worth Shs 178 million. (2017: Shs 800 million for IT hardware infrastructure upgrade).

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 32. FUTURE RENTAL COMMITMENTS UNDER OPERATING LEASES

The future lease payments in respect of obligations under operating leases are as follows:

	GROUP AND BANK	
	2018 Shs '000	2017 Shs '000
Within one year	3,549	35,862
Between one and five years	369,897	368,490
Over 5 years	77,269	188,444
	<b>450,715</b>	<b>592,796</b>

The lease rental expense incurred during the year in respect of company offices rental amounted to Shs. 173,711,349 compared to Shs. 163,135,859 in 2017.

### 33. SHAREHOLDING STRUCTURE

The shareholding structure is analysed as follows:

	No of Shares	% of Holding
Old Mutual Holdings Limited	32,160,000	67%
Micsha Capital Limited	3,840,000	8%
Food for the Hungry Association	4,800,000	10%
The Faulu Kenya Trust	7,200,000	15%
	<b>48,000,000</b>	<b>100%</b>

### 34. OPERATING SEGMENTS INFORMATION

The entity's business is not organised on the basis of differences in related products and services or differences in geographical areas of operation.

### 35. ULTIMATE AND IMMEDIATE HOLDING COMPANY

The immediate holding and parent company is Old Mutual Holdings Limited, a company incorporated and domiciled in Kenya under the Companies Act. The ultimate holding company is Old Mutual Plc. which is incorporated in United Kingdom.

### 36. INCORPORATION

Faulu Microfinance Bank Limited is domiciled and incorporated in Kenya under the Companies Act.

### 37. EVENTS SUBSEQUENT TO YEAR END

There are no significant events after reporting period which have been reported in these financial statements

### 38. CURRENCY

These financial statements are presented in Kenya Shillings thousands (Kshs'000).

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