[Digital Transformation, Sustainable Innovations and Development in the African Continent]

[Thursday 31st July and Friday 1st August 2025]

[KWUST 2025 Conference Proceedings]

ABSTRACT NO. 17

International Financial Reporting Standard (IFRS) 9 Stage 3 Loan Loss Provisions and the Financial Performance of Commercial Banks in Kenya

Ms. Lucy Ajwang & Ms. Alice Muthia

Kiriri Women's University of Science and Technology, Kenya

ABSTRACT

Since the mandatory adoption of International Financial Reporting Standard 9 (IFRS 9) on 1 January 2018, Kenyan banks have measured impairment with a forward-looking expected-credit-loss (ECL) model. Loans that are credit-impaired are classified in "Stage 3", requiring lifetime ECL recognition and extensive disclosure. While the standard aims to improve provisioning discipline, the higher and more volatile provisions could reduce profitability or, conversely, enhance it by signalling prudent risk management. Using secondary panel data for all 37 licensed commercial banks from 2018–2024, this study estimates the effect of the Stage 3 loan-loss-provision (LLP) ratio on return on assets (ROA) and return on equity (ROE). Fixed-effects and two-step system-GMM models are employed, controlling for bank-specific and macro-economic factors. Preliminary results show a significant negative association, suggesting that a 1 percentage-point increase in Stage 3 LLP ratio lowers ROA by 0.15 percentage points and ROE by 0.27 percentage points. These findings imply a trade-off between prudent provisioning and short-term profitability, underscoring the need for robust credit-risk practices and counter-cyclical capital buffers.

Keywords:

IFRS 9, Stage 3, expected-credit-loss, loan-loss provisions, ROA, ROE, Kenya.