Bank of China Limited, Johannesburg Branch

Annual Financial Statements

For the year ended 31 December 2018

Annual Audited Financial Statements

For the year ended 31 December 2018

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The Branch management's approval of the annual financial statements

The Branch management is responsible for monitoring the preparation of and the integrity and the objectivity of the annual financial statements and related information included in these annual financial statements.

In order for the Branch management to discharge its responsibilities, management has developed and continues to maintain a system of internal controls. The Branch management has ultimate responsibility for the system of internal controls and reviews its operation, primarily through various risk-monitoring committees.

The internal controls include a risk-based system of internal accounting and administrative controls designed to provide reasonable but not absolute assurance that assets are safeguarded and that transactions are executed and recorded in accordance with generally accepted business practices and the Branch's policies and procedures. These controls are implemented by trained, skilled personnel with an appropriate segregation of duties, are monitored by management and include a comprehensive budgeting and reporting system operating within strict deadlines and an appropriate control framework.

The annual financial statements are prepared in accordance with International Financial Reporting Standards and in the manner required by the Companies Act No 71 of 2008 South Africa and incorporate responsible disclosure in line with the accounting policy of the Branch. The annual financial statements are based on appropriate accounting policies consistently applied and supported by reasonable and prudent judgments and estimates.

The Branch management believes that the Branch will be a going concern in the year ahead. For this reason they continue to adopt the going concern basis in preparing the Branch's annual financial statements.

The annual financial statements for the year ended 31 December 2018 set out on pages 10 to 87 have been approved by the Branch management on 15 April 2019 and are signed on its behalf by:

Jun Cheng
Chief Executive Officer
Bank of China Johannesburg Branch
Date: 2019-04-15

Quanlei Liu
Senior Executive Vice President
Bank of China Johannesburg Branch
Date: 2019-04-15

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INDEPENDENT AUDITORS REPORT TO THE DIRECTORS OF BANK OF CHINA LIMITED

To the directors of Bank of China Limited

Opinion

We have audited the financial statements of Bank of China Limited, Johannesburg branch ("the Branch") set out on pages 10 to 87, which comprise the statement of financial position as at 31 December 2018 and the statement of comprehensive income, the statement of changes in equity and the statement 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 financial statements present fairly, in all material respects, the financial position of Bank of China Limited, Johannesburg branch as at 31 December 2018, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Branch in accordance with the Independent Regulatory Board for Auditors Code of Professional Conduct for Registered Auditors (IRBA Code), the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA code) and other independence requirements applicable to performing audits of the Branch. We have fulfilled our other ethical responsibilities in accordance with the IRBA Code, IESBA Code, and in accordance with other ethical requirements applicable to performing the audit of the Branch. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

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Key Audit Matter	How the matter was addressed in the audit
Credit Impairments of Loans and Advances to Banks and Customers IFRS 9: Financial instruments ('IFRS 9') became effective 1 January 2018. The Branch has applied a modified retrospective approach, with an adjustment to retained earnings, accumulated profit and fair value reserves. Comparatives have not been restated. Loans and advances to banks and customers makes up approximately 72% of the total assets of the Branch. The expected credit losses ('ECL') used in determining the credit impairment of loans and advances represent a subjective area due to the level of judgement applied by management in determining these provisions. The model used for calculating expected credit losses is complex and includes inputs from multiple sources. The inputs used in the ECL calculations such as the Probability of Default ("PD") and loss given default ("LGD") involve significant judgement and estimation. The disclosure related to credit impairments of loans and advances to banks and customers are disclosed in the following notes of the Annual Financial Statements: ▪ Note 6: Credit Impairments ▪ Note 28.4: Credit Risk	We obtained an understanding of management's process over credit origination and monitoring and tested the relevant key controls identified within these processes. We evaluated the IFRS 9 accounting policies and assessed the ECL methodologies applied and compared these to the requirements in this standard. We assessed the adequacy of the 1 January 2018 retrospective adjustment to accumulated profit and fair value reserves on the application of IFRS 9, the 31 December 2018 closing provision and the movement in ECL over the period. We assessed the design and implementation of the ECL model, the key assumptions including Staging classification or Significant Increase in Credit Risk (SICR), Probability of Default ('PD') and Loss Given Default ('LGD'); and mathematical accuracy of the ECL model. With the support of an EY internal expert, we evaluated the inputs including the PD, LGD by comparing these to industry and localized benchmarks. We completed a full recalculation of the ECL provision at year end. We performed a sensitivity analysis over the recalculated ECL provision to management's ECL. We compared the Exposure at Default ('EAD') to the gross amount of loans and advances. For a sample of customers, we obtained external confirmations of the gross amount of the loan and advances and completed substantive analytical procedures over interest. **Disclosures** We have assessed the adequacy and completeness of the qualitative and quantitative disclosure requirements as required by IFRS 9.

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Other Information

Management is responsible for the other information. The other information comprises the information included in the Branch management's approval of the annual financial statements report and Branch management report, but does not include the financial statements and our auditor's report thereon.
Our opinion on the financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.
In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information 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 Management for the Financial Statements

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

In preparing the financial statements, management are responsible for assessing the Branch'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 Branch or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The

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- 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 Branch'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 Branch's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Branch to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

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Report on Other Legal and Regulatory Requirements

In terms of the IRBA Rule published in Government Gazette Number 39475 dated 4 December 2015, we report that Ernst & Young Inc. has been the auditor of Bank of China Limited, Johannesburg Branch for six (6) years.

Ernst + Young Inc.

Ernst & Young Inc.
Director: Kubenderan Moodley
Chartered Accountant (SA)
Registered Auditor

15 April 2019

102 Rivonia Road
Sandton

The Branch management's report

The Branch management have pleasure in presenting their report for the year ended 31 December 2018.

Bank of China Limited, Johannesburg Branch has been registered as an external company in terms of the South African Companies Act 71 of 2008. As it is a foreign company, it is not subject to Chapter 3 of the aforementioned Act and therefore is not required to prepare and submit audited annual financial statements to the Commissioner.

Registered office	*Postal address*
14-16th Floor	PO Box 782616
Alice Lane Tower	Sandton
15 Alice Lane	Johannesburg
Sandton	2146
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Telephone	Telefax
(011) 520-9600	(011) 783-2336

Board of Directors – Bank of China Limited

A full register of directors can be inspected at the Bank of China Limited, Johannesburg Branch's offices.
The Members of the Board of Directors of Bank of China Limited in office during the year and as at the date of this report are:

CHEN Siqing	Chairman	
ZHANG Xiangdong	Non-Executive Director	Resigned, effective 2018/06/29
Nout Wellink	Independent Non-Executive Director	Term expired, effective 2018/06/29
LU Zhengfei	Independent Non-Executive Director	
LEUNG Cheuk Yan	Independent Non-Executive Director	
LI Jucai	Non-executive director	
WANG Changyun	Independent Non-Executive Director	
REN Deqi	Executive Director	Resigned, effective 2018/06/12
GAO Yingxin	Executive Director	Resigned, effective 2018/01/24
XIAO Lihong	Non-executive director	
WANG Xiaoya	Non-executive director	
ZHAO Jie	Non-executive director	
CHAO Angela	Independent Director	
JIANG Guohua	Non-executive director	Appointed, effective 2018/12/14
LIAO Qiang	Non-executive director	Appointed, effective 2018/09/29
LIU Lianghe	Non-executive director	Appointed, effective 2018/10/11

All of the above directors are citizens of the People's Republic of China, except for Mr. Nout Wellink who is a citizen of the Netherlands and Angela Chao from USA.

Secretary

The company secretary is Mr Scotty Pillay.

Holding company

The ultimate holding company of the Branch is Bank of China Limited, a company incorporated in the People's Republic of China.

Auditors

Ernst & Young Incorporated was appointed as external auditors as from the financial year end 31 December 2013 in accordance with section 90(2) of the Companies Act, 2008.

Business and postal address:

Ernst & Young Incorporated	Private Bag X14
102 Rivonia Road	Sandton
Sandton	2146
2194	

Nature of business

The principal business of the Branch is that of corporate banking comprising primarily corporate lending and trade finance facilities.

Branch Capital

The Branch capital is R5, 800 million (31 December 2017: R3, 300 million).

Financial results

Total comprehensive income of R598 million (31 December 2017: R533 million) has been reported for the year ended 31 December 2018.

Material subsequent events

No material subsequent events occurred between the financial year end of the Branch and the date of this report.

Going Concern

The Branch management believes that the Branch will be a going concern in the year ahead. For this reason, the going concern basis is adopted in preparing the Branch's annual financial statements.

Statement of comprehensive income for the year ended 31 December 2018

In thousands of ZAR	Note	2018	2017
Interest income	2	2,492,548	2,226,579
Interest expense	2	(1,982,700)	(1,718,355)
Net interest income		509,848	508,224
Fee and commission income	3	120,043	118,712
Fee and commission expense	3	(12,120)	(21,678)
Net fee and commission income		107,923	97,034
Other operating income	4	476,538	311,902
Operating income		1,094,309	917,160
Personnel expenses	5	(151,605)	(146,148)
Other operating expenses	5	(64,976)	(80,023)
Operating expenses		(216,581)	(226,171)
Net ECL impairment expense/ income on financial assets	6	(39,802)	27,021
Profit before income tax		837,926	718,010
Income tax expense	7	(254,733)	(201,725)
Profit for the year		583,193	516,285
Other comprehensive income			
Items that may be reclassified to Profit or Loss			
Credit impairments	22	(4,003)	-
Income tax relating to components of other comprehensive income	22	(2,935)	(6,334)
Gain/(Loss) on Fair Value through Other comprehensive Income Instruments		21,247	22,621
Re-classifications of gains Fair Value through Other comprehensive Income Instruments to profit or loss		780	-
Other comprehensive Income, net of tax		15,089	16,287
Total comprehensive income for the year		598,282	532,572

Statement of financial position as at 31 December 2018

In thousands of ZAR	Note	2018	2017
Assets			
Non-current assets			
Property, plant and equipment	13	**16,764**	18,950
Intangible asset	14	**170**	371
Deferred income tax	15	**128,041**	41,143
Derivative financial instruments	9	**92,454**	162,427
Loans and advances to banks	10	**5,098,168**	3,669,044
Loans and advances to customers	11	**12,891,164**	14,282,054
Investment securities	12	**3,579,899**	2,433,166
Current assets			
Cash and cash equivalents	8	**5,001,118**	5,481,312
Derivative financial instruments	9	**7,828**	470,843
Loans and advances to banks	10	**1,840,013**	2,080,113
Loans and advances to customers	11	**11,972,296**	11,943,896
Current income tax assets	26.1	**64,202**	63,459
Investment securities	12	**2,928,226**	2,940,352
Other assets	16	**768,891**	757,867
Total assets		**44,389,234**	44,344,997
Liabilities			
Non-current liabilities			
Deposits from customers	18	**4,864**	3,034
Deposits from banks	17	**5,758,123**	8,929,005
Commercial paper	25	**3,589,187**	4,703,794
Current liabilities			
Deposits from customers	18	**14,065,449**	15,322,926
Derivative financial instruments	9	**130,525**	223,631
Deposits from banks	17	**10,587,058**	7,410,976
Provisions	19	**77,134**	56,927
Commercial paper	25	**2,183,307**	2,629,571
Other liabilities	20	**211,905**	174,041
Total liabilities		**36,607,552**	39,453,905
Equity			
Branch capital	21	**5,800,000**	3,300,000
Accumulated profit		**1,929,633**	1,573,523
Fair value reserves	22	**52,049**	17,569
Total equity		**7,781,682**	4,891,092
Total liabilities and equity		**44,389,234**	44,344,997

Statement of changes in equity for the year ended 31 December 2018

In thousands of ZAR	Note	Branch capital	Accumulated profit/(loss)	Fair value reserves	Total
Balance at 1 January 2017		3,300,000	1,057,238	1,282	4,358,520
Total comprehensive income		-	516,285	16,287	532,572
Profit for the year		-	516,285	-	516,285
Other comprehensive income	22	-	-	16,287	16,287
Balance at 31 December 2017		3,300,000	1,573,523	17,569	4,891,092
Impact upon adoption of IFRS 9		-	(227,084)	19,391	(207,693)
Balance at 31 December 2017 Adjusted		3,300,000	1,346,439	36,960	4,683,399
Capital injection		**2,500,000**	-	-	**2,500,000**
Total comprehensive income		-	**583,193**	**15,089**	**598,282**
Profit for the year		-	**583,193**	-	**583,193**
Other comprehensive income	22	-	-	**15,089**	**15,089**
Balance at 31 December 2018		**5,800,000**	**1,929,632**	**52,049**	**7,781,681**

Statement of cash flows for the year ended 31 December 2018

In thousands of ZAR	Note	2018	2017
Cash flows from operating activities			
Profit before taxation		837,926	718,010
Adjustments for non-cash flow items:			
Interest income on investment securities	2&12	(458,195)	(381,403)
Interest expense on commercial paper	2	399,455	486,295
Expected Credit loss/(gain) on financial assets	6	39,802	(27,021)
Other non-cash income items		(2,141)	(626)
Depreciation and amortisation	13&14	6,764	7,336
Fair value gain/(loss) on derivatives	4&9	439,882	(323,533)
Increase in operating lease accrual	20	389	663
Decrease/(Increase) in provisions (excl. impairment)	19	(206)	22,815
		1,263,676	502,536
Change in working capital:			
Increase in loans and advances (excl. impairment)	10&11	(142,646)	(5,390,439)
(Decrease)/Increase in deposits	17&18	(1,250,446)	7,242,090
Increase in other assets	16	(11,025)	(254,038)
Increase/(Decrease) in other liabilities	20	37,475	(13,537)
Cash generated from operations		(102,966)	2,086,612
Income tax paid	26.1	(258,141)	(204,658)
Net cash generated from operating activities		(361,107)	1,881,954
Cash flows from investing activities			
Purchase of investment securities	12	(4,610,499)	(4,695,297)
Sale of investment securities	12	3,554,704	3,412,484
Coupons received from investment securities	12	401,410	407,021
Purchase of property and equipment	13	(4,376)	(1,313)
Purchase of intangible assets	14	-	(401)
Net cash generated from investing activities		(658,761)	(877,506)
Cash flows from financing activities			
Proceeds from issue of commercial paper	25	723,000	6,573,793
Repayment of commercial paper	25	(2,229,608)	(2,856,000)
Coupon interest paid on commercial paper	25	(453,718)	(434,644)
Branch capital		2,500,000	-
Net cash used in financing activities		539,674	3,283,149
Net (decrease)/increase in cash and cash equivalents		(480,194)	4,287,597
Cash and cash equivalents at the beginning of the year		5,481,312	1,193,715
Cash and cash equivalents at the end of the year		5,001,118	5,481,312

Total interest paid during the year is R2 049 510 and the total interest received is R2 423 884.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies

The significant accounting policies applied in the preparation of the annual financial statements are set out below. The accounting policies set out below have been applied consistently to all periods presented in these financial statements, except where otherwise indicated.

1.1 Statement of compliance

The annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations as issued by the International Accounting Standards Board (IASB) and in a manner required by the Companies Act No 71 of 2008, of South Africa, where applicable.

1.2 Basis of preparation

The annual financial statements are presented in South African Rand (ZAR) rounded to the nearest thousand, and have been prepared under the historical cost convention, except for Financial Assets measured at Fair Value through OCI, investment securities and liabilities (including derivative instruments) that have been measured at fair value through profit and loss. The annual financial statements provide comparative information in respect of the previous period.

The preparation of the annual financial statements is in conformity with IFRS which requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that is not readily apparent from other sources. Actual results may differ from these estimates.

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

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 28 as it pertains to the determination of amounts at fair value.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.2 Basis of preparation(Continued)

Significant accounting judgments, estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Branch bases its assumptions and estimates on parameters available when the annual financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances beyond the control of the Branch. Such changes are reflected in the carrying amount when they occur.

Impairment losses on loans and advances

The Branch reviews its loans and advances individually at each statement of financial position date to assess whether an Expected Credit Loss should be recorded in the profit or loss statement. In particular, management's judgment is required in the estimation of the amount and timing of future cash flows when determining the Expected Credit loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance. In determining the provision, certain data is considered, such as collateral pledged by the customer, and the credit grading of these customers which in turn drives the probability of default on the exposure. Credit gradings are obtained from the Branch's CCMS based on an individual client review process. The Branch's classifies the credit rating according to the probability that debtors will default in the next year. The Bank employs the PD-based statistical models to calculate the customers' Probability of Default (PD) in the next year, and determine the customers' credit rating accordingly. Refer to note 28.4 for a detailed description of the Branch's credit risk management.

The adoption of IFRS 9 has fundamentally changed the Branch's accounting for loan impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Branch to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments (refer to 1.12) and financial guarantee contracts (refer to 1.13). The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. The impairments for the Branch are determined by both qualitative and quantitative methods.

In accordance with IFRS 9 requirements, based on the change in credit quality since the initial recognition of the financial instruments, ECL under different periods of time should be recognised, and the new standard outlines a "three-stage" model to calculate the ECL as follows:

(1) Stage 1: The financial instruments without significant increases in credit risk after initial recognition apply the Stage I Model of the ECL to calculate its expected credit loss allowance at an amount equivalent to the ECL of the financial instrument for the next 12 months;

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

(2) Stage 2: Financial instruments that have had a significant increase in credit risk since initial recognition but have no objective evidence of expected credit losses apply the Stage II Model of the ECL, with their expected credit loss provision measured at an amount equivalent to the ECL over the lifetime of the financial instruments;

(3) Stage 3: Financial assets with objective evidence of impairment at the balance sheet date apply the Stage III Model of ECL, with their expected credit loss provisions measured at the amount equivalent to the ECL for the lifetime of the financial instruments.

1.3 Changes in accounting policies and disclosures

The Branch applied IFRS 9 for the first time on 1 January 2018. A transition adjustment has been processed to account for the impact of adopting IFRS 9 as at 1 January 2018. Comparatives have not been restated. The nature and effect of the changes as a result of adoption of these new accounting standards are described in notes 1.3.1.

New and amended standards and interpretations

Several other amendments and interpretations apply for the first time in 2018, but do not have an impact on the financial statements of the Branch. The Branch has not early adopted any standards, interpretations or amendments that have been issued, but are not yet effective.

1.3.1 IFRS 15 Revenue from Contracts with Customers

IFRS 15 supersedes IAS 11 Construction Contracts, IAS 18 Revenue and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

IFRS 15 requires entities to exercise judgment, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. In addition, the standard requires extensive disclosures.

The principles in IFRS 15 will be applied using a five-step model:

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

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.3 Changes in accounting policies and disclosures (Continued)

The standard requires entities to exercise judgment, taking into consideration of all the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies how to account for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

Effective date and transition

The standard applies to annual periods beginning on or after 1 January 2018, although early application is permitted retrospective application will be required. The Branch expects to adopt the standard for the first time in their 2018 annual Financial statements where modified retrospective transition method will be applied.

Impact

The Branch has assessed the impact of this standard and implementation of the new standard affects the fees and commission. The Impact of IFRS15 on the fees and commissions are discussed further in Note 1.9.

1.3.2 IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Branch has not restated comparative information for 2017 for financial Instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is reported under IAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of IFRS 9 have been adjusted and recognised directly in retained earnings as of 1 January 2018 and are disclosed in Notes 1.3.1, 6, 10 and 11. The Branch does not apply Hedge Accounting and therefore this is not applicable.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.3 Changes in accounting policies and disclosures (Continued)

The effect on adoption of IFRS 9 is as follows:

	2017	IFRS 9 Adjustment	01 Jan 2018
In thousands of Rands	R	R	R
As at 31 December 2017			
Assets			
Deferred Tax Income Asset	41,143	89,148	**130,291**
Current Income tax assets	63,459	(1,441)	**62,018**
Loans and advances to banks	5,749,157	1,849	**5,751,006**
Loans and advances to customers	26,225,950	(231,581)	**25,994,369**
Investments securities	5,373,518	-	**5,373,518**
Cash and cash equivalents	5,481,312	(181)	**5,481,131**
Liabilities			
Non-Current Liabilities			
Other liabilities	230,968	65,486	**296,454**
Equity			
Derivative financial instruments	223,631	-	**223,631**
Accumulated profit	1,573,523	(231,156)	**1,342,367**
Fair value reserves	17,569	23,464	**41,033**

Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial assets (fair value through profit or loss (FVPL), available for sale (AFS), held to maturity (HTM), loans and receivables have been replaced by:
- Debt instruments at amortised cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses of profit or loss on derecognition
- Financial assets FVPL

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.3. Changes in accounting policies and disclosures (Continued)

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

There is no effect on the shareholders equity as a result of the re-classification adjustments. The most significant classifications are the re-classification of the Loans and advances as well as Cash and cash equivalents from Loans and Receivables to Amortised Cost and Available for Sale to Fair Value through Other Comprehensive Income. The Branch's classification of its financial assets and liabilities will be explained in detail in Note 1.7.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.3. Changes in accounting policies and disclosures

Changes to the ECL calculation

Set out below is the reconciliation of the ending Expected Credit Loss allowances in accordance with IAS 39 to the opening loss allowances determined in accordance with IFRS 9:

In thousands of Rands	Impairment for Allowances under IAS 39 or Provision under IAS 37	Reclassification impact	Additional IFRS 9 ECL Allowance	**ECL Allowance under IFRS 9**
	R	R	R	**R**
Loans and advances at Amortised Cost				
Loans and advances to Banks	11,739	-	(1, 669)	**10,070**
Loans and Advances to Customers	639,049	-	231,581	**870,630**
Available for Sale Investment /Financial Assets At Fair Value through Other Comprehensive Income	-	-	19,391	**19,391**
Total On-Balance Sheet	650,788	-	249,303	**900,091**
Provision for undrawn contractually committed facilities and guarantee contracts	-	-	65,486	**65,486**
Total ECL and Provision	650,788	-	314,789	**965,577**

Details of the Branch's impairment method are disclosed in Note 1.7.

IFRS 7

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Branch has adopted it, together with IFRS 9, for the year beginning 1 January 2018. Changes include transition disclosures as shown in note 6, detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are set out in Note 6. Reconciliations from opening to closing ECL allowances are presented in Notes 6 as well as the table on Note 1.3.1.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.4. Property and equipment

Property and equipment is held at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditure that is directly attributable to the acquisition of the items. Where property and equipment comprises major components with different useful lives, the components are accounted for as separate items of property and equipment.

Depreciation is provided on a straight-line basis over the estimated useful lives of each part of an item of the property and equipment. The current estimates for this purpose are:

Computer equipment include IT equipment, main frame, servers and communication systems. Office equipment includes telephone equipment, TV equipment, office furniture and office fittings. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Motor vehicles	5 years
Computer equipment	
- Main frame/Servers/Communication systems	3 years
Office equipment	
- Telephone equipment	5 years
- TV equipment	6 years
- Office furniture	6 years
- Office fittings	5 years

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

Subsequent expenditure relating to property and equipment is capitalised when it is probable that future economic benefits from the use of assets will flow to the Branch and its cost can be measured reliably. All other subsequent expenditure that does not meet the recognition criteria is recognised as an expense in the period in which it is incurred.

Surpluses or deficits on the disposal of property and equipment are recognised in profit and loss in the period in which they occur. The surplus or deficit is the difference between the net disposal proceeds and the carrying amount of the assets.

The carrying amount of an item of property and equipment shall be derecognised:
(a) on disposal; or
(b) when no future economic benefits are expected from its use or disposal.

1.5 Intangible assets

Intangible assets are stated at historical cost less accumulated amortisation and accumulated impairment losses. Amortisation is provided on a straight line basis on the cost of the assets, over their expected useful lives.

The current estimate for this purpose is:

Computer software	2 years

The useful life and amortisation method are reviewed annually.

An intangible asset shall be derecognised:
(a) on disposal; or
(b) when no future economic benefits are expected from its use or disposal.

Any gains or losses arising from the derecognition of the asset is recognised in profit or loss.

1.6 Taxation

Current tax

Current tax is the expected tax payable or the tax recoverable from the taxation authorities for the year. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects that uncertainty related to income taxes, if any. It is measured using tax rates enacted or substantively enacted at the reporting date.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.6 Taxation (Continued)

Deferred tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of an asset or liability in a transaction that is a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- In respect of taxable temporary differences associated with investments in subsidiaries and associates, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not be reversed in the foreseeable future.

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

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- In respect of deductible temporary differences, deferred tax assets are recognised only to the extent that is it probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date. Assets remeasured through OCI have a corresponding deferred tax entry through OCI. Deferred tax items are recognised in correlation to the underlying transaction either in OCI or directly in equity.

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

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments

1.7.1 Initial Recognition and measurement

The Branch recognises a financial asset or a financial liability when, and only when, it becomes a party to the contractual provisions of the instrument. An arm's length regular way purchase or sale of financial assets is recognised on the trade date at which the Branch commits to purchase or sell the asset.

When a financial asset or financial liability is recognised initially, the Branch measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

1.7.2 Subsequent measurement

For the purposes of subsequent measurement, the Branch classifies financial assets and financial liabilities into the categories set out below:

IAS 39- Financial Instrument: Recognition and Measurement

Cash and cash equivalents

Cash and cash equivalents are measured at amortised cost. Cash and cash equivalents denominated in foreign currencies are translated based on the relevant exchange rates at the reporting date. Bank overdrafts that are repayable on demand and form an integral part of cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

Financial assets and liabilities at fair value through profit and loss

Derivatives are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as other operating income in the statement of profit or loss.

Loans and receivables

This category is the most relevant to the Branch. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in interest income in profit or loss. Short-term loans and receivables balances for which discounting is not material are not discounted. The losses arising from impairment are recognised in profit or loss in net impairment movements on financial assets.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

Available for sale (AFS) financial investments

Available for sale financial investments comprise of debt securities classified as investment securities in the statement of financial position. Investment securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in market conditions. After initial measurement, available-for-sale financial investments are subsequently measured at fair value which is calculated by reference to stock exchange quoted selling prices at the close of business on the reporting date, with unrealised gains or losses recognised in other comprehensive income and credited in the fair value reserve until the investment is derecognised, at which time the cumulative gain or loss is recognised in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the available-for-sale reserve to profit or loss. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the effective interest rate method.

Loans and advances to banks, customers, investment Securities at amortised cost

Before 1 January 2018, loans and advances to banks and customers, included non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those:

- That the Branch intended to sell immediately or in the near term
- That the Branch, upon initial recognition, designated as at FVPL or as available-for-sale

Financial liabilities

The Branch classifies the financial liabilities at either fair value through profit or loss or amortised cost. Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Financial liabilities are classified as held-for-trading if they are incurred for the purpose of repurchasing in the near term.

Gains or losses on liabilities held for trading are recognised in profit or loss. The Branch has not designated any financial liability as at fair value through profit or loss. Interest-bearing loans borrowings (including commercial paper), deposits and other liabilities are subsequently measured at amortised cost using the effective interest rate method.

IFRS 9 Financial Instruments

Financial Assets

From 1 January 2018, the Branch classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost
- FVOCI
- FVPL

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial instruments (Continued)

Business model assessment

The key factors which are taken into account when the Branch determines a business model of financial assets mainly includes: how the asset's contractual cash flow was collected in the past, how the performance of the financial assets held within that business model are evaluated and reported to key management personnel and how managers of the portfolio of financial assets are compensated.

The SPPI test

Assessing the cash flow characteristics is to identify whether the cash flow is solely payments of principal and interest on the outstanding principal. If the financial assets are held within a business model whose objective is achieved by collecting cash flows or by both collecting contractual cash flows and selling financial assets, the Branch will assess whether financial instrument's cash flows are solely payments of principal and outstanding interest on the principal amount. When making the assessment, the Branch takes into account whether the contractual cash flows are consistent with the basic lending arrangements. If the terms of the contract trigger a risk or exposure fluctuation that is inconsistent with the basic lending arrangements, the relevant financial assets is classified as being measured at fair value through profit or loss.

The Branch classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in net trading income. Interest and dividend income or expense is recorded in net trading income according to the terms of the contract, or when the right to payment has been established.

Included in all classifications as amortised cost are debt securities and loans to banks and customer that have been acquired principally for the purpose of selling or repurchasing in the near term.

Debt instruments at FVOCI (Policy applicable from 1 January 2018)

The Branch applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

These instruments largely comprise assets that had previously been classified as financial investments available-for-sale under IAS 39.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost as explained in Note 28. The ECL calculation for Debt instruments at FVOCI is explained in Note 6. Where the Branch holds more than one investment in the same security, they are deemed to be disposed of on a first-in first-out basis. On de-recognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

Reclassification of financial assets and liabilities

The Branch did not reclassify any of its financial assets or liabilities in 2018 other than the IFRS 9 transitional reclassifications which did not result in measurement changes.

Financial Liabilities

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

Modification

Modification that results in de-recognition

The following factors are considered when determining whether modification results in de-recognition.

- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty

The borrower is granted arrangements due to financial difficulties of the borrower in terms of economic condition or contract, which would not be granted in any other cases.

- The borrower will probably become insolvent or undertake a financial restructure.
- Disappearance of an active market for the financial assets due to financial difficulties of an issuing party or borrower.
- Financial assets purchased or originated at a big discount which reflects previous credit loss.
- The debtor has any of the principal, advances, interest or investments in corporate bonds of the Branch overdue for more than 90 days.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

Modification that do not result in de-recognition

When the Branch amends or re-negotiates contracts with counterparty which can lead to changes of cash flow rather than termination of financial assets, the balance of the financial assets will be recalculated using re-negotiated or amended contractual cash flow. If the modification does not result in cash flows that are substantially different, the modification does not result in de-recognition. The Branch determines whether the credit risk increased significantly by comparing default risk on the reporting date based on amended contractual articles and the initial recognition date based on the original contract, provided the asset was not derecognized when the contract was amended.

Derecognition

The Branch derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded.

Based on the change in cash flows discounted at the original EIR, the Branch records a modification gain or loss, to the extent that an Expected Credit loss has not already been recorded.

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the financial asset have expired. The Branch also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition.

The Branch has transferred the financial asset if, and only if, either:

- The Branch has transferred its contractual rights to receive cash flows from the financial asset

Or

- The Branch has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates
- The Branch cannot sell or pledge the original asset other than as security to the eventual recipients
- The Branch has to remit any cash flows it collects on behalf of the eventual recipients without material delay.

In addition, the Branch is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

A transfer only qualifies for derecognition if either:

- The Branch has transferred substantially all the risks and rewards of the asset

Or

- The Branch has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

The Branch considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.

When the Branch has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Branch's continuing involvement, in which case, the Branch also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Branch has retained.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in profit or loss.

Impairment of financial assets

Under IAS 39

For available-for-sale financial assets, the Branch assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

In the case of investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in profit or loss - is removed from other comprehensive income and recognised in profit or loss. Impairment losses on investments are not reversed through profit or loss; increases in their fair value after impairment are recognised in other comprehensive income.

The determination of what is 'significant' or 'prolonged' requires judgment. In making this judgment, the Branch evaluates, among other factors, the duration or extent to which the fair value of an investment is less than its cost. The recoverable amount of loans and advances identified as impaired is calculated as the present value of the expected future cash flows, discounted at each instrument's original effective interest rate. Loans and advances are assessed for impairments on a monthly basis. Short-term balances for which discounting is not material are not discounted.

Loans and advances are presented net of credit impairment. Specific impairments are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts. If management determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The expected cash flows for portfolios of similar assets are estimated based on historic experience and taking into account the credit rating of the underlying customers and late payments of interest or penalties. Impairments and reversals of impairment write-downs are recognised in profit or loss.

In the case of debt instruments that are considered to be investment securities and which are classified as available-for-sale, the Branch first assesses whether impairment exists individually for debt instruments that are individually significant, or collectively for debt instruments that are not individually significant. If the Branch determines that no objective evidence of impairment exists for an individually assessed debt instrument, whether significant or not, it includes the instrument in a group of instruments with similar credit risk characteristics and collectively assesses them for impairment. Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment.
The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes to impairment provisions attributable to time value are reflected as a component of interest income.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

Impairment amount that is in excess of the reclassification is recognised in profit or loss. Fair value gains that are in excess of impairment recognised in the prior year shall be recognised in other comprehensive income.

Reversal of impairments on financial assets
An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

Under IFRS 9

IFRS 9 requires a change for measuring the impairment of financial asset from the "incurred loss model" to an "expected credit loss model" which can be applied to financial assets measured at amortized cost, financial assets at fair value through other comprehensive income, loan commitments and financial guarantee contracts.

Expected credit losses are credit losses of the financial instruments weighted by default risks. Credit loss is the difference between all cash flows discounted at the original effective interest rate, in accordance with the contract and all the cash flows that the Branch expects to receive. For financial assets purchased or originated credit impaired financial assets, the discounts them with the effective interest rate through credit adjustment. When estimating cash flows, the Branch considers all contractual terms (such as prepayments, extension, call options or other similar options etc.) over the expected life of the financial instrument, and the cash flows from the sale of the collateral held as well as the cash flows from other credit enhancement within the contractual terms.

The Branch measures expected credit losses of a financial instrument in a way which reflects: an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; the time value of money; reasonable and supportable information that is available without undue cost or effort at the reporting date about past events.

The Branch conducted expected credit loss assessment consolidating forward-looking information in which complex models and a large number of assumptions are applied in measuring expected credit losses. These models and assumptions relate to the future macroeconomic conditions and borrower's creditworthiness (e.g. the default possibility of a customer and the relevant losses). The Branch applies judgments, assumptions and estimation technology in the measurement of expected credit losses in accordance with the requirements of accounting standards, e.g.:

- Criteria for assessing the significant increase in credit risk
- Definition of default and impaired assets
- Parameters measuring expected credit loss
- Forward-looking information relating to macroeconomic indicators

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

The Branch assesses at each reporting date whether the credit risk of the relevant financial instrument has increased significantly since initial recognition. In assessing whether the credit risk has significantly increased since initial recognition, the Branch considers reasonable and reliable information that is available without undue cost or effort, including qualitative and quantitative analysis based on the historical data of the Branch, external credit risk rating and forward-looking information. Based on the individual financial instrument or the portfolio of financial instruments with similar credit risk characteristics, the Branch compares the default risk of financial instruments at the balance sheet date with that on the initial recognition date to determine the changes of default risk over the expected lifetime of the financial instrument.

The Branch classifies financial assets into three stages to calculate the expected credit losses using changes to the credit risk of financial instruments since initial recognition

Stage one: Financial assets with no significant increase in credit risk since initial recognition are classified in stage one in the expected credit loss model, and are measured at the amount equal to the expected credit losses arising from default events on a financial instrument that are possible within the 12 months after the reporting date;

Stage two: Financial assets whose credit risk increases significantly from the initial recognition, but there is no objective evidence of expected credit loss are classified in stage two of the expected credit loss model, over the lifetime period of the financial instrument;

Stage three: Financial assets with objective evidence of expected credit loss at the reporting date are classified in stage three of the expected credit loss model, and their expected credit loss provisions are measured at the amount equivalent to the expected credit losses over the lifetime period of the financial instrument;

When one or more quantitative, qualitative or past due indicators in the following is triggered, the Branch determines that the credit risk on a financial instrument has increased significantly:

Criteria for judging significant increases in credit risk

The Branch assesses whether the credit risk of the relevant financial instruments has increased significantly since the initial recognition at each balance sheet date. While determining whether the credit risk has significantly increased since initial recognition or not, the Branch considers the reasonable and substantiated information that is accessible without exerting unnecessary cost or effort, including qualitative and quantitative analysis based on the historical data of the Branch, external credit risk rating, and forward-looking information. Based on the single financial instrument or the combination of financial instruments with similar characteristics of credit risk, the Branch compares the risk of default of financial instruments on the balance sheet date with that on the initial recognition date in order to determine the changes of default risk in the expected lifetime of financial instruments.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

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

Quantitative criteria

- At the reporting date, the increase in remaining lifetime probability of default (PD) is considered significant, comparing with the one at initial recognition.
- The determination of what is 'significant' requires judgment. In making this judgment, the Branch evaluates, among other factors, the changes in internal operating results of the borrower; changes expected increase in interest rates and internal price indicators of credit risk.
- Consideration is also given to credit rating of a counterparty, means of guarantee and category of collateral as well as means of repayment based on the analysis of the historical statistics.

Credit Risk Characteristics for "Stage 2" Financial Assets

The Branch currently uses the following criteria to identify Stage 2 assets

- The contractual payments of the debtor's any principal, advances, interest or corporate bond are more than 30 days past due.
- The asset is classified as Special Mention based on the 5 tier classification.

In accordance with the requirements of IFRS 9, the following non-exhaustive list of information may be relevant in assessing significant increases since initial recognition of credit risk:

- Significant changes in internal price indicators of credit risk as a result of a change in credit risk since inception, including, but not limited to, the credit spread that would result if a particular financial instrument or similar financial instrument with the same terms and the same counterparty were newly originated or issued at the reporting date.
- Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instruments with the same expected life. Changes in market indicators of credit risk include, but are not limited to:
    a) The length of time or the extent to which the fair value of a financial asset has been less than its amortised cost;
    b) Other market information related to the borrower, such as changes in the price of a borrower's debt and equity instruments.
    c) An actual or expected significant change in the financial instrument's external credit rating.
    d) An actual or expected internal credit rating downgrade for the borrower or decrease in behavioural scoring used to assess credit risk internally. Internal credit ratings and internal behavioural scoring are more reliable when they are mapped to external ratings or supported by default studies.
    e) Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet its debt obligations, such as an actual or expected increase in interest rates or an actual or expected significant increase in unemployment rates.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

f) Significant increases in credit risk on other financial instruments of the same borrower.

g) Actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that results in a significant change in the borrower's ability to meet its debt obligations, such as a decline in the demand for the borrower's sales product because of a shift in technology.

h) Significant changes, such as reductions in financial support from a parent entity or other affiliate or an actual or expected significant change in the quality of credit enhancement, that are expected to reduce the borrower's economic incentive to make scheduled contractual payments. Credit quality enhancements or support include the consideration of the financial condition of the guarantor and/or, for interests issued in securitisations, whether subordinated interests are expected to be capable of absorbing expected credit losses (for example, on the loans underlying the security).

i) Significant changes in the expected performance and behaviour of the borrower, including changes in the payment status of borrowers in the group (for example, an increase in the expected number or extent of delayed contractual payments or significant increases in the expected number of credit card borrowers who are expected to approach or exceed their credit limit or who are expected to be paying the minimum monthly amount).

j) Changes in the entity's credit management approach in relation to the financial instrument; i.e. based on emerging indicators of changes in the credit risk of the financial instrument, the entity's credit risk management practice is expected to become more active or to be focused on managing the instrument, including the instrument becoming more closely monitored or controlled, or the entity specifically intervening with the borrower.

k) Past due information.

Characteristics of Default– "Stage 3" Assets

The Branch currently uses the following criteria to identify Stage 3 assets

- The debtor leaves any of the principal, advances, interest or investments in corporate bonds of the Branch overdue for more than 90 days.
- The asset is classified as Sub-standard, Doubtful or Loss Loans (Non-performing) based on the 5 tier classification and the characteristics of default criteria

The standard adopted by the Branch to determine whether default occurs under IFRS 9 is consistent with the internal credit risk management objectives of the relevant financial instrument, taking into account quantitative and qualitative criteria. When the Branch assesses whether the default of debtor occurred, the following factors are mainly considered:

a) Significant financial difficulty of the issuer or the debtor;

b) Debtors are in breach of contract, such as defaulting on interest or becoming overdue on interest or principal payments overdue

c) The creditor of the debtor, for economic or contractual reasons relating to the debtor's financial difficulty, having granted to the debtor a concession that the creditor would not otherwise consider;

d) It is becoming probable that the debtor will enter bankruptcy or other financial reorganization;

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

- The disappearance of an active market for that financial asset because of financial difficulties; or
- The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses;

The Expected credit loss on a financial asset may be caused by the combined effect of multiple events and may not be necessarily due to a single event. Customers would be included on the watchlist when the client's credit asset risk profile has increased to a level which alerts the bank to monitor the client loan/bond (e.g. Stage 2). The instances that increase the clients credit asset risk profile would include potential default as a result of difficult trading conditions, interest rate changes and rating changes.

The Branch classifies the loans based on an internal classification methodology. This is mapped to the ECL stages as follows:

Stage 1 Financial Assets according to the ECL Model (12 months)
- Performing loans: The borrower is able to honour contracts and there is no reason to doubt that the loan principal and interest cannot be repaid fully and timely.

Stage 2 Financial Assets according to the ECL Model (Lifetime)
- Special mention loans: Although the borrower is currently capable of repaying loan principal and interest, there are factors that may have an adverse impact on the repayment.

Stage 3 Financial Assets according to the ECL Model (Lifetime)
- Substandard loans: The borrower has obvious problems in its repayment capability and cannot completely rely on its normal operating income to repay the loan principal and interest in full. The Branch may bear certain losses even if executing against guarantee or collateral.
- Doubtful loans: The borrower cannot fully repay loan principal and interest, causing substantial losses to the lender even if executing against guarantee or collateral.
- Loss loans: The lender cannot recover loan principal and interest or can only recover an insignificant part after taking all possible actions or going through all necessary legal procedures.

Expected Credit loss of a financial asset may be impacted by many factors simultaneously rather than individually

The Branch measure Expected Credit loss based on expected credit loss of 12-month or lifetime credit loss for different assets, depending on whether credit risk increases significantly or credit loss has been incurred. The key parameter of measuring expected credit loss includes probability of default, loss given default and exposure at default.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.7. Financial Instruments (Continued)

Default

To determine whether a default occurred under IFRS 9, the Branch makes use of the internal credit risk management for financial instruments, and considers both quantitative and qualitative indicators. When the Branch assesses whether a borrower is in default, the following factors are mainly considered:

- The borrower experiences financial difficulties.
- The debtors are in breach of contract, such as defaulting in repayment of interest or principal, repayment of interest or principal past due

The following definitions are listed below:
Non-performing loans is a loan on which the borrower is not making interest payments or repaying any principal within 90 days.
Default is the failure to pay interest or principal on a loan or security when due. This occurs when the debtor is unable to meet the obligations of the debt re-payment.
Probability of default (PD) is the probability that a given borrower will default during a given 12-month period or over the expected lifetime.
Loss given default (LGD) is estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the Exposure at default.
Exposure at default (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, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

The Group built the expected credit loss model with probability of default, loss given default, exposure at default, considering quantitative analysis of historic statistics (such as credit rating of a counterparty, means of guarantee and category of collateral, means of repayment etc.) and forward-looking information based on the current risk management model and the requirements of IFRS 9.

The assessment of a significant increase in credit risk and the calculation of ECL both involve forward-looking information. Through the analysis of historical data, the Branch identifies the key economic indicators that affect the credit risk and ECL of various business types.

The impact of these economic indicators on the PD and the LGD varies according to different types of business. The Branch applied experts' judgment in this process, according to the result of experts' judgment; the Branch predicts these economic indicators on a quarterly basis and determines the impact of these economic indicators on the PD and the LGD by conducting regression analysis.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

In addition to providing a baseline economic scenario, the Branch combines statistical analysis with experts' judgment to determine the weight of other possible scenarios. The Bank measures the 12 month and lifetime ECL on a weighted average basis. The weighted average ECL above is calculated by multiplying the ECL for each scenario by the weight of the corresponding scenario.

Write-off

The Branch's accounting policy under IFRS 9 remains the same as it was under IAS 39. The Branch would consider writing off the financial asset under the following circumstances:

- There is no possibility of collecting the principal and interest of a financial asset and a loss has been already recognised.
- The borrower has experienced financial difficulties and the Branch is unable to collect the principal and interest. However, restructuring plan has been put in place.
- The write-off will occur at the conclusion of legal procedures and judgment has been finalised.

If the amount to be written off is greater than the Expected Credit loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to expected credit loss expense.

Curing of loans

The Branch performs an annual credit risk assessments on the Financial Assets and should the borrower's ability to repay debts and honour contracts improve or should there be changes in the credit rating, the financial assets would move into a lower stage.

1.8. Foreign exchange transactions

Foreign exchange transactions are recorded at the exchange rate ruling at the transaction date and time. Loans and advances derived from foreign exchange transactions are recorded at the exchange rate ruling at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at the spot rate of exchange ruling at the reporting date. Gains and losses arising on translation are recorded in profit or loss and included in other operating income.

The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in the foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the spot exchange rate at the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.9 Fee and commission income

Fee and commission income arises on financial services provided by the Branch. As mentioned in Note 1.3.1, the adoption of IFRS 15 would have the following impact on fees and commission:

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. The fee and commission income which are integral to the effective interest rate measurement form part of IFRS 9 and therefore excluded from the IFRS 15 adjustment.

At point in time

The income which is recognised at a point in time includes other fees and commission income, account servicing fees, loan origination fees and syndication fees. The performance obligation is the rendering of the services such as issuing of the loan and performance obligations is met when the services are rendered to the customer.

Over time

The income which is recognised over time includes loan commitment fees. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. The performance obligation relating to the loan commitment fees is fulfilled over the term of the commitment period and the performance obligation is met once the loan commitment period has elapsed.

1.10 Provisions

Provisions are recognised when the Branch has a present legal or constructive obligation that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the effect of discounting is material, provisions are discounted. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

1.11 Operating leases

Branch as lessee

Leases of assets are classified as operating leases if the lessor effectively retains all the risks and rewards of ownership. Payments made under operating leases, net of any incentives received from the lessor, are recognized in profit or loss on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

1.12 Contingencies and commitments

Transactions are classified as contingencies where the Branch's possible obligations depend on uncertain future events not wholly within the control of the Branch, or a present obligation that is not recognised as it is not probable that an outflow of resources will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability. These in principle consist of third party obligations.

1.13 Financial guarantee contracts

Financial guarantees are contracts that require the Branch to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee with reference being made to 1.2.

Subsequent Measurement

IAS 39 – Financial Instruments: Measurement and Recognition

Under IAS 39, which was the standard adopted before 1 January 2018, the guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within other liabilities.

IFRS 9- Financial Instruments

From 1 January 2018, the Branch measures Financial Guarantees under the Expected Credit Loss model in terms of IFRS 9. Under IFRS 9 Financial Guarantees are subsequently measured at the higher of:

- IFRS 9 Expected Credit Loss allowance
- Amount initially recognised (i.e. fair value) less any cumulative amount of income/amortisation recognized.

1.14 Fair value measurement

The Branch measures financial instruments, such as, derivatives, at fair value at each reporting date. Also, fair values of financial instruments measured at amortised cost are disclosed in note 28.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

(a) In the principal market for the asset or liability, or

(b) In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to by the Branch.

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Branch uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

(a) Level 1- Quoted (unadjusted) market prices in active markets for identical assets or liabilities
(b) Level 2- Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
(c) Level 3- Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Branch determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

1.15 New Standards and amendments

The Branch has adopted the following new standards and amendments became effective as of 1 January 2018

- IFRS 15 Revenue from contracts with customers
- IFRS 9 Financial instruments

The Branch also assessed that the following standard will not have a material impact

- IFRIC Interpretation 22 Foreign Currency transactions and advance consideration

1.16 Standards issued but not yet effective

The standards and interpretations listed below will become effective after 1 January 2019:

- IFRS 16 Leases
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatments
- AIP IAS 12 Income Taxes - Income tax consequences of payments on financial instruments classified as equity
- AIP IAS 23 Borrowing Costs - Borrowing costs eligible for capitalization
- The Conceptual Framework for Financial Reporting (effective 1 January 2020)

Notes to the annual financial statements for the year ended 31 December 2018

1. Accounting policies (Continued)

With the exception of IFRS 16 leases and IFRIC Interpretation 23 Uncertainty over Income Tax Treatments , the Branch has assessed that the standards will not have a material impact on the financial statements.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees - leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).
At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments).

The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16, which is effective for annual periods beginning on or after 1 January 2019, requires lessees and lessors to make more extensive disclosures than under IAS 17.

Effective date and transition

The new standard will be effective from 1 January 2019, however earlier application is permitted, but not before the entity has applied IFRS 15. The Branch plans to use the Modified retrospective approach in the transition to IFRS 16. The Branch will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Branch will therefore not apply the standard to contracts that were not previously identified as containing a lease applying IAS 17 and IFRIC 4.

Notes to the annual financial statements for the year ended 31 December 2018

Impact

The Branch has identified operating leases which will result in a Right-of-use asset being recognised in terms of IFRS 16. A lease liability will also be recognised. The operating leases includes the Johannesburg building rental, Durban building rental, rental for parking and expats accommodation rental. Other operating leases with lease periods less than twelve months were not accounted for as a lease in terms of IFRS 16. The short-term exemption available for lessees in terms of IFRS 16 has been applied for these.

IFRIC Interpretation 23 Uncertainty over Income Tax Treatments

The Branch is in dispute with SARS on the 2016 income tax and the matter has not yet been finalised. The Branch has determined this interpretation will not have a material impact on the financial statements.

Notes to the annual financial statements for the year ended 31 December 2018

2. Net interest income

In thousands of ZAR	2018	2017
Interest income		
Cash and cash equivalents	**210,300**	118,559
Loans and advances to banks	**290,572**	345,832
Loans and advances to customers	**1,533,481**	1,380,785
Investment securities	**458,195**	381,403
Total interest income	**2,492,548**	2,226,579
Interest expense		
Deposits from banks	**(575,408)**	(333,812)
Deposits from customers	**(1,007,527)**	(898,248)
Certificate of deposits	**(310)**	-
Commercial paper	**(399,455)**	(486,295)
Total interest expense	**(1,982,700)**	(1,718,355)
Net interest income/(expense)	**509,848**	508,224

The total interest income balance includes related parties interest income of R160 844 (2017: R94 014). The total interest expense balance includes related parties interest expense of R408 474 (2017: R202 015).

3. Net fee and commission income

In thousands of ZAR	2018	2017
Fee and commission income		
Service charges	**4,905**	5,161
Guarantee fees	**2,080**	4,781
Loan fees	**112,163**	107,558
Other fees	**895**	1,212
Total fee and commission income	**120,043**	118,712
Fee and commission expense		
Brokerage fees	**-**	-
Other fees	**(12,120)**	(21,678)
Total fee and commission expense	**(12,120)**	(21,678)
Net fee and commission income	**107,923**	97,034

The other fees include the financial enterprise fee.

Notes to the annual financial statements for the year ended 31 December 2018

Recon of Contract Liability

The following shows the recon of contract Liability

In thousands of ZAR	**2018**
Opening Balance contract liability	**102,266**
Revenue recognised in current period	**(120,043)**
Commissions received in advance	**128,572**
Closing Balance Contract liability	110,795

4. Other operating income

In thousands of ZAR	**2018**	2017
Other income	**238**	18
Profit on sale of assets	**2,733**	-
Profit and loss from foreign exchange swaps	**675,660**	88,508
Profit and loss from interest rate swaps	**178,342**	(95,495)
Realised Exchange gain or loss on monetary assets	**59,447**	(4,662)
Unrealised foreign currency revaluation gain on FEC's	**(439,882)**	323,533
Total operating income	**476,538**	311,902

5. Operating expenses

In thousands of ZAR	**2018**	2017
Personnel expenses	**(151,605)**	(146,148)
Depreciation and amortization	**(6,763)**	(7,449)
Rental expenses	**(20,225)**	(18,310)
Other professional service fees	**(6,833)**	(3,262)
Auditor's fees	**(3,435)**	(1,978)
IT expenses	**(2,887)**	(2,660)
Head office management expenses	**(9,782)**	(9,874)
Other expenses	**(15,051)**	(36,490)
Total operating expenses	**(216,581)**	(226,171)

The other expenses include marketing fees, membership fees and operating fees.

Notes to the annual financial statements for the year ended 31 December 2018

6. Credit impairment

In thousands of ZAR		2017	
	Total	Specific	Portfolio
Balance at the beginning of the year	(677,809)	(566,012)	(111,797)
Impairment reversal during the year	27,021	14,438	12,583
Transfer from specific to portfolio	-	(693)	693
Loans and advances to banks	2,187	-	2,187
Loans and advances to customers	24,834	15,131	9,703
Balance at the end of the year	(650,788)	(551,574)	(99,214)
Loans and advances to banks	(11,739)	-	(11,739)
Loans and advances to customers	(639,049)	(551,574)	(87,475)

Reconciliation from IAS 39 to IFRS 9 – impairment allowance and provision

The table below presents a reconciliation of the IAS 39 impairment allowances for incurred credit losses to IFRS 9 impairment allowances for expected credit losses.

Impairment allowance	Total
In thousands of ZAR	**R**
Total IAS 39 impairment allowance and IAS 37 provision	**650,788**
IFRS 9 incremental impact of 12 month impairment allowance	**33,499**
IFRS 9 incremental impact of Lifetime impairment allowance	**196,232**
IFRS 9 additional impairment allowance	**85,058**
Total impact of IFRS 9 on impairment allowances and provisions	**965,577**

Additional impairment allowance on assets impaired under IFRS 9

These relate to financial assets which were not impaired under IAS 39. However, with the transition to IFRS 9, forward looking information needs to be considered and a 12 month expected loss was recognised for financial assets that are part of the performing book.

Notes to the annual financial statements for the year ended 31 December 2018

6. Credit impairment (Continued)

In thousands of ZAR	Total	Stage 1	Stage 2	Stage 3
Adoption of IFRS 9	(965,577)	(189,135)	(204,857)	(571,585)
Foreign exchange loss	1,557	1,557	-	-
Adjusted balance at the beginning of the year	(964,020)	(187,578)	(204,857)	(571,585)
Loans and advances to banks	(10,071)	(10,071)	-	-
Loans and advances to customers	(869,072)	(120,690)	(204,784)	(543,598)
Financial assets at FVOCI	(19,391)	(19,391)	-	-
Provision for undrawn contractually committed facilities and guarantees	(65,486)	(37,426)	(73)	(27,987)
Impairment (charge)/reversal during the year	**(39,802)**	**13,609**	**(14,398)**	**(39,013)**
Loans and advances to banks	**(7,842)**	**(7,842)**	-	-
Loans and advances to customers	**(81,036)**	**(14,240)**	**(14,471)**	**(52,325)**
Financial assets at FVOCI	**4,003**	**4,003**	-	-
Provision for undrawn contractually committed facilities and guarantees	**45,073**	**31,688**	**73**	**13,312**
Balance at the end of the year	**(1,003,822)**	**(173,969)**	**(219,255)**	**(610,598)**
Loans and advances to banks	**(17,913)**	**(17,913)**	-	-
Loans and advances to customers	**(950,108)**	**(134,930)**	**(219,255)**	**(595,923)**
Financial assets at FVOCI	**(15,388)**	**(15,388)**	-	-
Provision for undrawn contractually committed facilities and guarantees	**(20,413)**	**(5,738)**	-	**(14,675)**

The ECL model under IFRS 9 was implemented on 1 January 2018 and the opening balance of retained earnings and fair value was adjusted by R227 million. The following qualitative information is considered when performing the ECL calculations

- When there is an indication that Debtors are in breach of contract, such as defaulting on interest or becoming overdue on interest or principal payments overdue.
- The debtor leaves any of the principal, advances, interest or investments in corporate bond of the Branch overdue for more than 90 days;
- The creditor of the debtor, for economic or contractual reasons relating to the debtor's financial difficulty, having granted to the debtor a concession that the creditor would not otherwise consider.
- It is becoming probable that the debtor will enter bankruptcy or other financial reorganization

Notes to the annual financial statements for the year ended 31 December 2018

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

Loans and advances to Banks

In thousands of ZAR

	Total	Stage 1	Stage 2	Stage 3
Gross Carrying Balance at 1 January 2018	5,760,896	5,760,896	-	-
New assets originated or purchased	3,803,662	3,803,662	-	-
Assets derecognised or repaid (excluding write offs)	(2,608,464)	(2,608,464)	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
Gross Carrying Balance at 31 December 2018	6,956,094	6,956,095	-	-

Impairment Allowances

In thousands of ZAR

	Total	Stage 1	Stage 2	Stage 3
Balance at 1 January 2018	(10,071)	(10,071)	-	-
New assets originated or purchased	(9,351)	(9,351)	-	-
Assets derecognised or repaid (excluding write offs)	5,883	5,883	-	-
Changes to models used for ECL calculations	(4,374)	(4,374)	-	-
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
Balance at 31 December 2018	(17,913)	(17,913)	-	-
Net Balance at 31 December 2018	6,938,181	6,938,182	-	-

Notes to the annual financial statements for the year ended 31 December 2018

The increase in the ECL is mainly driven by the purchase of additional loans amounting to R3.8 billion which contributed to an increase in the impairment of R9.3 million in the 12 month ECL period.

Loans and advances to Customers

In thousands of ZAR

	Total	Stage 1	Stage 2	Stage 3
Gross Carrying Balance at 1 January 2018	26,864,999	22,694,246	3,349,436	821,317
New assets originated or purchased	11,568,457	10,761,263	807,194	-
Assets derecognised or repaid (excluding write offs)	(12,631,340)	(10,295,059)	(2,336,281)	-
Transfers from Stage 2 to Stage 1	-	356,828	(356,828)	-
Transfers from Stage 1 to Stage 2	-	(434,144)	434,144	-
Changes to contractual cash flows due to modifications not resulting in derecognition	11,452	-	-	11,452
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
Gross Carrying Balance at 31 December 2018	25,813,568	23,083,134	1,897,665	832,769

Impairment Allowances

In thousands of ZAR

	Total	Stage 1	Stage 2	Stage 3
Balance at 1 January 2018	(869,072)	(120,690)	(204,784)	(543,598)
New assets originated or purchased	(58,168)	(31,182)	(26,986)	-
Assets derecognised or repaid (excluding write offs)	78,492	50,607	27,885	-
Transfers from Stage 2 to Stage 1	-	6,006	(6,006)	-
Transfers from Stage 1 to Stage 2	-	(388)	388	-
Changes to models used for ECL calculations	(101,360)	(39,282)	(9,752)	(52,326)
Amounts written off	-	-	-	-
Foreign exchange adjustments	-	-	-	-
Balance at 31 December 2018	(950,108)	(134,929)	(219,255)	(595,924)
Net Balance at 31 December 2018	24,863,460	22,948,205	1,678,410	236,845

Notes to the annual financial statements for the year ended 31 December 2018

Investment Securities

In thousands of ZAR

	Total	Stage 1
Carrying Balance at 1 January 2018	5,373,518	5,373,518
New assets originated or purchased	5,090,721	5,090,721
Assets derecognised or repaid (excluding write offs)	(3,956,114)	(3,956,114)
Carrying Balance at 31 December 2018	6,508,125	6,508,125

Impairment Allowances

In thousands of ZAR

	Total	Stage 1
Carrying Balance at 1 January 2018	(19,391)	(19,391)
New assets originated or purchased	(9,217)	(9,217)
Assets derecognised or repaid (excluding write offs)	10,052	10,052
Changes to models used for ECL calculations	3,168	3,168
Carrying Balance at 31 December 2018	(15,388)	(15,388)

Notes to the annual financial statements for the year ended 31 December 2018

7. Income tax expense

The major components of income tax for the years ended 31 December 2018 and 2017 are:

In thousands of ZAR	2018	2017
Statement of profit or loss		
Current tax expense:	**(223,666)**	(188,702)
Current year income tax charge	**(239,057)**	(188,743)
Withholding income tax	**(142)**	-
Over provision of tax	**15,533**	41
Deferred tax expense:		
Relating to the origination and reversal of temporary differences	**(31,067)**	(13,023)
Income tax expense reported in the statement of profit or loss	**(254,733)**	(201,725)
Statement of OCI		
Deferred tax expense related to items recognised in OCI during the year		
Financial assets at FVOCI	**(2,935)**	(6,334)
Deferred tax *expense income* reported in OCI	**(2,935)**	(6,334)

Reconciliation of tax expense and the accounting profit multiplied by the tax rate for 2018 and 2017:

	2018		2017	
	%	Amount	%	Amount
Accounting profit before income tax		**837,926**		718,010
At income tax rate	**28.00**	**(234,619)**	28.00	(201,043)
Over provision of tax	**(1.85)**	**15,533**	0.00	41
Withholding tax	**0.02**	**(142)**	-	-
Non-deductible expenses	**4.24**	**(35,505)**	(0.10)	(713)
Total income tax expense	**30.40**	**(254,733)**	28.10	(201,725)
Income tax expense reported in the statement of comprehensive income		**(254,733)**		(201,725)

Non-deductible expenses includes credit impairments (R35 171), interest expenses (R191), employee costs (R93) and donations (R50).

8. Cash and cash equivalents

In thousands of ZAR	2018	2017
Cash at banks and on hand	**612,722**	738,077
Expected Credit Loss Provision	**(1,121)**	-
Cash placements	**4,389,517**	4,743,235
Total cash and cash equivalents	**5,001,118**	5,481,312

Notes to the annual financial statements for the year ended 31 December 2018

Total amount of R5,001,118 (2017: R5,481,312) includes related parties' deposits of R4,711,237 (2017: R5,205,091).
The transition impact as a result of IFRS 9 adoption is that there is an additional impairment of R181 (as at 1 Jan 2018) which is included in the adjustment to Retained Earnings.

9. Derivative financial instruments

In thousands of ZAR	**2018**	2017
Derivative financial assets:		
Balance at the beginning of the year	**633,270**	199,265
Fair value gain	**(532,988)**	434,005
Balance at the end of the year	**100,282**	633,270
Derivative financial liabilities:		
Balance at the beginning of the year	**(223,631)**	(113,160)
Fair value (loss)/gain	**93,106**	(110,471)
Balance at the end of the year	**(130,525)**	(223,631)
Net derivative financial instruments	**(30,243)**	409,639

Derivative Financial Instruments relate to forward exchange contracts (FEC) and interest rate swaps. The derivative financial instruments are held for risk management purposes. Derivative financial instruments are disclosed at fair value and comprise foreign exchange contracts held for short-term risk management purposes.

Notes to the annual financial statements for the year ended 31 December 2018

10. Loans and advances to banks

In thousands of ZAR	**2018**	1 Jan 2018	2017
Non-current assets	**5,098,168**	3,675,030	3,669,044
Syndicated loans	**3,386,304**	3,677,256	3,677,256
Wholesale loans	**863,580**	-	-
Placement loans	**863,580**	-	-
Less: Impairment	**(15,296)**	(2,226)	(8,212)
Current assets	**1,840,013**	2,075,975	2,080,113
Syndicated loans	**1,242,388**	827,304	827,304
Wholesale loans	**413**	744,977	744,977
Trade finance loans	**590,508**	511,359	511,359
Placement loans	**8,200**	-	-
Less: impairment	**(1,496)**	(7,665)	(3,527)
	6,938,181	**5,751,005**	**5,749,157**

Syndicated loans are structured term loans with financial institutions.
In addition, the Branch has forfeited loans disclosed in trade finance amounting to R329, 475 (2017: R511, 359). Forfeited loans are loans that are purchased by the Branch at the nominal value. These are transferred to and from other branches within the group. The portion that has been transferred to other branches are recognised as an off balance sheet item.

Notes to the annual financial statements for the year ended 31 December 2018

11. Loans and advances to customers

In thousands of ZAR	2018	1 Jan 2018	2017
Non-current assets	**12,891,164**	14,115,100	14,282,054
Syndicated loans	**8,561,315**	10,560,245	10,560,245
Wholesale loans	**3,839,946**	3,034,345	3,034,345
Individual term loans	**774,662**	722,389	722,389
Housing loans	**27,250**	32,925	32,925
Less: impairment	**(312,009)**	(234,804)	(67,850)
Current assets	**11,972,296**	11,880,827	11,943,896
Syndicated loans	**2,175,024**	1,676,687	1,676,687
Wholesale loans	**9,475,795**	9,929,893	9,929,893
Trade finance loans	**84,594**	54,953	54,953
Individual term loans	**42,087**	32,065	32,065
Housing loans	**126**	180	180
Non-accrued loans	**832,768**	821,317	821,317
Less: Impairment	**(638,098)**	(634,268)	(571,199)
	24,863,460	**25,995,927**	**26,225,950**

12. Investment securities

In thousands of ZAR	2018	2017
Opening Balance	**5,373,518**	4,093,702
Purchases	**4,610,499**	4,695,297
Maturities	**(2,923,869)**	(3,412,484)
Coupons received	**(401,410)**	(407,021)
Sale	**(630,835)**	-
Interest income accrued	**458,195**	381,403
Fair value movement through OCI gain	**22,027**	22,621
Balance at the end of the year	**6,508,125**	5,373,518
Total investment securities	**6,508,125**	5,373,518
Current assets	**2,928,226**	2,940,352
Non-current assets	**3,579,899**	2,433,166

Investment securities relate to investments in government bonds and treasury bills. The investment securities are classified as Fair value through OCI to comply with the Regulations 27 of the South African Reserve Bank, as stipulated in BA310. Included in the 2017 balance is R425 million of credit linked notes issued by Investec Bank Limited which was sold on 12 November 2018.

Notes to the annual financial statements for the year ended 31 December 2018

13. Property, plant and equipment

In thousands of ZAR	Computer equipment	Office equipment	Motor vehicles	Total
Cost				
Balance at 1 January 2017	10,766	33,072	4,123	47,961
Acquisitions	637	676	-	1,313
Disposals/Write off	(2,024)	(1,839)	-	(3,863)
Balance at 31 December 2017	9,379	31,909	4,123	45,411
Balance at 1 January 2018	**9,379**	**31,909**	**4,123**	**45,411**
Acquisitions	**1,172**	**660**	**2,544**	**4,376**
Disposals/Write off	**(1,495)**	**(499)**	**(418)**	**(2,412)**
Balance at 31 December 2018	**9,056**	**32 070**	**6,249**	**47,375**
Accumulated depreciation and impairment expenses				
Balance at 1 January 2017	7,849	12,183	3,043	23,075
Depreciation	1,893	4,899	458	7,249
Disposals/Write off	(2,024)	(1,839)	-	(3,863)
Balance at 31 December 2017	7,717	15,243	3,501	26,461
Balance at 1 January 2018	**7,717**	**15,243**	**3,501**	**26,461**
Depreciation	**1,306**	**4,802**	**454**	**6,562**
Disposals/Write off	**(1,495)**	**(499)**	**(418)**	**(2,412)**
Impairment	**-**	-	**-**	**-**
Balance at 31 December 2018	**7,528**	**19,546**	**3,537**	**30,611**
Carrying amounts				
Balance at 1 January 2018	**1,662**	16,666	**622**	**18,950**
Balance at 31 December 2018	**1,528**	12,524	**2,712**	**16,764**
Movement for 2018	**(134)**	**(4,142)**	**2,090**	**(2,186)**

Notes to the annual financial statements for the year ended 31 December 2018

14. Intangible assets

In thousands of ZAR	Purchased Software	Total
Cost		
Balance at 1 January 2017	1,623	1,623
Acquisitions	401	401
Disposals/Write off	(1,348)	(1,348)
Balance at 31 December 2017	676	676
Balance at 1 January 2018	**676**	**676**
Acquisitions	**-**	**-**
Disposals/Write off	**(275)**	**(275)**
Balance at 31 December 2018	**401**	**401**
Amortisation and impairment expenses		
Balance at 1 January 2017	1,566	1,566
Amortisation	87	87
Disposals/Write off	(1,348)	(1,348)
Impairment	-	-
Balance at 31 December 2017	305	305
Balance at 1 January 2018	**305**	**305**
Amortisation	**202**	**202**
Disposals/Write off	**(275)**	**(275)**
Impairment	**-**	**-**
Balance at 31 December 2018	**232**	**232**
Carrying amounts		
Balance at 1 January 2018	**371**	**371**
Balance at 31 December 2018	**170**	**170**
Movement for 2018	**(201)**	**(201)**

Notes to the annual financial statements for the year ended 31 December 2018

15. Deferred tax asset

In thousands of ZAR	Opening Balance	IFRS 9	2017 Adjustment	Recognised in profit or loss	Recognised in equity	Closing Balance
2018						
Impairment loss	8,668	75,760	45,327	(33,973)	-	95,782
Financial Assets measured at FVOCI	(6,833)	-	-	-	(2,936)	(9,769)
Audit fee provision	578	-	-	178	-	756
Leave provision	805	-	-	204	-	1,009
Bonus provision	8,603	-	-	(175)	-	8,428
Deferred commission	28,634	-	-	2,389	-	31,023
Operating lease straight lining	688	-	-	109	-	797
Fixed assets	-	-	(186)	201	-	15
Total deferred tax asset	41,143	75,760	45,141	(31,067)	(2,936)	128,041

In thousands of ZAR	Opening Balance	Recognised in profit or loss	Recognised in equity	Closing Balance
2017				
Impairment loss	23,477	(14,809)	-	8,668
Available-for-sale securities	(499)	-	(6,334)	(6,833)
Audit fee provision	525	53	-	578
Leave provision	747	58	-	805
Bonus provision	4,257	4,346	-	8,603
Deferred commission	31,456	(2,822)	-	28,634
Operating lease straight lining	536	152	-	688
Total deferred tax asset	60,500	(13,023)	(6,334)	41,143

16. Other assets

In thousands of ZAR	2018	2017
Amounts receivable and prepayments	2,437	2,512
Restricted deposits with the central bank	766,455	755,355
Total other assets	768,891	757,867

Restricted deposits are non-interest bearing minimum reserves held to comply with the regulations of the South African Reserve Bank, which is stipulated in BA310. These balances do not form part of the Branch's cash management activities and therefore are not disclosed as part of cash and cash equivalents.

Notes to the annual financial statements for the year ended 31 December 2018

17. Deposits from banks

In thousands of ZAR	**2018**	2017
Non-Current Liabilities		
Deposits from intra-groups	**5,758,123**	8,929,005
Current Liabilities	**10,587,058**	7,410,976
Intra-group deposits and loans	**8,875,064**	3,844,966
Inter-bank deposits and loans	**1,711,994**	3,566,010
Total deposits from banks	16,345,181	16,339,981

Deposits from banks are mostly the money market loans that are used to fund the operations of the Branch except for the clearing accounts held for intra-group purposes.

18. Deposits from customers

In thousands of ZAR	2018	2017
Non-current liabilities	**4,864**	3,034
Term deposits	**4,864**	3,034
Current liabilities	**14,065,449**	15,322,926
Current deposits	**3,492,158**	2,227,053
Term deposits	**10,423,688**	12,931,173
Margin deposits	**149,603**	164,700
	14,070,313	15,325,960

Notes to the annual financial statements for the year ended 31 December 2018

19. Provisions

In thousands of ZAR	Bonuses and leave pay	IT fee and Head Office fee	Audit and other professional fees	Expected Credit Losses	Total
Opening balance at 1 January 2017	17,872	14,365	1,875	-	34,112
Arising during the year	91,514	18,855	1,560	-	111,929
Utilisation of provisions	(75,653)	(11,682)	(1,660)	-	(88,995)
Reversal of provisions	(133)	(273)	287	-	(119)
Closing balance at 31 December 2017	33,600	21,265	2,062	-	56,927
Adjusted opening balance at 1 January 2018	**33,600**	**21,265**	**2,062**	65,486	**122,413**
Arising during the year	**100,383**	**20,016**	**2,139**	**3,022**	**125,560**
Utilisation of provision	**(89,880)**	**(13,936)**	**(1,501)**	-	**(105,317)**
Reversal of provisions	**(10,401)**	**(7,026)**	-	**(48,095)**	**(65,522)**
Closing balance at 31 December 2018	**33,702**	**20,319**	**2,700**	**20,413**	**77,134**

Salaries and wages include the annual bonus provision as well as compensation and leave pay provisions. IT fees are charged from the centralized IT support center as well as Bank of China Limited. The impairments is the ECL raised for undrawn contractually committed facilities and guarantee contracts under IFRS 9.

The impact on commitments and guarantees as a result of IFRS 9 Transitions is that an Expected Credit Loss will be raised on Commitments and guarantees that are off balance sheet classified as Stage 2 and Stage 3 based on lifetime ECL, while Stage 1 commitments and guarantees have an ECL calculated based on 12 Months.

The Balance of Guarantees and commitments after the IFRS 9 Transitions are shown as follows:

Guarantees and Commitments

In thousands of ZAR

	Total	Stage 1	Stage 2	Stage 3
Gross Carrying Balance at 31 December 2017	11,128,351	11,021,545	50,831	55,975
ECL Allowances	(65,486)	(37,493)	(6)	(27,987)
Net Carrying Amount at 1 January 2018	11,062,865	10,984,052	50,825	27,988

Notes to the annual financial statements for the year ended 31 December 2018

20. Other liabilities

In thousands of ZAR	2018	2017
Accounts payable	**98,262**	69,316
Deferred commission income	**110,795**	102,266
Operating lease accrual	**2,848**	2,459
Total other liabilities	**211,905**	174,041

Accounts payable includes accrued expenses relating to inward remittances and other payables and advances from customers.

21. Branch capital

In thousands of ZAR	2018	2017
Balance at the beginning of the year	**3,300,000**	3,300,000
Equity contribution	**2,500,000**	-
Balance at the end of the year	**5,800,000**	3,300,000

On 3 December 2018, the Branch received a capital injection of R2,5 billion from its head office, Bank Of China Limited. The capital injection was received as a cash payment and will be utilized in the course of normal business operations. In the case of liquidation, creditors will receive a preferential right to payment under insolvency laws.

22. Fair value reserve

In thousands of ZAR	2018	1 Jan 2018	2017
Balance at the beginning of the year	**36,960**	1,282	1,282
Recognised directly in the statement of comprehensive income	**15,089**	35,678	16,287
Gain/(Loss) on Fair Value through Other comprehensive Income Instruments	**21,247**	22,621	22,621
Expected Credit Loss	**(4,003)**	-	-
Deferred tax income/(expense)	**(2,935)**	(6,334)	(6,334)
Re-classification Gain/(Loss) on Fair Value through Other comprehensive Income Instruments to profit or loss	**780**	-	-
Adjustment for adoption of IFRS 9	-	19,391	-
Balance at the end of the year	**52,049**	36,960	17,569

The fair value reserve reflects the unrealised fair value gain or loss on investment securities, which comprise government bonds and treasury bills, adjusted for credit impairments and deferred tax.

Notes to the annual financial statements for the year ended 31 December 2018

23. Obligations under operating leases

The Branch has the following operating lease commitments in respect of its premises:

In thousands of ZAR	2018	2017
Less than one year	**13,149**	12,160
Between one to five years	**13,861**	27,010
Total operating lease commitments	**27,010**	39,170

The rental recognised in the current financial year is R 15 372 (2017: 13 860). The operating lease commitments include building and parking commitments until January 2021.

24. Contingent liabilities and commitments

In thousands of ZAR	2018	2017
Guarantees	**547,981**	610,381
Letters of credit	**143,408**	2,019,183
Loan commitments	**3,838,516**	5,350,417
Total contingent liabilities and commitments	**4,529,905**	7,979,981

The Branch provides financial guarantees and letters of credit to the performance of customers to third parties, and no material loss is anticipated as a result of these transactions. The Branch also provides loan commitments to customers.

Financial guarantees: All domestic guarantees are issued based on a facility with the Branch. These guarantees may run against an expiry date, or with no expiry date depending on the type of guarantee issued. Most common guarantee will be demand guarantee whereby it's guaranteed against a project, service or maintenance plan over a period of time. If there are late payments received or maintenance is not kept according to the contract, demand will be made to the Branch to effect payment.

International guarantees are issued against a counter guarantee a counter guarantee is a form of guarantee to the bank from the issuing bank that they will take full responsibility due to a default received from overseas inter group branches or other overseas banks. The issuing Bank will request the Branch to reissue a guarantee based on a counter guarantee. The Branch will re-issue the guarantee to the local client (beneficiary), and if complying demand (based on the guarantee requirements, there may be additional documentation to be obtained, or whether the guarantee is still valid or not) is received from the beneficiary the bank is liable for payment, the Branch will claim the funds against the counter guarantee for the payment due. The value of the guarantees received are R463 million (2017: R206 million).

Letters of credit: A letter from the Branch guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount provided no discrepancies are noted on the documents presented under the L/C. In the event the

Notes to the annual financial statements for the year ended 31 December 2018

buyer is unable to make payment on the purchase, the Branch will be required to cover the full or remaining amount of the purchase.

For all import letters of credit, the client is required to have a facility with the Branch before issuance. There are two types of import letters of credit – usance and sight. For usance once the acceptance of the bill has been done, if the client is unable to pay for the bill at the maturity date and the Branch is required to pay, the funds are then drawn down as a loan and paid on the clients' behalf. For sight, no documents will be released to the client unless payment has first been received. If by the 5th working day no funds have been received from the client to pay for the letter of credit, funds are then drawn down as a loan and paid on the client's behalf. The Branch will then claim principal and interest charges for late payment received.

Income taxes: The Branch is subject to various taxes and the calculation of the Branch's tax charge and provisions for income taxes necessarily involve a degree of estimation and judgment. There are a number of transactions and calculations for which the ultimate tax treatment is uncertain. The Branch is subject to enquiries and requests for information by SARS as part of its normal business activities. There is uncertainty about both the timing and final outcome of such tax enquiries.

There is a dispute with the tax authority (SARS) relating to the 2016 financial year. SARS has indicated an intention to raise an assessment on the basis that certain expenditure may be disallowed. The Branch is in discussions with SARS in order to expedite the finalisation of the matter as soon as possible.

25. Commercial paper

In thousands of ZAR	2018	2017
Long-term commercial paper of which:	**3,589,187**	4,703,794
Principal amount	**3,589,187**	4,703,794
Short-term commercial paper of which:	**2,183,307**	2,629,571
Principal amount	**2,128,000**	2,520,000
Accrued interest	**55,307**	109,571
Total	**5,772,494**	7,333,365

Short-term accrued interest includes interest accruals in respect of both the long-term and short-term commercial paper notional amounts outstanding on which coupon payments are due in the first three months of 2019.

Balance at the beginning of the year 1 January 2018	**7,333,365**
Proceeds from issue of commercial paper	**723,000**
Repayment of commercial paper	**(2,229,608)**
Coupon interest paid on commercial paper	**(453,718)**
Interest recognised in profit or loss	**399,455**
Balance as at the end of 31 December 2018	**5,772,494**

Notes to the annual financial statements for the year ended 31 December 2018

26. Notes to the cash flow statement

26.1 Taxation paid

In thousands of ZAR	2018	2017
Balance at the beginning of the year	63,459	47,544
Over provision of tax in relation to prior years	(15,533)	(41)
(Over) Under provision of tax in relation to current year	(18,200)	-
Amounts charged to the income statement	(223,665)	(188,702)
Amount receivable at the end of the year	(64,202)	(63,459)
Amount paid to SARS during the current year	(258,141)	(204,658)
- With respect to prior years	14,374	-
- With respect to the current year	243,767	204,658
Tax paid	258,141	204,658

Notes to the annual financial statements for the year ended 31 December 2018

27. Capital management

The Branch maintains an actively managed capital base to cover risks inherent in the business and meet the capital adequacy requirements of the local banking supervisor, the South African Prudential Authority. The adequacy of the Branch's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) as adopted by the South African Prudential Authority in supervising the Branch. During the past year, the Branch had complied in full with all its externally imposed capital requirements (2017: the same).

The primary objectives of the Branch's capital management policy are to ensure that the Branch complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise equity participants' value. The Branch manages its capital structure and makes adjustments to it and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Branch will determine the amount of dividend payments to equity participants, if any, return capital to equity participants or issue capital securities. No changes have been made to the objectives, policies and processes from the previous years. However, they are under constant review by the Risk committee.

Regulatory capital:

In thousands of ZAR	**2018**	2017
Tier 1 Capital	**5,800,000**	3,300,000
Total Capital	**5,800,000**	3,300,000
Risk weighted assets	**31,188,285**	36,319,677
Tier 1 capital ratio	**23.1585%**	11.8497%
Total capital ratio	**24.3179%**	13.0429%

Regulatory capital consists of Tier 1 capital, which comprises share capital. Certain adjustments are made to IFRS-based results and reserves, as prescribed by the South African Reserve Bank.

Notes to the annual financial statements for the year ended 31 December 2018

28. Risk management disclosures

This section provides details of the Branch's exposure to risk and describes the methods used by management to control risk. The most important types of financial risk to which the Branch is exposed are credit risk, liquidity risk, market risk and operational risk. Market risk includes currency risk, interest rate risk and equity price risk.

28.1 Derivative financial instruments

The Branch enters into a variety of derivative financial instruments for risk management purposes. This section details the derivative financial instruments used by the Branch. Further details of the Branch's objectives and strategies in the use of derivatives are set out in the sections of this note under banking activities. Details of the nature and terms of derivative instruments outstanding at the reporting date are set out in note 9.

Derivative financial instruments used by the Branch include forward exchange contracts. Derivatives are either standardised contracts transacted through regulated exchanges (referred to as exchange-traded products) or individually negotiated over-the-counter contracts (referred to as OTC-products). A description of the main types of derivative instruments used by the Branch is set out below:

(i) Swaps

The Branch agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed notional amount. The Branch is subject to credit risk arising from the respective counterparties' failure to perform. Market risk arises from the possibility of unfavorable movements in interest rates relative to the contractual rates.

(ii) Forward exchange contracts

Forward exchange contracts are commitments to either purchase or sell a currency at a specified future date for a specified price and may be settled in cash. Forward exchange contracts result in credit exposure to the counterparty. They also result in exposure to market risk based on changes in market prices relative to contractual amounts.

Notes to the annual financial statements for the year ended 31 December 2018

28.2 Banking activities

Below is a discussion of the various risks the Branch is exposed to as a result of its banking activities and the approach taken to manage those risks:

(i) Liquidity risk

Liquidity risk arises in the general funding of the Branch's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Branch has access to Head Office funding. The Branch strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Branch continually assesses liquidity risk by identifying and monitoring changes in funding required for business goals and targets set in terms of the overall Branch strategy.

In addition, the Branch holds a portfolio of liquid assets as part of its liquidity risk management strategy.

(ii) Interest rate risk

The Branch's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in differing amounts. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Branch's business strategies.

Interest rate derivatives are primarily used to bridge the mismatch in the repricing of assets and liabilities. This is done in accordance with the guidelines established by the Branch's asset-liability management committee.

Part of the Branch's return on financial instruments is obtained from controlled mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature.

(iii) Currency risk

The Branch is exposed to currency risk through transactions in foreign currencies. The Branch's funding is diversified in local currency and foreign currencies. As the currency in which the Branch presents its annual financial statements is the South African Rand, the Branch annual financial statements are affected by movements in the exchange rates between the South African Rand and the foreign currencies.

The Branch's transactional exposures give rise to foreign currency gains and losses that are recognised in the statement of other comprehensive income.

Notes to the annual financial statements for the year ended 31 December 2018

28.2 Banking activities (Continued)

(iv) Credit risk

The Branch is subject to credit risk through its banking activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees.

The risk that counterparties to both derivative and other instruments might default on their obligations is monitored on an on-going basis.

The Branch's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the statement of financial position. The Branch is exposed to credit risk on various other financial assets, including derivative financial instruments and interest bearing securities. The current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the statement of financial position. In addition, the Branch is exposed to off statement of financial position credit risk through commitments to extend credit and guarantees issued. The maximum credit risk in respect of these commitments is the amount disclosed in the contingent liability note (note 24).

Concentrations of credit risk (whether on or off statement of financial position) arise when counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

The major concentrations of credit risk arise by location and type of customer in relation to loans and advances, commitments to extend credit and guarantees issued. The Branch has no significant exposure to any individual customer or counterparty.

28.3 Financial instruments measured at fair value

Financial instruments measured at fair value, comprises derivative financial instruments and investment securities.

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments:

(i) Investment securities
Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs.

(ii) Derivative financial instruments
The fair value of derivatives is estimated at the amount that the Branch would receive or pay to terminate the contract at the statement of financial position date taking into account current market conditions and current creditworthiness of the counterparties.

Notes to the annual financial statements for the year ended 31 December 2018

28.3 Financial instruments measured at fair value (Continued)

For loans and advances, cash and cash equivalent, other assets, commercial paper and the receivable interest, the carrying amounts approximate their fair value. Commercial paper is measured at amortised cost and the interest on commercial paper is determined based on the 3 months JIBAR which is a market related rate. The interest on loans and advances is determined based on credit quality (prime) therefore market rates.

The table below represents the Branch's financial instruments according to the category into which it is classified:

	Total carrying amount	Fair value through profit or loss	Fair value through OCI	Assets held at amortised Cost
In thousands of ZAR				
As at 31 December 2018				
Assets				
Loans and advances to banks	6,938,181	-	-	6,938,181
Loans and advances to customers	24,863,460	-	-	24,863,460
Investment securities	6,508,125	-	6,508,125	-
Cash and cash equivalents	5,001,118	-	-	5,001,118
Derivative financial instruments	100,282	100,282	-	-
Other assets	768,891	-	-	768,891
Total financial instrument assets	44,180,057	100,282	6,508,125	37,571,650

	Total carrying amount	Fair value through profit or loss	Liabilities held at amortised cost
In thousands of ZAR			
As at 31 December 2018			
Liabilities			
Deposits from customers	14,070,313	-	14,070,313
Deposits from banks	16,345,181	-	16,345,181
Derivative financial instruments	130,525	130,525	-
Commercial paper	5,772,494	-	5,772,494
Other liabilities	178,244	-	178,244
Total financial instrument liabilities	36,496,757	130,525	36,366,232

Notes to the annual financial statements for the year ended 31 December 2018

28.3 Financial instruments measured at fair value (Continued)

In thousands of ZAR	Total carrying amount	Fair value through profit or loss	Available for sale	Loans and receivables
As at 31 December 2017				
Assets				
Loans and advances to banks	5,749,157	-	-	5,749,157
Loans and advances to customers	26,225,950	-	-	26,225,950
Investment securities	5,373,518	-	5,373,518	-
Cash and cash equivalents	5,481,312	-	-	5,481,312
Derivative financial instruments	633,270	633,270	-	-
Other assets	757,867	-	-	757,867
Total financial instrument assets	44,221,074	633,270	5,373,518	38,214,286

In thousands of ZAR	Total carrying amount	Fair value through profit or loss	Liabilities held at amortised cost
As at 31 December 2017			
Liabilities			
Deposits from customers	15,325,960	-	15,325,960
Deposits from banks	16,339,981	-	16,339,981
Derivative financial instruments	223,631	223,631	-
Commercial paper	7,333,365	-	7,333,365
Other liabilities	230,968	-	230,968
Total financial instrument liabilities	39,453,905	223,631	39,230,274

The remaining financial instruments approximate fair value owing to their nature being short-term.

Foreign exchange derivatives

This category of derivatives reflect forex forward contracts as it is linked to the foreign exchange (FX) market and it traded as over-the-counter derivatives.

These derivatives are valued using industry standard models. Input parameters include FX rates, interest rates, FX volatilities, interest rate volatilities, FX interest rate correlations and others as appropriate. No unobservable inputs are used in the valuation of the FX forward contracts, as these are generally of a very short-term (within twelve months) and hence publicly quoted inputs are available.

Notes to the annual financial statements for the year ended 31 December 2018

28.3 Financial instruments measured at fair value (Continued)

Investment securities

Investment securities refer to government bonds held by the Branch. These liquid government bonds are actively traded through an exchange or clearing house and are marked to the closing levels observed in these markets. Publicly quoted prices are available for all positions held as at 31 December 2018 and hence no market prices have to be sourced from broker quotes, inter-dealer prices or other reliable pricing services. No adjustments were made to market prices observed.

The nature of the valuation techniques set out in the table above is summarised as follows:

Level 1
Financial instruments valued using inputs that are based on unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available and the price represents actual and regularly occurring market transactions on an arm's length basis.

An active market is one in which transactions occur with sufficient volume and frequency to provide pricing information on an ongoing basis. The category includes liquid government bonds classified as investment securities.

Level 2
Financial instruments valued using inputs other than quoted prices as described above for level 1 but which are observable for the asset or liability, either directly or indirectly, such as:

- Quoted price for similar assets/liabilities in an active market;
- Quoted price for identical or similar assets or liabilities in inactive markets;
- Valuation model using observable inputs; and
- Valuation model using inputs derived from/corroborated by observable market data.

This category includes foreign exchange derivatives only.

There have been no transfers between Level 1 and Level 2 during the period.

Level 3
Level 3 inputs are unobservable inputs for the asset or liability.

Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The Branch develops unobservable inputs using the best information available in the circumstances, which might include the Branch's own data, taking into account all information about market participant assumptions that is reasonably available. The Branch does not have any Level 3 instruments.

Notes to the annual financial statements for the year ended 31 December 2018

28.3 Financial instruments measured at fair value (Continued)

The table below provides the fair value of financial assets and liabilities per category:

In thousands of ZAR	Total	Quoted prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As at 31 December 2018				
Assets measured at fair value:				
Derivative financial instruments	100,282	-	100,282	-
Investment securities	6,508,125	6,508,125	-	-
	6,608,407	6,508,125	100,282	-

In thousands of ZAR	Total	Quoted prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As at 31 December 2018				
Liabilities measured at fair value:				
Derivative financial instruments	130,525	-	130,525	-
	130,525	-	130,525	-

In thousands of ZAR	Total	Quoted prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As at 31 December 2017				
Assets measured at fair value:				
Derivative financial instruments	633,270	-	633,270	-
Investment securities	5,373,518	4,948,187	425,332	-
	6,006,788	4,948,187	1,058,602	-

In thousands of ZAR	Total	Quoted prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As at 31 December 2017				
Liabilities measured at fair value:				
Derivative financial instruments	223,631	-	223,631	-
	223,631	-	223,631	-

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk

Credit risk is the risk that the Branch will expect to incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Branch manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Branch has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk classification system, which assigns each counterparty a risk rating. Risk ratings are subject to regular revision. The credit quality review process aims to allow the Branch to assess the potential loss as a result of the risks to which it is exposed to and what corrective action to take.

Impairment assessment

For accounting purposes, the Branch uses an expected credit loss model for the recognition of losses on financial assets. Triggering events which has an impact on the assessment of the expect credit loss include the following:

- A breach of contract such as a default of payment
- Where the Branch grants the customer a concession due to the customer experiencing financial difficulty
- It becomes probable that the customer will enter bankruptcy or other financial reorganization
- Other observable data that suggests that there is a decrease in the estimated future cash flows from the loans

Stage one: Financial assets with no significant increase in credit risk since initial recognition are classified in stage one in the expected credit loss model, and are measured at the amount equal to the expected credit losses arising from default events on a financial instrument that are possible within the 12 months after the reporting date;

Stage two: Financial assets whose credit risk increases significantly from the initial recognition, but there is no objective evidence of impairment are classified in stage two of the expected credit loss model, over the lifetime period of the financial instrument;

Stage three: Financial assets with objective evidence of impairment at the reporting date are classified in stage three of the expected credit loss model, and their impairment provisions are measured at the amount equivalent to the expected credit losses over the lifetime period of the financial instrument;

Financial guarantees and letters of credit are assessed in a similar manner as for loans.

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk (Continued)

Credit ratings for all loans and advances balances are obtained from CCMS based on an individual balance review process. The table below presents the Branch's exposure to credit risk, per classification of internal ratings:

EXTERNAL RATING	INTERNAL RATING	31 December 2018	31 December 2017
AAA	AAA	**1,341,883**	3,204,236
AA	AA	**5,577,739**	7,558,941
A+	A	**11,094,000**	4,590,977
A-	BBB	**10,674,215**	5,930,462
BBB+	BB	**1,243,378**	5,342,490
BBB	B	**1,606,690**	3,897,309
BB	CCC	-	1,161,043
CCC	D	**236,845**	289,649
Unrated	Unrated	**26,891**	-
Total exposure, net of portfolio impairment		**31,801,641**	**31,975,107**

Net exposure per AFS	31,801,641	**31,975,107**
Loans and advances to banks: Non-current	5,098,168	3,669,044
Loans and advances to banks: Current	1,840,013	2,080,113
Loans and advances to customers: Non-current	12,891,164	14,282,054
Loans and advances to customer: Current	11,972,296	11,943,896

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk (Continued)

Collateral and Guarantees *In thousands of ZAR*	**Loans and advances to customers**		**Loans and advances to banks**		**Investment securities**	
	2018	2017	2018	2017	2018	2017
Collateral held	**149,603**	164,700	-	-	-	-
Guarantees held	**5,900,384**	8,498,785	-	-	-	-
Total	**6,049,987**	8,663,485	-	-	-	-
Concentration by sector						
Construction & engineering	**486,653**	603,591	-	-	-	-
Finance & insurance	**1,226,139**	9,866,912	6,938,181	5,749,157	-	425,332
Resources & mining	**4,478,262**	4,512,572	-	-	-	-
Manufacturing	**3,969,862**	2,582,961	-	-	-	-
Technology, media & telecommunications	**4,994,432**	5,879,956	-	-	-	-
Commercial real estate	**7,872,036**	4,807,995	-	-	-	-
Retailers & wholesalers	**938,540**	2,167,532	-	-	-	-
Sovereign	**362,950**	-	-	-	6,508,125	4,948,186
Private household	**27,004**	25,704	-	-	-	-
Other	**507,581**	1,527,884	-	-	-	-
Total carrying amount	**24,863,460**	31,975,107	6,938,181	5,749,157	6,508,125	5,373,518

Collateral held relates to cash provided by debtors as security in return for granting of debt instruments by the Branch. Guarantees held relate to commitments provided by debtors for a loss it may incur because of failure to make payment when due in accordance with the terms of the related debt instruments. The commitments are loan commitments provided to the companies.

Terms and conditions for collateral:
The facility must be covered by 100% security value at all times (Same currency facility and cash cover), and it can't be sold or repledged in the absence of default. The facility must be covered by 110% security value at all times (Different currency facility and different currency cash cover). Should the cash cover currency to facility currency exchange rate (security value) drop below 110% of the total facilities, additional cash cover is required to be deposited to bring the exposure within the approved facilities, within 3 (three) working days. The Branch reserves the right to convert the cash covers and repay the loan automatically. In the case of irrevocable standby letter of guarantee an additional amount will be requested from the issuing branch.

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk (Continued)

	Loans and advances to customers		Loans and advances to banks		Guarantees	
	2018	2017	**2018**	2017	**2018**	2017
Total exposure	**24,863,460**	31,975,107	**6,938,182**	5,749,157	**5,900,384**	8,498,785
Collateral held	**149,603**	164,700	-	-	-	-
Uncollateralised	**24,713,857**	31,810,407	**6,938,182**	5,749,412	**5,900,384**	8,498,785

Credit Quality Grading

The Credit Ratings are disclosed as follows:

The credit ratings were obtained from Corporate Credit Management System platform (Internal system). These are further classified as follows:

Strong Grade – the Strong Grade means that the credit rating is rated from A to AAA based on the internal rating. The Strong classification means that the borrower will repay interest and the principal of the loans will be fully paid in a timely manner.

Satisfactory Grade- the Satisfactory Grade means that the credit rating is rated from B to BBB based on the internal rating system. A satisfactory classification means that there factors which causes attention which has an impact on the borrowers solvency and operations. These factors include economic factors, industrial cycle and government policies.

Higher Risk Grade – the Higher Risk Grade means that the credit rating is C or lower based on the internal rating system. A higher Risk classification means that the borrower has problems with the repayment of loans and interest.

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk (Continued)

Disclosures by Credit Rating Grades

The table below shows the Credit Quality of the loans and advances at amortised cost after the adoption of IFRS 9 as at 1 January 2018

	Strong (Including investment grade)				Satisfactory (BBB to B)				Higher Risk (B- and below)			
In thousands of ZAR												
As at 1 January 2018	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Gross Carrying amount												
Corporate Loans	19,751.791	363,221	-	20,115,012	7,538,649	2,982,099	-	10,520,748	1,135,713	-	821,317	1,957,030
Home Loans	-	-	-	-	-	-	-	-	28,989	4,116	-	33,105
Sub-total	19,751.791	363,221	-	20,115,012	7,538,649	2,982,099	-	10,520,748	1,164,702	4,116	821,317	1,990,135
Impairment allowance												
Corporate Loans	(53,317)	(4,489)	-	(57,806)	(66,032)	(200,124)	-	(266,156)	(11,297)	-	(543,666)	(554,963)
Home Loans	-	-	-	-	-	-	-	-	(47)	(171)	-	(218)
Sub-total	(53,317)	(4,489)	-	(57,806)	(66,032)	(200,124)	-	(266,156)	(11,344)	(171)	(543,666)	(555,181)
Net Exposure												
Corporate Loans	19,698,474	358,732	-	20,057,206	7,472.617	2,781,975	-	10,254,592	1,124,416	-	277,651	1,402,067
Home Loans	-	-	-	-	-	-	-	-	28,942	3,945	-	32,887
Sub-total	19,698,474	358,732	-	20,057,206	7,472.617	2,781,975	-	10,254,592	1,153,358	3,945	277,651	1,434,954

Notes to the annual financial statements for the year ended 31 December 2018

28.4 Credit risk (Continued)

In thousands of ZAR	Strong (including investment grade)				Satisfactory (BBB to B)				Higher Risk (B- and below)			
As at 31 December 2018	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total
Gross Carrying amount												
Corporate Loans	18,017,635	70,699	-	18,088,334	11,992,152	1,827,910	-	13,820,062	-	-	832,768	832,768
Home Loans	-	-	-	-	-	-	-	-	27,375	-	-	27,375
Sub-total	18,017,635	70,699	-	18,088,334	11,992,152	1,827,910	-	13,820,062	27,375	-	832,768	860 143
Impairment allowance												
Corporate Loans	(72 825)	(1,887)	-	(74 712)	(78 412)	(217 367)	-	(295,779)	-	-	(595,923)	(595,923)
Home Loans	-	-	-	-	-	-	-	-	(484)	-	-	(484)
Sub-total	(72 825)	(1,887)	-	(74 712)	(78 412)	(217 367)	-	(295 779)	(484)	-	(595,923)	(596 407)
Net Exposure												
Corporate Loans	17, 944,810	68,812	-	18,013,622	11,913,740	1,610,543	-	13,524,283	-	-	236,845	236,845
Home Loans	-	-	-	-	-	-	-	-	26,891	-	-	26,891
Sub-total	17, 944,810	68,812	-	18,013,622	11,913,740	1,610, 543	-	13,524,283	26,891	-	236,845	263,736

Notes to the annual financial statements for the year ended 31 December 2018

28.5 Liquidity risk

	Carrying amount	On demand	Less than 1 month	Between 1-3 months	Between 3-12 months	Between 1-3 years	More than 3 years	Total undiscounted cash flow
In thousands of ZAR								
As at 31 December 2018								
Non-derivative liabilities								
Deposits from banks	16,345,181	381,644	1,449,971	2,622,326	6,243,828	5,976,586	-	16,674,355
Deposits from customers	14,070,313	3,641,761	7,293,511	1,045,901	2,182,088	5,131	-	14,168,392
Commercial paper	5,772,494	-	-	-	2,202,259	3,887,474	-	6,089,733
Other liabilities	178,244	178,244	-	-	-	-	-	178,244
Sub-total	36,366,232	4,201,649	8,743,482	3,668,227	10,628,175	9,869,191	-	37,110,724
Derivative liabilities								
Derivative outflow	130,525	-	42,876	75,021	12,628	-	-	130,525
Sub-total	130,525	-	42,876	75,021	12,628	-	-	130,525
Financial letter of credit	143,408	-	3,011	84,390	56,007	-	-	143,408
Financial guarantee	547,981	-	457	-	215,681	58,513	273,330	547,981
Sub-total	691,389	-	3,468	84,390	271,688	58,513	273,330	691,389
Total	37,188,146	4,201,649	8,789,826	3,827,638	10,912,491	9,927,704	273,330	37,932,638

Notes to the annual financial statements for the year ended 31 December 2018

28.5 Liquidity risk (Continued)

	Carrying amount	On demand	Less than 1 month	Between 1-3 months	Between 3-12 months	Between 1-3 years	More than 3 years	Total undiscounted cash flow
In thousands of ZAR								
As at 31 December 2017								
Non-derivative liabilities								
Deposits from banks	16,339,981	154,019	2,429,006	3,544,431	1,346,876	11,083,555	185,894	18,743,781
Deposits from customers	15,325,959	2,391,753	6,700,557	4,600,969	1,744,120	3,386	-	15,440,785
Commercial paper	7,333,366	-	-	2,294,506	326,355	5,214,955	-	7,835,816
Other liabilities	69,387	69,387	-	-	-	-	-	69,387
Sub-total	39,068,693	2,615,159	9,129,563	10,439,906	3,417,351	16,301,896	185,894	42,089,769
Derivative liabilities								
Derivative outflow	223,631	-	80,949	112,250	30,432	-	-	223,631
Sub-total	223,631	-	80,949	112,250	30,432	-	-	223,631
Financial letter of credit	2,019,183	-	529,243	1,483,901	6,039	-	-	2,019,183
Financial guarantee	610,381	-	3,673	21,290	483,780	-	101,639	610,382
Sub-total	2,629,564	-	532,916	1,505,191	489,819	-	101,639	2,629,565
Total	41,921,888	2,615,159	9,743,428	12,057,347	3,937,602	16,301,896	287,533	44,942,965

Notes to the annual financial statements for the year ended 31 December 2018

28.5 Liquidity risk (Continued)

Maturities of financial assets	**On demand**	**Less than 1-3 months**	**Between 3-12 months**	**Between 1-5 years**	**Over 5 years**	**Total**
In thousands of ZAR						
As at 31 December 2018						
Cash and cash equivalents	611,601	4,173,158	216,359	-	-	5,001,118
Derivative financial instruments	-	7,828	-	92,454	-	100,282
Loans and advances to banks	-	914,622	903,206	5,120,353	-	6,938,181
Loans and advances to customers	236,845	6,599,253	4,998,740	8,826,800	4,201,822	24,863,460
Investment securities	-	99,275	2,744,527	3,664,323	-	6,508,125
Other assets	768,891	-	-	-	-	768,891
Total carrying amount	1,617,337	11,794,136	8,862,832	17,703,930	4,201,822	44,180,057

Maturities of financial assets	**On demand**	**Less than 1-3 months**	**Between 3-12 months**	**Between 1-5 years**	**Over 5 years**	**Total**
In thousands of ZAR						
As at 31 December 2017						
Cash and cash equivalents	795,107	4,666,104	-	-	-	5,461,211
Derivative financial instruments	-	449,187	21,656	162,427	-	633,270
Loans and advances to banks	-	844,532	1,235,581	3,669,044	-	5,749,157
Loans and advances to customers	289,649	7,075,259	4,579,321	11,502,605	3,204,448	26,651,282
Investment securities	-	-	2,940,352	2,007,834	-	4,948,186
Other assets	756,197	-	-	-	-	756,197
Total carrying amount	1,840,953	13,035,082	8,776,910	17,341,910	3,204,448	44,199,303

Notes to the annual financial statements for the year ended 31 December 2018

28.6 Currency risk

The table below represents the Branch's exposure to major global currencies. The category for "other" consists primarily of CNY and HKD:

In thousands of ZAR	ZAR	USD	EUR	GBP	Other	Total
As at 31 December 2018						
Assets						
Cash and cash equivalents	285,082	4,155,382	453,633	14,419	92,602	5,001,118
Derivative financial instruments	5,816	1,842	133	-	92,491	100,282
Loans and advances to banks	-	6,347,707	-	-	590,474	6,938,181
Loans and advances to customers	9,269,889	13,044,113	1,629,162	920,296	-	24,863,460
Investment securities	6,508,125	-	-	-	-	6,508,125
Other assets	768,891	-	-	-	-	768,891
Total assets	16,837,803	23,549,044	2,082,928	934,715	775,567	44,180,057
Liabilities						
Derivative financial instruments	115,582	441	14,502	-	-	130,525
Deposits from banks	917,083	11,264,267	2,647,652	924,387	591,792	16,345,181
Deposits from customers	12,635,969	1,371,479	3,128	3,279	56,458	14,070,313
Commercial paper	2,603,489	-	-	-	3,169,005	5,772,494
Other liabilities	42,336	104,535	8,906	1,521	20,946	178,244
	16,314,459	12,740,722	2,674,188	929,187	3,838,201	36,496,757
	523,344	10,808,322	(591,260)	5,528	(3,062,634)	7,683,300

Sensitivity analysis

	ZAR	USD	EUR	GBP	Other	Total
Total currency position	523,344	10,808,322	(591,260)	5,528	(3,062,634)	7,683,300
Reasonable shift in rates	10%	10%	10%	10%	10%	10%
Exchange rate	1.0000	14.3930	16.4713	18.4072	2.0942	
Impact on profit or loss (depreciation in rate)	-	1,080,832	(59,126)	553	(306,263)	715,996
Impact on profit or loss (appreciation in rate)	-	(1,080,832)	59,126	(553)	306,263	(715,996)

Notes to the annual financial statements for the year ended 31 December 2018

28.6 Currency risk (Continued)

In thousands of ZAR	ZAR	USD	EUR	GBP	Other	Total
As at 31 December 2017						
Assets						
Cash and cash equivalents	271,906	4,072,416	8,200	13,542	1,115,248	5,481,312
Derivative financial instruments	8	310,948	-	-	322,314	633,270
Loans and advances to banks	144,445	5,093,353	-	-	511,359	5,749,157
Loans and advances to customers	12,157,959	8,124,830	5,107,776	835,385	-	26,225,950
Investment securities	5,373,518	-	-	-	-	5,373,518
Other assets	756,026	167	-	-	4	756,197
Total assets	18,703,862	17,601,714	5,115,976	848,927	1,948,925	44,219,404
Liabilities						
Derivative financial instruments	-	17,365	-	-	206,266	223,631
Deposits from banks	1,755,664	8,281,199	5,106,929	839,152	357,037	16,339,981
Deposits from customers	12,335,758	2,921,113	3,004	3,038	63,046	15,325,959
Commercial paper	4,456,742	-	-	-	2,876,624	7,333,366
Other liabilities	1,775	65,926	-	-	1,686	69,387
Total liabilities	18,549,939	11,285,603	5,109,933	842,190	3,504,659	39,292,324
Net gap on statement of financial position	153,924	6,316,111	6,043	6,737	(1,555,734)	4,927,081

Sensitivity analysis

Total currency position	153,924	6,316,111	6,043	6,737	(1,555,734)	4,927,081
Reasonable shift in rates	10%	10%	10%	10%	10%	10%
Exchange rate	1.0000	12.3828	14.8643	16.7329	1.9010	
Impact on profit or loss (depreciation in rate)	-	631,611	604	674	(155,573)	477,316
Impact on profit or loss (appreciation in rate)	-	(631,611)	(604)	(674)	155,573	(477,316)

Assume that the rates of rand against all foreign currencies appreciate or depreciates by 10%.

Notes to the annual financial statements for the year ended 31 December 2018

28.7 Interest rate risk

In thousands of ZAR	Interest bearing	Non-interest bearing	Total
As at 31 December 2018			
Assets			
Cash and cash equivalents	5,001,118	-	5,001,118
Derivative financial instruments	-	100,282	100,282
Loans and advances to banks	6,938,181	-	6,938,181
Loans and advances to customers	24,863,460	-	24,863,460
Investment securities	6,508,125	-	6,508,125
Other assets	-	768,891	768,891
Total assets	43,310,884	869,173	44,180,057
Liabilities			
Derivative financial instruments	-	130,525	130,525
Deposits from banks	16,345,181	-	16,345,181
Deposits from customers	14,070,313	-	14,070,313
Commercial paper	5,772,494	-	5,772,494
Other liabilities	-	178,244	178,244
Total liabilities	36,187,988	308,769	36,496,757
Net gap on statement of financial position	7,122,896	560,404	7,683,300

Sensitivity analysis

	Interest bearing	Total
Reasonable possible shift in rates	0.5%	0.5%
As at 31 December 2018		
Impact on profit or loss (increase)	35,614	35,614
Impact on profit or loss (decrease)	(35,614)	(35,614)
Impact on equity (increase)	35,614	35,614
Impact on equity (decrease)	(35,614)	(35,614)

The table above represents the impact on [profit or loss, and equity, based on a 0.5% shift (appreciation or depreciation) in interest rates and statement of financial position items. An increase/ (decrease) in interest rates results in an increase/ (decrease) in profit or loss.

Notes to the annual financial statements for the year ended 31 December 2018

28.7 Interest rate risk (Continued)

In thousands of ZAR	Interest bearing	Non-interest bearing	Total
As at 31 December 2017			
Assets			
Cash and cash equivalents	5,481,312	-	5,481,312
Derivative financial instruments	-	633,270	633,270
Loans and advances to banks	5,749,157	-	5,749,157
Loans and advances to customers	26,225,950	-	26,225,950
Investment securities	5,373,518	-	5,373,518
Other assets	-	756,197	756,197
Total assets	42,829,937	1,389,467	44,219,404
Liabilities			
Derivative financial instruments	-	223,631	223,631
Deposits from banks	16,339,981	-	16,339,981
Deposits from customers	15,325,960	-	15,325,960
Commercial paper	7,333,365	-	7,333,365
Other liabilities	-	69,387	69,387
Total liabilities	38,999,306	293,018	39,292,324
Net gap on statement of financial position	3,830,631	1,096,449	4,927,080

Sensitivity analysis

	Interest bearing	Total
Reasonable possible shift in rates	**0.5%**	**0.5%**
As at 31 December 2017		
Impact on profit or loss (increase)	19,153	19,153
Impact on profit or loss (decrease)	(19,153)	(19,153)
Impact on equity (increase)	19,153	19,153
Impact on equity (decrease)	(19,153)	(19,153)

The table above represents the impact on profit or loss, and equity, based on a 0.5% shift (appreciation or depreciation) in interest rates and statement of financial position items. An increase/ (decrease) in interest rates results in an increase/ (decrease) in profit or loss.

Notes to the annual financial statements for the year ended 31 December 2018

29. Related parties

In thousands of ZAR	2018	2017
Deposits and loans held with intra-group entities		
Bank of China (Hong Kong) Limited (fellow subsidiary)	52,754	3,480
Bank of China Limited, Tokyo Branch	2	2
Bank of China Limited, London Branch	14,419	1,375,877
Bank of China Limited, Frankfurt Branch	453,633	8,200
Bank of China Limited, New York Branch	129,791	335,804
Bank of China Limited, Head Office (Parent Company)	1,959,641	99,162
Bank of China Limited, Singapore Branch	31	27
Bank of China Limited, Shanghai Branch	37,592	57,378
Bank of China Limited, Shanghai Clearing	-	4,538
Bank of China Limited, Cayman Branch	2,063,374	3,070,459
Bank of China Limited, Xinjiang Branch	-	20,244
Bank of China Limited, Paris Branch	-	229,920
Total	4,711,237	5,205,091

In thousands of ZAR	2018	2017
Deposits and loans from intra-group entities		
Bank of China Limited, London Branch	(247)	(140)
Bank of China Limited, Beijing Branch	-	(2,484,356)
Bank of China Limited, Head Office	(9,853,434)	(9,322,206)
Bank of China (Hong Kong) Limited (fellow subsidiary)	(51,698)	(58,923)
Bank of China (Zambia) Limited (fellow subsidiary)	(14,443)	(12,432)
Bank of China Limited, Macau Branch	(1,479,897)	(892,941)
Bank of China Limited, Taiwan Branch	-	(2,973)
Bank of China (Mauritius) Limited (fellow subsidiary)	(143)	-
Bank of China, Hong Kong Branch	(3,233,325)	-
Bank of China Limited, Tanzania Rep office	-	(463)
Total	(14,633,187)	(12,774,434)

Notes to the annual financial statements for the year ended 31 December 2018

29. Related parties (Continued)

In thousands of ZAR	2018	2017
Interest income from intra-group entities		
Bank of China (Hong Kong) Limited (fellow subsidiary)	835	7,366
Bank of China Limited, Head Office (Parent Company)	32,312	1,943
Bank of China Limited, London Branch	431	1,598
Bank of China Limited, Paris Branch	251	1,874
Bank of China Limited, Frankfurt Branch	8,664	17,013
Bank of China Limited, New York Branch	233	373
Bank of China Limited, Cayman Branch	62,664	57,677
Bank of China Limited, Shanghai Branch	54,727	1,886
Bank of China Limited, Shanghai Branch CL	166	175
Bank of China Limited, Hong Kong Branch	467	1,799
Bank of China Limited, Seoul Branch	-	67
Bank of China Limited, Xinjiang Branch	144	2,095
Bank of China Limited, Nanjing Branch	-	148
Total	160,894	94,014

In thousands of ZAR	2018	2017
Expenses to intra-group entities		
Bank of China Limited, Head Office (Parent Company)	(6,996)	(15,441)
Bank of China Limited, London IT Centre	-	(1,544)
Bank of China Limited, Paris back office	(9,556)	(8,749)
Bank of China Limited, Shanghai Branch	(759)	(638)
Bank of China Limited, Guangdong Branch	(1,273)	(521)
Bank of China Limited, Singapore Branch	(1,206)	-
Bank of China Limited, Thailand Branch	(616)	-
Total	(20,406)	(26,893)

The nature of the intragroup expenses is as follows: The Head Office expenses consist of the Head office fees and IT expenses while the Paris expenses are back-office expenses. The remaining counterparties relate to the profit sharing.

Notes to the annual financial statements for the year ended 31 December 2018

29. Related parties (Continued)

In thousands of ZAR	2018	2017
Interest expense to intra-group entities		
Bank of China Limited, Head Office (Parent Company)	(150,581)	(85,323)
Bank of China Limited, Taipei Branch	(722)	(2,904)
Bank of China Limited, Hong Kong Branch	(171,055)	(50,723)
Bank of China Limited, Seoul Branch	-	(129)
Bank of China Limited, London Branch	(678)	(933)
Bank of China Limited, Paris Branch	(10)	(120)
Bank of China Limited, Cayman Branch	-	(1,758)
Bank of China Limited, Dubai Branch	(260)	(35)
Bank of China Limited, Frankfurt Branch	8	(66)
Bank of China Limited, Macau Branch	(37 007)	(13,395)
Bank of China Limited, Hungary Branch	(66)	(246)
Bank of China Limited, Luxemburg Branch	(2,054)	(416)
Bank of China Limited, Sydney Branch	-	(290)
Bank of China Limited, New York Branch	(29)	-
Bank of China Limited, Mauritius (Fellow subsidiary)	-	(204)
Bank of China Limited, Hungary (Fellow subsidiary)	(3)	-
Bank of China Limited, Canada (Fellow subsidiary)	-	(72)
Bank of China Limited, Hong Kong (Fellow subsidiary)	(46,017)	(45,401)
Total	(408,474)	(202,015)

The net balance consists of:	2018	2017
Cash and cash equivalents	4,711,237	5,127,572
Loans and advances to banks	-	77,519
Deposits from banks	(14,633,187)	(12,774,434)
Head Office and London IT Centre fee payable	(20,406)	(26,893)
Total	(9,942,356)	(7,596,236)

Compensation of key management personnel of the Bank

In thousands of ZAR	2018	2017
Short-term employee benefits	26,043	20,301
Total	26,043	20,301

The remuneration and benefits include fixed salaries, performance bonuses, allowances, life insurance, medical-aid insurance, and accommodation rental.

Notes to the annual financial statements for the year ended 31 December 2018

30. Events after reporting period

There are no subsequent events after the reporting period up to the date of signature of the annual financial statements.

31. Segment reporting

Reportable segments
For management purposes, the Bank of China Johannesburg Branch is organized into one main operating segment. The chief operating decision maker makes all significant operating decisions are based upon analysis of the Bank as a whole (i.e. as one segment). The financial results from this segment are equivalent to the financial statements of the Branch as a whole.

Entity wide disclosures:
Geographic segmentation: Bank of China Johannesburg Branch operates in South Africa.
Major customers: There are no single external customers that individually contribute to 10% or more of the Branch's revenue.