



MIDDLE EAST BANK KENYA LIMITED

ANNUAL REPORT & FINANCIAL STATEMENTS

2019

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Board of directors: Akber A K Esmail - Chairman
Isaac Mwige - Managing Director
Nancy Kaminchia
Thomas Mulwa
Faith Kibowen
Dhiren Rana
Titus Ibui

Company secretary: Zainash Registrars
1st Floor, Pacis Centre
Off Waiyaki Way, Westlands
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Nairobi, Kenya

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Nairobi, Kenya

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Fax: +254 20 343776
Email: ho@mebkenya.com
Website: www.mebkenya.com

Auditors: PricewaterhouseCoopers LLP
PwC Tower
Waiyaki Way/Chiromo Road, Westlands
P.O Box 43963 – 00100
Nairobi, Kenya

Branches: **Milimani Road Branch**
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Industrial Area Branch
Butere Road
Off Dar es Salaam Road
P.O Box 18973 – 00400
Nairobi, Kenya

Nkrumah Road Branch
Nkurumah Road
P.O Box 90343 – 80100
Mombasa, Kenya

Eldoret Branch
Ronald Ngala Street
P.O Box 7847 – 30100
Eldoret, Kenya

Mwembe Tayari Branch
Kenyatta Avenue
P.O Box 90343 – 80100
Mombasa, Kenya

Board and senior management committees

Board Audit Committee

F Kibowen - Chairperson
N Kaminchia
T Mulwa
T Ibui
D Rana

Board Credit Committee

T Mulwa - Chairman
A A K Esmail
T Ibui
D Rana

Board Risk & Compliance Committee

N Kaminchia - Chairperson
T Ibui
A A K Esmail
D Rana

Senior Management & ICT Steering Committees

I Mwige - Managing Director (*Senior Management Committee only*)
S Musyoka - Head, SME & Retail Banking
M Gitahi - Head, Internal Audit
E Omolo - Head, Compliance
C Mbela - Head, Corporate
J Ndwiga - Head, Institutional Banking
G Settim - Head, ICT
E Ong'are - Manager, Credit
S Odiero - Head, Finance (Acting)
D Kalume - Head, Operations (Acting)

Assets & Liabilities Committee

Managing Director - Chairman
Head, Treasury
Head, Finance
Head, Credit
Head, Operations
Head, Corporate
Head, Institutional Banking

Risk Management Committee

Managing Director - Chairman
Head, Finance
Head, Compliance
Head, Internal Audit
Head, Operations
Head, Credit
Head, Admin
Head, Human Resources
Head, ICT

Management Credit Committee

Managing Director - Chairman
Head, Credit
Head, Corporate

Meetings of the Board of Directors and Committees of the Board in 2019

Board of Directors Meetings in 2019

The Board of Directors held three ordinary meetings in 2019

Director	June 2019	October 2019	December 2019
A A K Esmail	√	√	√
I Mwine*	-	√	√
D Rana	√	√	√
N Kaminchia	√	√	√
T Ibui**	-	x	√
A D Raja***	-	-	-
T Mulwa	√	√	√
F Kibowen	x	√	x

Board Audit Committee Meetings in 2019

The Board Audit Committee held three meetings in 2019

Director	March 2019	October 2019	December 2019
A D Raja***	√	-	-
N Kaminchia	√	√	√
T Ibui**	-	√	x
T Mulwa	√	√	√
F Kibowen	√	√	√
D Rana	-	-	√

Board Risk and Compliance Committee Meetings in 2019

The Board Risk and Compliance Committee held two meetings in 2019

Director	October 2019	December 2019
N Kaminchia	√	√
T Ibui**	-	√
A A K Esmail	√	√
D Rana	√	√

Board Credit Committee Meetings in 2019

The Board Credit Committee held 2 meetings in 2019

Director	June 2019	September 2019
A A K Esmail	√	√
I Mwine*	-	√
D Rana	√	√
T Ibui**	-	√
T Mulwa	√	√

√ Attended Meeting

x Absent from meeting with apology

* Mr. Isaac Mwine was appointed Managing Director on 3rd July 2019

** Mr. Titus Ibui was appointed to the Board of Directors on 20th August 2019

*** Mr. Anil Raja resigned as a member of the Board of Directors on 13th June 2019

I present the 39th annual report and accounts for the year ended 31st December 2019 to the shareholders of our Bank.

In 2019, the Kenyan economy experienced economic growth driven by relative stability in macroeconomic environment, lower oil prices, boost in agriculture due to favorable weather, improved business confidence coupled with rebound in tourism and hospitality sectors. However, challenges from public sector wage bill and spiraling public debt continue to pile pressure on Government revenues.

In the domestic foreign exchange market, the US dollar experienced minimal volatility during the year and this impacted our foreign exchange income. The Shilling fluctuated within a narrow range from Kshs 101.90 to US \$ 1 at the beginning of the year and closed the year at Kshs 101.45. On the other hand, the GB pound significantly fluctuated from Kshs 129.93 at the beginning of the year and closed at Kshs 133.06. The Euro also significantly fluctuated from Kshs 116.87 at the beginning of the year and closed at Kshs 113.69. Thus, the Shilling continued being resilient on the backdrop of strong remittance flows and export proceeds.

The Central Bank Rate (CBR) currently stands at 7% p.a. The cap on lending rates was removed during the year. Interest capping has negatively impacted interest income in the entire Banking industry. During the year, yields on Government securities have been on the decline due to high liquidity in the market.

The Bank's financial position tremendously improved in 2019 compared to previous year. Total assets stood at Kshs 8.466bn from Kshs 5.361bn in the previous year. Balance sheet increase was largely attributed to increase in customer deposits. Total shareholder funds slightly decreased from Kshs 1.158bn in 2018 to Kshs 1.155bn in 2019 largely due to dividend payout. Profitability before tax greatly improved to Kshs 59.6m from Kshs 0.5m in previous year. Increased customer advances resulted in lower liquidity ratio of 24.2%. The Bank continued with strong capital adequacy ratios and was well above the minimum statutory ratios.

Our outlook for 2020 is grim following the onset of COVID 19 pandemic that has adversely impacted the entire global economy. The macroeconomic environment is expected to be volatile due to the uncertainties surrounding the pandemic as no cure has yet been found. Kenya's economy was initially projected to grow at 6.1% but the trajectory now seen is a sharp downturn which might be negative. On the backdrop of this, various tax incentives have been implemented by the Government whilst new revenue collection measures have been proposed. The pandemic has resulted in a decrease in collection of various taxes and the new proposals are targeted towards countering this.

Despite all this, our major focus for 2020 will be on revamping the Bank to tap deeper into the SME segment through new products and channels. Aggressive efforts will also be geared towards continued deposit mobilization. Trade finance and other non-funded business will be explored to shore up income since reduced credit growth and restructured loans will negatively impact our interest income.

On corporate governance, the Bank continues to uphold this with close Board and management oversight. The various Board and Management Committees remained active with specific responsibilities that ensure they effectively carry out their monitoring roles to ensure regulatory compliance as well as the Bank's profitability.

Finally, I remain grateful for the support of my fellow Board Members and their efforts in working for the continued success of the Bank. At the same time, I must also express my sincere appreciation for the hard work and dedication of the members of staff in ensuring that the Bank meets its key objectives.

AAK Esmail
Chairman

The directors submit their report together with the audited financial statements of Middle East Bank Kenya Limited (the "Bank") for the year ended 31 December 2019.

BUSINESS REVIEW

The Bank is engaged in the business of banking and the provision of related services and is licensed under the Banking Act.

The Bank's activities are principally related to the use of financial instruments. The Bank accepts deposits from customers that are both interest bearing and non-interest bearing, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets while maintaining sufficient liquidity to meet all claims that fall due.

The Bank made significant progress in 2019 compared to 2018. The balance sheet grew from Kshs 5.36 billion to Kshs 8.5 billion, underpinned by growth in deposits from Kshs 4.15 billion to Kshs 6.84 billion and loans from Kshs 2.56 billion to Kshs 5.96 billion. Profit before tax rose from Kshs 0.5 million to Kshs 59.6 million. Interest income was Kshs 653 million (2018: Kshs 501 million) while Interest expense was Kshs 322 million (2018: Kshs 257 million). The government removed interest rate capping on loans in November, 2019 and this opportune move is expected to spur credit growth in the industry, especially to the SME and Retail Sectors and the Bank is well positioned to benefit from this opportunity. The Bank had strong capital adequacy ratios which continue to be well above the minimum statutory ratios.

The Bank adopted International Financial Reporting Standard (IFRS) 16, Leases, effective 1 January 2019. The Bank recorded a charge to its opening equity on 1 January 2019 of Kshs 640,000 (net of tax) to reflect the impact of the new requirements of classification and measurement of Leases at the adoption date of IFRS 16 and did not restate comparative periods, as permitted by transitional provisions of the standard. Accordingly, the current year 2019 results on classification and measurement of Leases are based on IFRS 16 while the prior years' results are based on International Accounting Standard (IAS) 17, Leases, and therefore, certain amounts related to the financial instruments herein in notes 20 and 25 are not comparable. The main impact under IFRS 16 is that the Bank recognized the discounted present value of future lease liabilities in relation to leases which had previously been classified as 'operating leases' (under the principles of IAS 17 Leases). For detailed description of the changes, refer to Note 2 (c) (i) in these financial statements.

In the banking business, Banks are faced with exposure to various risks, among them credit risk, liquidity risk and market risk.

Credit risk is the risk that a counter party will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the reporting date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration of the Bank's portfolio, could result in impairment losses. Management therefore carefully manages credit risk exposure and regularly undertakes a portfolio review to vet the potential risk of each economic sector that the Bank is exposed to.

Liquidity risk is the risk that the Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits and calls on cash settled contingencies. The Central Bank of Kenya requires that the Bank maintains a cash reserve ratio of 5.25% and minimum liquidity ratio of 20% which the Bank continues to comply with. The treasury department monitors liquidity ratios daily, and this is closely reviewed by the Assets and Liability Committee (ALCO).

Market risk is the risk that changes in market prices, which include currency exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument. ALCO has the responsibility of market risk management and to control market risk exposures within acceptable limits, while optimising the return on risk.

The Bank has a well-trained staff complement of 62 across the 5 branches who understand the Bank's core values with strong emphasis on customer focus. The Bank has also heavily invested in Information Technology and rolled out a new core banking software in 2017.

DIVIDEND

The profit for the year of Shs 3,614,000 (2018 Shs 2,611,000) has been added to retained earnings. The directors recommend the approval of a final dividend of Shs 0.20 per share (2018: Shs 0.20 per share) amounting to Shs 5,068,000 (2018: Shs 5,068,000).

DIRECTORS

The directors who held office during the year and to the date of this report are as follows:

A A K Esmail	Chairman
I Mwine	Managing Director, appointed on 3 rd July 2019
D Rana	Resigned as Managing Director on 3 rd July 2019
N Kaminchia	
T Mulwa	
F Kibowen	
T Ibui	Appointed on 20 th August 2019
A Raja	Resigned on 13 th June 2019

In line with Central Bank of Kenya Prudential Guidelines, except for three directors (two directors who joined the board in the second half of the year), all directors attended over 75% of board meetings. Evaluation of the directors was through peer and self-evaluation.

AUDITORS

DISCLOSURES TO AUDITORS

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

- (a) there was, as far as each director is aware, no relevant audit information of which the company's auditors are unaware; and
- (b) each director had taken all steps that ought to have been taken as a director, so as to be aware of any relevant audit information and to establish that the company's auditors are aware of that information

TERMS OF APPOINTMENT OF AUDITORS

PricewaterhouseCoopers LLP continue in office in accordance with the Company's Articles of Association and Section 719 of the Kenyan Companies Act, 2015.

The directors monitor the effectiveness, objectivity and independence of the auditors. This responsibility includes the approval of the audit engagement contract and the associated fees on behalf of the shareholders.

By order of the Board

Zainash Registrars

Secretary

26 March 2020

The Kenyan Companies Act 2015 requires the directors to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank at the end of the financial year and of its profit or loss for that year. The directors are responsible for ensuring that the Bank keeps proper accounting records that are sufficient to show and explain the transactions of the Bank; disclose with reasonable accuracy at any time the financial position of the Bank; and that enables them to prepare financial statements of the Bank that comply with prescribed financial reporting standards and the requirements of the Kenyan Companies Act 2015. They are also responsible for safeguarding the assets of the Bank and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

- i. Designing, implementing and maintaining internal control as they determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;
- ii. Selecting suitable accounting policies and then apply them consistently; and
- iii. Making judgements and accounting estimates that are reasonable in the circumstances

Having made an assessment of the ability of the Bank to continue as a going concern, the directors have disclosed in note 2 (a)(ii) of these financial statements matters relating to the use of going concern basis for preparation of these financial statements.

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

Approved by the Board of Directors on 26 March 2020 and signed on its behalf by:

Isaac Mwige

Director

Akber Esmail

Director



INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Middle East Bank Kenya Limited (the "Bank") set out on pages 11 to 75 which comprise the statement of financial position at 31 December 2019, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 31 December 2019 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act 2015.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

With effect from 11 December 2019, PricewaterhouseCoopers, a partnership carrying on business under registration number BN.287839 was converted to PricewaterhouseCoopers LLP (LLP-2Y1AB7), a limited liability partnership under the Limited Liability Partnerships Act, 2011.

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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED (CONTINUED)

Other information (continued)

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the financial statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015 and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA LIMITED (CONTINUED)

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

- 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 Bank'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 Bank'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 Bank 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.

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

In our opinion the information given in the report of the directors on page 5 to 6 is consistent with the financial statements.

PricewaterhouseCoopers
Certified Public Accountants
Nairobi

27 March 2020

CPA Kang'e Saiti, Practising Certificate No. 1652.
Signing Partner responsible for the independent audit.

Statement of comprehensive income

	Notes	2019 Shs'000	2018 Shs'000
Interest income	5(a)	652,692	500,781
Interest expense	5(b)	(321,680)	(256,885)
Net interest income		331,012	243,896
Credit impairment (charges)/ decrease	16	(104,409)	5,822
Net interest income		226,603	249,718
Fee and commission income		132,737	34,740
Foreign exchange income		12,700	7,238
Other operating income	6	50,217	42,800
Net operating income		422,257	334,496
Operating expenses	7	(362,628)	(333,984)
Profit before income tax		59,629	512
Income tax (charge) /credit for the year	9	(56,015)	2,099
Profit for the Year		3,614	2,611
Other comprehensive income		-	-
Total comprehensive income for the Year		3,614	2,611

Statement of financial position

	Notes	2019 Shs'000	2018 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	12	521,097	353,903
Government securities at amortized cost	13	1,172,971	1,467,979
Deposits and balances due from banking institutions	14	286,294	501,054
Loans and advances to customers	16	5,964,756	2,560,398
Property and equipment	18	174,998	165,150
Prepaid operating lease rentals	19	72,478	73,444
Right of use assets	20	25,741	-
Intangible assets	21	36,010	41,775
Other assets and prepayments	15	136,633	84,101
Deferred income tax	17	75,306	113,060
Total assets		8,466,284	5,360,864
LIABILITIES			
Deposits from banks	22	300,000	-
Deposits from customers	23	6,837,845	4,146,661
Other liabilities and accrued expenses	24	136,033	55,611
Lease liabilities	25	29,538	-
Current income tax		7,084	714
Total liabilities		7,310,500	4,202,986
SHAREHOLDERS' EQUITY			
Share capital	26	506,831	506,831
Regulatory reserve	27	7,457	88,721
Retained earnings		641,496	562,326
Total shareholders' equity		1,155,784	1,157,878
Total equity and liabilities		8,466,284	5,360,864

The financial statements on pages 11 to 75 were approved for issue by the board of directors on 26 March 2020 and signed on its behalf by:

Isaac Mwigie
Director

Nancy Kaminchia
Director

Akber Esmail
Director

Zainash Registrars
Company Secretary

Statement of changes in equity

	Notes	Share capital Shs'000	Regulatory reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Balance at 1 January 2018		506,831	13,456	640,048	1,160,335
Total comprehensive loss for the year					
Profit for the year		-	-	2,611	2,611
Transfer to regulatory reserve	27	-	75,265	(75,265)	-
Transactions with owners					
Dividends:					
- final for 2017 paid	11	-	-	(5,068)	(5,068)
At end of year		506,831	88,721	562,326	1,157,878
Year ended 31 December 2019					
At start of year		506,831	88,721	562,326	1,157,878
Changes on initial application of IFRS 16, net of tax		-	-	(640)	(640)
Restated balance at 1 January 2019		506,831	88,721	561,686	1,157,238
Total comprehensive income for the year					
Profit for the year		-	-	3,614	3,614
Transfer from regulatory reserve	27	-	(81,264)	81,264	-
Transactions with owners					
Dividends:					
- final for 2018 paid	11	-	-	(5,068)	(5,068)
At end of year		506,831	7,457	641,496	1,155,784

Statement of cash flows

	Notes	2019 Shs'000	2018 Shs'000
Cash flows from operating activities			
Interest receipts		652,692	500,781
Interest payments		(318,089)	(256,885)
Fee and commission receipts		132,737	34,740
Foreign exchange receipts		12,700	7,238
Other income received		50,217	42,800
Payments to employees and suppliers		(330,439)	(311,142)
Income tax paid		(11,616)	(6,370)
Cash flows from operating activities before changes in operating assets and liabilities		188,202	11,162
Changes in operating assets and liabilities:			
Gross loans and advances		(3,511,442)	214,216
Cash reserve requirement		(149,899)	(17,913)
Other assets and prepayments		(52,532)	10,284
Government securities at amortized cost		295,008	(493,904)
Customer deposits		2,691,184	238,986
Other liabilities and accrued expenses		80,422	2,261
Interest paid on lease liabilities	25	3,591	-
Net cash generated from operating activities		(455,466)	(34,908)
Cash flows from investing activities			
Purchase of property and equipment	18	(25,116)	(3,100)
Purchase of intangible assets	21	(5,000)	(20,314)
Net cash used in investing activities		(30,116)	(23,414)
Cash flows from financing activities			
Repayment of lease liability	25	(6,815)	-
Dividends paid	11	(5,068)	(5,068)
Cash used in financing activities		(11,883)	(5,068)
Net decrease in cash and cash equivalents		(497,465)	(63,390)
Cash and cash equivalents at start of year		679,157	742,547
Cash and cash equivalents at end of year	29	181,692	679,157

Notes

1 General information

The Bank is incorporated in Kenya under the Companies Act and is domiciled in Kenya. The address of its registered office is:

Mebank Tower
Milimani Road
P O Box 47387-00100
Nairobi, Kenya

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, except for *IFRS 16, Leases, applied for the first time from January 2019* as explained in Note 2 (c)(i), and (ii).

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board. This is the first set of the Company's annual financial statements in which IFRS 16 *Leases* has been applied. Resultant changes to significant accounting policies are described in Note 2 (c)(i) and (ii).

(i) Basis of measurement

The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below.

For those assets and liabilities measured at fair value, 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. When measuring the fair value of an asset or a liability, the Bank uses market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Bank using valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would ordinarily take into account in an arms-length transaction.

Fair values are categorized into three levels of fair value hierarchy based on the degree to which the inputs to the measurements are observable and the significance of the inputs to the fair value measurement in its entirety:

Level 1 – fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – fair value measurements are derived from inputs other than quoted prices used in Level 1 that are observable for the assets or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 – fair values measurements are derived from valuation techniques that include inputs for assets or liabilities that are not based on observable market data (unobservable inputs). Transfers between levels of the fair value hierarchy are recognized by the Bank at the end of the reporting period during which the change occurred.

Notes (continued)

2 Summary of significant accounting policies

(a) Basis of preparation

(ii) *Going concern*

The Bank has reported a significant increase in performance with profit before tax for the year of Shs 59.6m up from Shs 0.5m in 2018. Net profit after tax was Shs 3.6m, up from Shs 2.6m in 2018. Correspondingly, the Balance Sheet has grown from Shs 5.36bn to Shs 8.5bn.

The financial statements reflect adequate liquidity at the reporting date. Related parties hold substantial deposits at the year end. In line with Basel 111 guidelines on liquidity coverage, related party depositors are considered stable depositors since they have established relationships with the Bank that make withdrawal highly unlikely.

The Bank's ratio of loans and advances to customer deposits is at 87.2% (2018: 61.7%). This compares well with the local banking industry which averages 70% across all tiers.

With the removal of the interest rate cap in November 2019, significant credit growth is expected across all sectors of the economy as banks ease off on investment in government securities and increase lending to corporate, retail and SME sectors.

The Bank has constituted a strong team to mobilize deposits and grow business and has forecasted significant growth in customer deposit and loan volumes in 2020.

Consequently, directors have sought and received a letter of financial support from the shareholders that they will support the Bank to meet its financial obligation for the next twelve months from the date of signing these financial statements.

Long term measures currently being pursued by the Bank include:

- Mobilization of deposits to increase the Bank's funding and focus to increase the Bank's lending and effectively increase the net interest margin and profitability.
- Raising additional capital.

Based on the above measures and factors, the directors believe that the going concern assumption is appropriate in the preparation of these financial statements

(b) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires the directors to exercise judgement in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statement are disclosed in Note 4.

Notes (continued)

2 Summary of significant accounting policies

(c) Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

IFRS 16 - Leases

The Bank has adopted IFRS 16, Leases, which replaced IAS 17, Leases, and which became effective from 1 January 2019. The Bank now recognises lease liabilities relating to leases under which the Bank is the lessee that were previously classified as operating leases, other than leases with less than 12 months to run from 1st January 2019 and leases of low value items. Corresponding right-of-use assets have been recognised, measured as if the Bank's new accounting policy had been applied since the commencement of each lease but discounted using the lessee's incremental borrowing rate at 1 January 2019. The difference between the lease liabilities and right-of-use assets at 1 January 2019 has been recognised as an adjustment to retained earnings at that date. As permitted by the transition provisions in the new standard, comparative amounts have not been restated.

	2019 Shs'000
Lease liabilities	21,399
Right of use of assets	20,484
Deferred tax	275
	<hr/>
Net adjustment to retained earnings 1 January 2019	640
	<hr/>

Impact on profit and loss for the year

Charge for depreciation for right of use assets (Note 20)	7,021
Charge for interest on lease liability (Note 25)	3,591
Lease repayments (Note 25)	(7,929)
	<hr/>
Decrease in profit for the year	2,683
	<hr/>

IFRIC 23, 'Uncertainty over income tax treatments'

IFRIC 23 provides a framework to consider, recognise and measure the accounting impact of tax uncertainties. The Interpretation provides specific guidance in several areas where previously IAS 12 was silent. The Interpretation also explains when to reconsider the accounting for a tax uncertainty. Most entities will have developed a model to account for tax uncertainties in the absence of specific guidance in IAS 12. These models might, in some circumstances, be inconsistent with IFRIC 23 and the impact on tax accounting could be material. Management has done an assessment with no significant impact.

Notes (continued)

2 Summary of significant accounting policies (continued)

(d) Interest income and expense

Interest income and expense are recognized in profit or loss for all interest-bearing instruments measured at amortized cost using the effective interest method.

Effective interest rate

Income from Government securities at amortized cost, deposits and balances due from other banking institutions and loans and advances to customers is recognized in profit or loss using the effective interest rate method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

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

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

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

Amortized cost and gross carrying amount

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

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

Calculation of interest income

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Fees and commissions

Fees and commissions income are generally recognized on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognized as an adjustment to the effective interest rate on the loan.

Fees and commissions expense are generally recognized on an accrual basis when incurred.

(f) Translation of foreign currencies

(a) Functional and presentation currency

The accounting records are maintained in the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings, which is the Bank's presentation currency. The figures shown in the financial statements are stated in Kenya Shillings (Shs), rounded to the nearest thousand (Shs '000).

(b) Transactions and balances

Transactions in foreign currencies during the year are translated into the Functional Currency using the exchange rates prevailing at the dates of the transaction or valuation where items are re-measured.

Monetary items denominated in foreign currency are translated at the closing rate as at the reporting date.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities

Classification and measurement of financial instruments

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss (FVTPL) and financial assets at amortized cost. Management determines the appropriate classification of its financial assets at initial recognition.

Classification of financial instruments

The Bank classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table as follows:

Category (as defined by IFRS 9)		Class (as determined by the Bank)	Subclasses
	Financial assets at amortized cost	Cash and balances with Central Bank of Kenya	
		Government securities at amortized cost	
		Deposits and balances due from banking institutions	
		Loans and advances to customers	Commercial loans
	Overdrafts		
	Personal loans		
	Mortgages		
	Financial liabilities at amortized cost	Deposits and balances due to banking institutions	
		Customer deposits	Current accounts and demand deposits
			Savings and transaction accounts
Fixed deposit accounts			
Off-balance sheet financial Instruments	Acceptances and letters of credit		
	Guarantees and performance bonds		
	Undrawn formal stand-by facilities, credit lines and other commitments to lend		

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Measurement methods

Amortized cost and effective interest rate

The amortized cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortized cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates the credit adjusted effective interest rate, which is calculated based on the amortized cost of financial assets instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cashflows.

When the Bank revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted using the effective interest rate. Any changes are recognized in the profit or loss.

Interest Income and interest expense

Interest income and interest expense is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortized cost of the financial asset
- b) Financial assets that are not POCI but have subsequently become credit impaired for which revenue is calculated by applying the effective interest rate to their amortized cost.

Initial recognition and measurement

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

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

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognized as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortized over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realized through settlement.

Financial assets

(i) Classification and subsequent measurement

The Bank classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (FVPL);
- Fair value through other comprehensive income (FVOCI); or
- Amortized cost.

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

Debt instruments

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

Classification and subsequent measurement of debt instruments depend on:

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

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

- Amortized cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortized cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognized and measured as described in note 3 (a). Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial assets (continued)

Debt instruments (continued)

- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortized cost which are recognized in profit or loss. When the financial asset is derecognized, the cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss and recognized in 'Net Investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.
- Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method

Business model

The business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Bank in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the 'other' business model and measured at FVPL.

SPPI

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss. Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial assets (continued)

i) Classification and subsequent measurement (continued)

The Bank reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

(ii) Impairment

The Bank assesses, on a forward-looking basis, the expected credit losses ('ECL') associated with its debt instrument assets carried at amortized cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Bank recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

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

Note 3 (a) provides more detail of how the expected credit loss allowance is measured.

(iii) Modification of loans

The Bank sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Bank assesses whether the new terms are substantially different from the original terms. The Bank does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

Notes (continued)

2 Summary of significant accounting policies (continued)

Financial instruments (continued)

Financial assets (continued)

iii) Modification of loans (continued)

If the terms are substantially different, the Bank derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognized is deemed to be credit-impaired at initial

recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognized in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

(iv) Derecognition other than on a modification

Financial assets, or a portion thereof, are derecognized when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

The Bank enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Bank:

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

Collateral (shares and bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Bank retains a subordinated residual interest.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial liabilities

(i) Classification and subsequent measurement

In both the current and prior period, financial liabilities are classified as subsequently measured at amortized cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognized for the consideration received for the transfer. In subsequent periods, the Bank recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments.

(ii) Derecognition

Financial liabilities are derecognized when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance; and
- The premium received on initial recognition less income recognized in accordance with the principles of IFRS 15.

Loan commitments provided by the Bank are measured as the amount of the loss allowance. The Bank has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognized as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognized together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognized as a provision.

(h) Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

(i) Assets carried at amortized cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or Bank of financial assets is impaired. A financial asset or a Bank of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or Bank of financial assets that can be reliably estimated.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- (a) significant financial difficulty of the issuer or obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- (d) it becomes probable that the borrower will enter bankruptcy or other financial reorganization;

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

(i) Assets carried at amortized cost (continued)

- (e) the disappearance of an active market for that financial asset because of financial difficulties; or
- (f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
 - (i) adverse changes in the payment status of borrowers in the portfolio; and
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a Bank of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. If a loan or held at amortized cost investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Bank may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset uses the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are Banked on the basis of similar credit risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for Banks of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated

Future cash flows in a Bank of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Bank and historical loss experience for assets with credit risk characteristics similar to those in the Bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

(i) Assets carried at amortized cost (continued)

Estimates of changes in future cash flows for Banks of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in property prices, payment status, or other factors indicative of changes in the probability of losses in the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Impairment charges relating to loans and advances to banks and customers are classified in loan impairment charges whilst impairment charges relating to investment securities (at amortized cost and loans and receivables categories) are classified in 'Net gains/(losses) on investment securities'.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in profit or loss.

Renegotiated loans

Loans whose terms have been renegotiated are treated as new loans and their classification is maintained unless:

- For loans that are not impaired, the loans have exhibited weaknesses which may weaken the assets or inadequately protect the institution's position at some future date, in which case they are classified as 'impaired'; or
- For impaired loans, all past due principal and interest is repaid in full at the time of renegotiation, in which case they may revert to 'past due but not impaired' classification. They may then be reclassified as 'neither past due nor impaired' if a sustained record of performance is maintained for six months from the date of renegotiation.

In subsequent years, the renegotiated terms apply in determining whether the asset is considered to be past due.

(i) Property and equipment

All property and equipment are stated at historical cost less depreciation. Depreciation is calculated on a straight-line basis to write down the cost of each asset to its residual value over its estimated useful life as follows:

– Buildings	50 years
– Leasehold improvements	Over the period of the lease
– Fixtures, fittings and equipment	5 -10 years
– Computers software and hardware	3 years
– Motor vehicles	4 years

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

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit.

Notes (continued)

2 Summary of significant accounting policies (continued)

(j) Intangible assets

Costs associated with maintaining computer software programs are recognized as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognized as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalized as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

Computer software development costs recognized as assets are amortized over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized on the basis of the expected useful lives. The Core banking Software has a maximum expected useful life of 8 years.

(k) Offsetting

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

(l) Income tax

Income tax expense is the aggregate of the charge to the statement of comprehensive income in respect of current income tax and deferred income tax.

(a) Current income tax

Current income tax is the amount of income tax payable on the profit for the year determined in accordance with the Kenyan Income Tax Act.

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Income tax (continued)

(b) Deferred income tax

Deferred income tax is provided in full, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. However, if the deferred income tax arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current income tax assets against current income tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same entity or different taxable entities where there is an intention to settle the balances on a net basis.

(m) Employee benefits

Retirement benefit obligation

The Bank operates a defined contribution retirement benefit scheme for its permanent employees. A defined contribution plan is a pension plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The assets of the scheme are held in separate trustee administered funds, which are funded by contributions from both the Bank and employees. The Bank and its employees also contribute to the National Social Security Fund, which is a defined contribution scheme. The Bank's contributions to the defined contribution schemes are charged to profit or loss in the year to which they relate. The estimated monetary liability for employees' accrued annual leave entitlement at the reporting date is recognized as an expense accrual.

(n) Dividends payable

Dividends on ordinary shares are charged to equity in the period in which they are declared. Proposed dividends are shown as a separate component of equity until declared.

(o) Forward foreign exchange contract

Forward foreign exchange contracts are carried at their fair value. Fair values are obtained from appropriate pricing models.

Gains and losses on forward foreign exchange contracts are included in foreign exchange income as they arise.

Notes (continued)

2 Summary of significant accounting policies (continued)

(p) Acceptances and letters of credit

Acceptances and letters of credit are accounted for as off-balance sheet transactions and disclosed as contingent liabilities.

(q) Leases

(i) The Bank's leasing activities and how these are accounted for

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable
- the exercise price of a purchase option if the Bank is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the lease term reflects the Bank exercising that option.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the Bank, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Bank:

- where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received
- uses a build-up approach that starts with a risk-free interest rate adjusted for credit risk for leases held by the Bank, which does not have recent third-party financing, and
- makes adjustments specific to the lease, e.g. term, country, currency and security.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

Notes (continued)

2 Summary of significant accounting policies (continued)

(q) Leases (continued)

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs, and
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the Bank is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less

Extension and termination options

Extension and termination options are included in a number of property and equipment leases across the Bank. These are used to maximise operational flexibility in terms of managing the assets used in the Bank's operations. The majority of extension and termination options held are exercisable only by the Bank and not by the respective lessor.

Leases under which the Company is the lessor

Leases that transfer substantially all the risks and rewards of ownership of the underlying asset to the lessee are classified as finance leases. All other leases are classified as operating leases. Payments received under operating leases are recognized as income in the profit and loss account on a straight-line basis over the lease term. The Bank has not entered into any finance leases.

Accounting policy prior to 1 January 2019

Below is the Bank's policy applied in the previous year on leases. Leases were divided into finance leases and operating leases.

a) The Bank is the lessee

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

Notes (continued)

2 Summary of significant accounting policies (continued)

(r) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with Banks, other short-term highly liquid investments with original maturities of three months or less, including cash and balances with Central Bank of Kenya, treasury and other eligible bills and amounts due from other banks. Cash and cash equivalents exclude the cash reserve requirements held with the Central Bank of Kenya.

(s) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are classified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits and balances due to banking institutions or deposits due to customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to customers or deposits and balances from banking institutions as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

(t) Share capital

Ordinary shares are classified as equity. Any premium received over and above the par value of the shares is classified as share premium in equity.

(u) Regulatory reserve

Where impairment losses required by Central Bank of Kenya Prudential Guidelines exceed those computed under IFRS, the excess is recognized as a regulatory reserve and is accounted for as an appropriation of retained earnings. The regulatory reserve is non-distributable.

Notes (continued)

3 Financial risk management

By their nature, the Bank's activities are principally related to the use of financial instruments including derivatives. The Bank's business involves taking on risks in a targeted manner and managing them professionally. The core functions of the Bank's risk management are to identify all key risks, measure these risks and manage the risk positions. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice.

The Bank accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Bank seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Bank also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances; the Bank also enters into guarantees and other commitments such as letters of credit and performance, and other bonds.

Financial risk management is carried out by the treasury function under policies approved by the Board of Directors. The Board provides written principles for overall risk management as well as policies covering specific areas such as foreign exchange risk, interest rate risk and credit risk. In addition, internal audit is responsible for the independent review of risk management and the control environment.

(a) Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counter party will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the reporting date. Significant changes in the economy, or in the health of a particular industry segment that represents a concentration of the Bank's portfolio, could result in losses that are different from those provided for at the reporting date. Management therefore carefully manages its exposure to credit risk and regularly undertakes a portfolio review to vet the potential risk of each economic sector that the Bank is exposed to.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or Banks of borrowers, and to industry segments. Such risks are monitored on a revolving basis and are subject to annual review. Limits on the level of credit risk by product and industry sector are regularly reviewed and approved by the Board of Directors.

The exposure to any one borrower including banks is further restricted by sub-limits covering on and off-balance sheet exposures.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments.

However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Measurement of expected credit losses

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Measurement of expected credit losses (continued)

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

Significant judgements are also required in applying the accounting requirement for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing the appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL;
- Establishing groups of similar financial assets for the purposes of measuring ECL;
- Determining the relevant period of exposure to credit risk when measuring ECL for credit cards and revolving credit facilities; and
- Determining the appropriate business models and assessing the “solely payments of principal and interest (SPPI)” requirements for financial assets.

Significant increase in credit risk

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

The Bank identifies a significant increase in credit risk where

- exposures have a regulatory risk rating of ‘watch’;
- an exposure is greater than 30 days past due – this is in line with the IFRS 9 “30 days past due (DPD) rebuttable presumption”;
- an exposure has been restructured in the past due to credit risk related factors or which was non-performing and is now regularised (subject to the regulatory cooling off period), or
- by comparing, where information is available, an exposure’s:
 - credit risk quality at the date of reporting; with
 - the credit risk quality on initial recognition of the exposure.

The assessment of significant deterioration is key in establishing the point of switching between the requirement to measure an allowance based on 12-month expected credit losses and one that is based on lifetime expected credit losses.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Determining whether credit risk has increased significantly

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

The framework aligns with the Bank's internal credit risk management process. The Bank will deem the credit risk of a particular exposure to have increased significantly since initial recognition if, the financial asset is more than 30 days in arrears.

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

The following qualitative criteria is applied:

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

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

Definition of default

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

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

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

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Incorporation of forward-looking information

Under IFRS 9, the Bank incorporates forward-looking information in its measurement of ECLs.

The Bank applies linear regression to determine the forward-looking adjustment to incorporate in its ECL. The Bank formulates three economic scenarios: a base case, which is the median scenario assigned a probability of occurring based on the predictive strength of the relationship between the Bank's default rate and the macro economic variables (MEV's), and two less likely scenarios, one upside and one downside, each assigned a probability of occurring based on half the difference between the base case and 100%.

External information considered includes economic data and forecasts published by governmental bodies and monetary authorities in Kenya, supranational organisations such as the World Bank and the International Monetary Fund and selected private-sector and academic forecasters.

The Bank has identified key drivers of credit risk and credit losses for its overall portfolio of financial instruments and, using an analysis of historical data, has estimated relationships between macro-economic variables and credit risk and credit losses. These are reviewed by management periodically to ascertain relevance based on management's understanding of the current industry environment.

The key drivers for credit risk are GDP, growth in commercial bank loans, exports of goods and services and inflation.

Modified financial assets

The contractual terms of loans and advances may be modified because of a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognized and the renegotiated loans and advances recognized as a new loans and advances at fair value.

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

The Bank renegotiates loans and advances with customers in financial difficulties (referred to as 'restructuring') to maximise collection opportunities and minimise the risk of default.

Under the Bank's restructuring policy, loans and advances restructuring is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Modified financial assets (continued)

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. The Bank Credit Committee regularly reviews reports on restructuring activities.

Generally, forbearance is a qualitative indicator of default and credit impairment and expectations of restructuring are relevant to assessing whether there is a significant increase in credit risk (see above).

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

Inputs into measurement of ECLs

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

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

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

PD

Loan listings and the borrower central bank risk classifications from 2016 to date were used as the primary input in the determination of the PD structures.

PD estimates for loans and advances are estimates at a certain date, calculated based on statistical migration matrices that model the chance of an exposure transitioning to default over time and will be assessed at portfolio level for portfolios of assets that have similar characteristics. The Bank has categorised its loans and advances into four portfolios, Corporate, Small and Medium enterprises (SME), Personal and Staff loans.

The PD estimates for other financial instruments assessed for impairment is based on external credit rating information obtained from reputable external rating agencies such as Moody's, Standard and Poors, Fitch and Global credit rating.

The PD estimates applied are probability weighted incorporating a forward-looking adjustment which is determined based on a base scenario, upside and downside scenario. Please see the section on forward-looking information.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Inputs into measurement of ECLs (continued)

Loss Given Default (LGD)

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on collateral available against exposures and the history of recovery rates of claims against defaulted counterparties.

The LGD models consider the type of collateral, seniority of the claim, time to recover in the event of foreclosure, counterparty industry and recovery costs of any collateral that is integral to the financial asset. LGD estimates are calibrated to consider the time to recover cash flows for different collateral types and apply the forced sale value (FSV) of collateral. The collateral values to consider will be calculated on a discounted cash flow basis using the effective interest rate (EIR) or a close proxy of the EIR.

Exposure at Default

EAD represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortisation, and prepayments. For loan commitments and financial guarantees, the EAD will consider the amount drawn, as well as potential future amounts that may be drawn or repaid under the contract, which will be estimated based on historical observations and forward-looking forecasts.

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

The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee. For guarantee facilities, overdrafts and other revolving facilities that include both a drawn and an undrawn commitment component, the Bank will measure ECLs over a period of one year unless the expected life of the exposure can be reasonably determined.

Where modelling of a parameter is carried out on a collective basis, the financial instruments will be grouped on the basis of shared risk characteristics that include:

- Product type; and
- Industry.

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

In measuring expected credit losses the bank has segmented its loans and advances to customers into several segments, Corporate, SME, Personal and staff loans based on their different risk characteristics.

The following tables set out information about the credit quality and credit risk exposure of financial assets measured at amortized cost. Unless specifically indicated, the amounts in the table represent gross carrying amounts. For loan commitments and non-financial guarantees the amounts in the table represent the undrawn portion of amounts committed. Loan commitments are overdraft facilities.

Corporate segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Normal	4,521,510	-	-	4,521,510
Watch	-	15,049	-	15,049
Non-performing	-	-	749,515	749,515
Total exposure	4,521,510	15,049	749,515	5,286,074
Loss allowance	(32,297)	-	(97,209)	(129,506)
Carrying amount	4,489,213	15,049	652,306	5,156,568

SME segment				
Normal	302,177	-	-	302,177
Watch	-	3,371	-	3,371
Non-performing	-	-	111,952	111,952
Total exposure	302,177	3,371	111,952	417,500
Loss allowance	(4,510)	(3)	(37,945)	(42,458)
Carrying amount	297,667	3,368	74,007	375,042

Personal segment				
Normal	299,289	-	-	299,289
Watch	-	-	-	-
Non-performing	-	-	30,938	30,938
Total exposure	299,289	-	30,938	330,227
Loss allowance	(8,180)	-	(3,804)	(11,984)
Carrying amount	291,109	-	27,134	318,243

Staff segment				
Normal	92,322	-	-	92,322
Watch	-	-	-	-
Non-performing	-	-	25,990	25,990
Total exposure	92,322	-	25,990	118,312
Loss allowance	(2,097)	-	(1,312)	(3,409)
Carrying amount	90,225	-	24,678	114,903

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit quality

Non-financial guarantees	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Normal	726,680	-	-	726,680
Watch	-	-	-	-
Non-performing	-	-	-	-
Total exposure	726,680	-	-	726,680
Loss allowance	(29)	-	-	(29)
Carrying amount	726,651	-	-	726,651

Loan commitments				
Normal	309,375	-	-	309,375
Watch	-	-	-	-
Non-performing	-	-	-	-
Total exposure	309,375	-	-	309,375
Loss allowance	(1,129)	-	-	(1,129)
Carrying amount	308,246	-	-	308,246

Total loans and advances				
Normal	5,215,298	-	-	5,215,298
Watch	-	18,420	-	18,420
Non-performing	-	-	918,395	918,395
Total exposure	5,215,298	18,420	918,395	6,152,113
Loss allowance	(47,084)	(3)	(140,270)	(187,357)
Carrying amount	5,168,214	18,417	778,125	5,964,756

Total off-balance sheet	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Normal	1,036,055	-	-	1,036,055
Watch	-	-	-	-
Non-performing	-	-	-	-
Total exposure		-	-	
Loss allowance	(1,158)	-	-	(1,158)
Carrying amount	1,034,897	-	-	1,034,897

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

<u>Maximum exposure to credit risk before collateral held</u>	2019	2018
	Shs'000	Shs'000
Balances with Central Bank of Kenya (Note 12)	462,528	254,502
Government securities at amortized cost (Note 13)	1,172,971	1,467,979
Deposits and balances due from banking institutions (Note 14)	286,294	501,054
Loans and advances to customers (Note 16)	5,964,756	2,560,398
Other assets	127,962	74,389
Credit risk exposures relating to off-balance sheet items (Note 25):		
- Acceptances and letters of credit	12,986	24,829
- Guarantee and performance bonds	726,680	245,678
- Commitments to lend	2,308,983	650,412
	11,063,160	5,779,241

The maximum exposure table represents a worst-case scenario of credit risk exposure to the Bank at 31 December 2019 and 2018, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on carrying amounts as reported in the balance sheet. As shown above, 56% of the total maximum exposure is derived from loans and advances to customers and deposits and balances from banking institutions (2018: 53%). 11% represents investments in government securities (2018: 25%).

Loans and advances to customers and off-balance sheet items, other than to major corporates, are secured by collateral in the form of charges over land and buildings and/or plant and machinery or corporate guarantees. All other financial assets have no collateral held on them.

Management is confident in its ability to continue to control and sustain minimal exposure of credit risk to the Bank resulting from both its loan and advances portfolio and debt securities based on the following:

- the Bank exercises stringent controls over the granting of new loans;
- 84% of the loans and advances portfolio are neither past due nor impaired (2018: 41%);
- 98% of the loans and advances portfolio are backed by collateral; and
- 100% of the investments in debt securities are government securities.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit risk exposure

Financial assets that are past due or impaired

The Bank aligns the classification of assets that are past due or impaired in line with the Central Bank of Kenya prudential guidelines. In determining the classification of an account, performance is the primary consideration. Classification of an account reflects judgement about the risk of default and loss associated with the credit facility.

Accounts are classified into five categories as follows:

CBK PG/04 Guidelines	Days past due	IFRS 9 Stage allocation
Normal	0-30	1
Watch	31-90	2
Substandard	91-180	3
Doubtful	181 - 365	3
Loss	Over 365 or considered uncollectible	3

Loans and advances are summarised as follows:

	2019 Shs'000	2018 Shs'000
Neither past due nor impaired	5,213,575	1,581,663
Past due but not impaired	38,027	185,375
Impaired	<u>900,511</u>	<u>1,010,272</u>
Gross	6,152,113	2,777,310
Less: allowance for impairment	<u>(187,357)</u>	<u>(216,912)</u>
Net	<u><u>5,964,756</u></u>	<u><u>2,560,398</u></u>

Loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed based on the Central Bank of Kenya rating which the Bank has adopted:

	2019 Shs'000	2018 Shs'000
Normal – neither past due nor impaired	5,213,575	1,581,663
Watch – renegotiated loan (not past due nor impaired)	<u>116,407</u>	<u>9,166</u>
	<u><u>5,329,982</u></u>	<u><u>1,590,829</u></u>

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Loans and advances renegotiated

Of the total gross amount of loans and advances, the following amounts have been renegotiated:

	2019 Shs'000	2018 Shs'000
Renegotiated loans and advances	116,407	9,166

Loans and advances renegotiated in 2019 and 2018 were neither past due nor impaired.

Loans and advances past due but not impaired

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. The gross amounts of loans and advances that were past due but not impaired were as follows:

	2019 Shs'000	2018 Shs'000
Past due up to 30 days	3,105	1,203
Past due 31 - 90 days	34,922	184,172
	<u>38,027</u>	<u>185,375</u>

Loans and advances individually impaired

Of the total gross amount of impaired loans, the following amounts have been individually assessed:

	Loans		Overdrafts	
	2019 Shs'000	2018 Shs'000	2019 Shs'000	2018 Shs'000
Individually assessed impaired loans and advances	533,862	623,363	366,650	362,910
Fair value of collateral	<u>506,303</u>	<u>460,366</u>	<u>185,085</u>	<u>277,483</u>

The Bank assesses at each reporting date whether there is objective evidence that loans and advances are impaired. Objective evidence that loans and advances are impaired includes observable data that comes to the attention of the Bank about loss events such as significant financial difficulty of the borrower, breach of contract, bankruptcy or other financial re-organisation or local economic conditions that correlate with defaults on the assets in the Bank.

Notes (continued)

3 Financial risk management (continued)

(b) Concentration risk

Economic sector risk concentrations within the customer loan and deposit portfolios were as follows:

	2019		2018	
	Loans and advances %	Unused credit commitments %	Loans and advances %	Unused credit commitments %
Manufacturing	5.31	5.59	5.73	33.48
Wholesale and retail trade	55.83	69.14	41.59	0.14
Transport and communications	3.48	2.16	5.35	1.96
Business services	0.18	-	0.44	-
Agricultural	0.97	-	1.89	-
Individuals	4.28	-	3.65	-
Foreign Trade	4.07	1.59	9.08	-
Real estate	23.08	21.52	20.85	64.42
Building and construction	1.42	-	9.11	-
Other	1.38	-	2.31	-
	100.00	100.00	100.00	100.00

Customer deposits	2019 %	2018 %
Central Government	0.30	0.04
Insurance companies	1.53	1.61
Private enterprise	34.86	11.58
Non-profit institutions & individuals	39.83	65.23
Resident foreign currency	17.08	4.11
Non-resident foreign currency	6.40	17.43
	100.00	100.00

(c) Liquidity risk

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits and calls on cash settled contingencies. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

The matching and controlled mismatching of the maturities of assets and liabilities is fundamental to the management of the Bank. By the very nature of operations, it is unusual for banks to ever completely match assets and liabilities. The Central Bank of Kenya requires that the Bank maintain a cash reserve ratio and minimum liquidity ratios. In addition, the Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-Bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The treasury department monitors liquidity ratios on a daily basis, and this is closely reviewed by the Assets and Liability Committee (ALCO).

The table below analyses assets and liabilities into relevant maturity brackets based on the remaining period at 31 December 2019 to the contractual maturity date. All figures are in thousands of Kenya Shillings.

At 31 December 2019	Up to 1 Month	1-6 Months	6-12 Months	1-5 Years	Over 5 Years	Total
Assets						
Cash and balances with Central Bank of Kenya	521,097	-	-	-	-	521,097
Government securities at amortized cost	-	492,474	195,109	273,128	228,220	1,188,931
Deposits and balances due from banking institutions	286,294	-	-	-	-	286,294
Other assets	136,633	-	-	-	-	136,633
Loans and advances to customers	2,098,564	1,105,458	781,875	1,634,659	344,200	5,964,756
Total assets	3,042,588	1,597,932	976,984	1,907,787	572,420	8,097,711
Liabilities and equity						
Deposits from banks	300,000	-	-	-	-	300,000
Deposits from customers	2,738,756	3,239,420	859,669	-	-	6,837,845
Other liabilities and accrued expenses	125,924	-	-	10,109	-	136,033
Lease liabilities	-	2,674	2,972	23,892	-	29,538
Shareholders' funds	-	-	-	-	1,155,784	1,155,784
Total liabilities and equity	3,164,680	3,242,094	862,641	34,001	1,155,784	8,459,200
Net liquidity gap	(122,092)	(1,644,162)	114,343	1,873,786	(583,364)	(361,489)

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

At 31 December 2018	Up to 1 Month	1-6 Months	6-12 Months	1-5 Years	Over 5 Years	Total
Assets						
Cash and balances with Central Bank of Kenya	353,903	-	-	-	-	353,903
Government securities at amortized cost	-	489,051	523,715	390,422	64,791	1,467,979
Deposits and balances due from banking institutions	501,054	-	-	-	-	501,054
Other assets	84,101	-	-	-	-	84,101
Loans and advances to customers	1,847,439	232,804	102,105	293,915	84,135	2,560,398
Total assets	2,786,497	721,855	625,820	684,337	148,926	4,967,435
Liabilities and equity						
Customer deposits	792,056	2,080,886	1,273,719	-	-	4,146,661
Other liabilities and accrued expenses	45,842	-	-	9,769	-	55,611
Shareholders' funds	-	-	-	-	1,157,878	1,157,878
Total liabilities and equity	837,898	2,080,886	1,273,719	9,769	1,157,878	5,360,150
Net liquidity gap	1,948,599	(1,359,031)	(647,899)	674,568	(1,008,952)	(392,715)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for Banks ever to be completely matched since business transacted is often of uncertain terms and of different types. An unmatched position potentially enhances profitability but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk

Market risk is the risk that changes in market prices, which include currency exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument. Market risk arises from open positions in interest rates and foreign currencies, both of which are exposed to general and specific market movements and changes in the level of volatility. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while optimising the return on risk. Overall responsibility for managing market risk rests with the Assets and Liabilities Committee (ALCO). The Treasury department is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day to day implementation of those policies.

(i) Currency risk

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored regularly by management. In addition, the Central Bank of Kenya monitors the foreign currency position on a regular basis.

The Bank had the following significant foreign currency positions (all amounts expressed in thousands of Kenya Shillings):

At 31 December 2019	USD	GBP	Euro	Other	Total
Assets					
Cash and balances with Central Bank of Kenya	163,338	1,638	6,951	3,827	175,754
Deposits and balances due from banking institutions	166,833	50,030	69,357	23	286,243
Loans and advances to customers	1,168,687	120	31	-	1,168,838
Other assets and prepayments	310	-	-	-	310
Total assets	1,499,168	51,788	76,339	3,850	1,631,145
Liabilities					
Customer deposits	1,515,231	45,713	71,895	-	1,632,839
Deposits and balances due to banking institutions	-	-	-	-	-
Other liabilities and accrued expenses	1,663	-	-	-	1,663
Total liabilities	1,516,894	45,713	71,895	-	1,634,502
Net balance sheet position	(17,726)	6,075	4,444	3,850	(3,357)
Net off-balance sheet position	(50,606)	(6,154)	-	-	(56,760)
Overall net position	(68,332)	(79)	4,444	3,850	(60,117)

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(i) Currency risk (continued)

	USD	GBP	Euro	Other	Total
At 31 December 2018					
Total assets	884,834	42,997	23,443	230	951,504
Total liabilities	842,807	43,743	24,597	-	911,147
Net balance sheet position	42,027	(746)	(1,154)	230	40,357
Net off-balance sheet position	-	-	-	-	-
Overall net position	42,027	(746)	(1,154)	230	40,357

The off-balance sheet position represents the difference between the notional amounts of foreign currency derivative financial instruments and their fair values.

At 31 December 2019, if the Shilling had strengthened/weakened by 5% against the major currencies with all other variables held constant, pre tax profit for the year would have been lower/higher by Shs 0.319 million (2018: Shs 2.017 million) as illustrated below:

Impact on shilling strengthening per currency (Shs '000)

	USD	GBP	Euro	Other	Total
At 31 December 2019 (5%)	3,416	4	(222)	(192)	3,006
At 31 December 2018 (5%)	(2,101)	37	58	(11)	(2,017)

Impact on shilling weakening per currency (Shs '000)

	USD	GBP	Euro	Other	Total
At 31 December 2019 (5%)	(3,416)	(4)	222	192	(3006)
At 31 December 2018 (5%)	2,101	(37)	(58)	11	2,017

(ii) Interest rate risk

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board of Directors sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

The table below summarises the exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorized by the earlier of contractual repricing or maturity dates. The Bank does not bear an interest rate risk on off balance sheet items. All figures are in thousands of Kenya Shillings.

At 31 December 2019	Up to 1 Month	1-3 Months	3-12 Months	Over 1 Year	Non- interest bearing	Total
Assets						
Cash and balances with Central Bank of Kenya	-	-	-	-	521,097	521,097
Government securities at amortized cost	-	246,476	441,107	485,388	-	1,172,971
Deposits and balances due from banking institutions	-	-	-	-	286,294	286,294
Other assets and prepayments	-	-	-	-	136,633	136,633
Loans and advances to customers	5,964,756	-	-	-	-	5,964,756
Total assets	5,964,756	246,476	441,107	485,388	944,024	8,081,751
Liabilities and Shareholders' funds						
Deposits from banks	300,000	-	-	-	-	300,000
Customer deposits	2,045,579	1,598,638	2,616,142	-	577,486	6,837,845
Other liabilities and accrued expenses	-	-	-	-	136,033	136,033
Lease liabilities	-	-	-	29,538	-	29,538
Current income tax payable	-	-	-	-	7,084	7,084
Shareholders' funds	-	-	-	-	1,155,784	1,155,784
Total liabilities and shareholders' funds	2,345,579	1,598,638	2,616,142	29,538	1,876,387	8,466,284
Interest sensitivity gap	3,619,177	(1,352,162)	(2,175,035)	455,850	(932,363)	(384,533)

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

	Up to 1 Month	1-3 Months	3-12 Months	1-5 Years	Non-interest Bearing	Total
At 31 December 2018						
Total assets	2,610,398	297,074	715,692	455,213	889,058	4,967,435
Total liabilities and shareholders' funds	398,069	2,080,886	1,273,719	-	1,608,190	5,360,864
Interest sensitivity gap	2,212,329	(1,783,812)	(558,027)	455,213	(719,132)	(393,429)

Fair values and effective interest rates of financial assets and liabilities

The effective interest rates by major currency for monetary financial instruments at 31 December 2019 and 2018 were in the following ranges:

	2019		2018	
	Shs	USD Euro	Shs	USD Euro
Assets				
Government securities (%)	9.10	-	9.84	-
Deposits with banking institutions (%)	7.12	-	9.00	-
Loans and advances to customers (%)	16.27	10.35	13.09	10.23
Liabilities				
Customer deposits (%)	7.27	2.37	7.12	2.98
Deposits and balances due to banking institutions (%)	6.50	2.78	-	-

The fair value of government securities at amortized cost at 31 December 2019 is estimated at Shs 1,201 million (2018: Shs 1,461 million) compared to their carrying value of Shs 1,173 million (2018: Shs 1,468 million).

The fair values of the Bank's other financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual repricing or maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the reporting date.

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

Cash flow and fair value interest rate risk

Fixed interest rate financial instruments expose the company to fair value interest rate risk. Variable interest rate financial instruments expose the Bank to cashflow interest rate risk.

The Bank's fixed interest rate financial instruments are government securities, deposits with financial institutions and borrowings. The Bank's variable interest rate financial instruments are loans and advances. The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cashflows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date.

The Bank regularly monitors financial assets and liabilities. As at 31 December 2019, a 10 basis points increase in interest rates would have resulted in an increase in pre-tax profit of Shs 92 million (2018: decrease of Shs 17 million).

As at 31 December 2019, a 10 basis points decrease in interest rates would have resulted in an increase in pre-tax profit of Shs 92 million (2018: decrease of Shs 17 million).

(e) Fair value estimation

Effective 1 January 2009, the Bank adopted the amendment to IFRS 7 for financial instruments that are measured in the balance sheet at fair value, this requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and
- Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry bank, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

There are no financial assets or liabilities measured at fair value as at 31 December 2019.

Notes (continued)

3 Financial risk management (continued)

(f) Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the balance sheet, are:

- to comply with the capital requirements set by the Central Bank of Kenya;
- to safeguard the Bank's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- to maintain a strong capital base to support the development of its business.

Capital adequacy and use of regulatory capital are monitored regularly by management, employing techniques based on the guidelines developed by the Basel Committee, as implemented by the Central Bank of Kenya for supervisory purposes. The required information is filed with the Central Bank of Kenya on a monthly basis.

The Central Bank of Kenya requires each Bank to:

- a) hold the minimum level of regulatory capital of Shs 1 billion;
- b) maintain a ratio of core regulatory capital to the risk-weighted assets plus risk-weighted off-balance sheet assets (the 'Basel ratio') at or above the required minimum of 8%;
- c) maintain core capital of not less than 8% of total deposit liabilities; and
- d) maintain total capital of not less than 12% of risk-weighted assets plus risk-weighted off-balance sheet items.

The Bank's total regulatory capital is divided into two tiers:

- Tier 1 capital (core capital): share capital, share premium, plus retained earnings.
- Tier 2 capital (supplementary capital): 25% (subject to prior approval) of revaluation reserves, subordinated debt not exceeding 50% of Tier 1 capital and hybrid capital instruments. Qualifying Tier 2 capital is limited to 100% of Tier 1 capital.

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

Notes (continued)

3 Financial risk management (continued)

(f) Capital management (continued)

The table below summarises the composition of regulatory capital and the ratios of the Bank for at 31 December:

	2019	2018
	Shs'000	Shs'000
Tier 1 capital	1,086,257	1,023,539
Tier 1 + Tier 2 capital	<u>1,093,714</u>	<u>1,112,261</u>
Risk-Weighted assets		
On-balance sheet	2,691,240	1,773,872
Off-balance sheet	216,660	28,675
Market risk weighted assets	5,294	53,001
Operational risk weighted assets	<u>593,411</u>	<u>619,600</u>
Total Risk-Weighted assets	<u>3,506,605</u>	<u>2,475,148</u>
Basel ratio		
Tier 1 (minimum – 10.5%)	31.0%	24.7%
Tier 1 + Tier 2 (minimum – 14.5%)	<u>31.2%</u>	<u>41.4%</u>

4 Critical accounting estimates and judgements in applying accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Measurement of expected credit losses

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

Significant judgements are also required in applying the accounting requirement for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing the appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL;
- Establishing groups of similar financial assets for the purposes of measuring ECL;
- Determining the relevant period of exposure to credit risk when measuring ECL for credit cards and revolving credit facilities; and
- Determining the appropriate business models and assessing the “solely payments of principal and interest (SPPI)” requirements for financial assets.

Notes (continued)

5 Net Interest income

(a) Interest income	2019 Shs'000	2018 Shs'000
Loans and advances to customers	521,010	355,865
Government securities at amortized cost	121,110	136,928
Cash and short-term funds	10,572	7,988
	<hr/>	<hr/>
	652,692	500,781
	<hr/>	<hr/>
(b) Interest expense		
Customer deposits	317,037	256,408
Deposits and balances due to banking institutions	1,052	477
Interest on lease liability (Note 25)	3,591	-
	<hr/>	<hr/>
	321,680	256,885
	<hr/>	<hr/>
6 Other operating income		
Rental income	48,920	41,895
Other income	1,297	905
	<hr/>	<hr/>
	50,217	42,800
	<hr/>	<hr/>

Notes (continued)

7 Operating expenses	2019 Shs'000	2018 Shs'000
The following items are included within operating expenses:		
Employees benefits (Note 8)	210,692	184,733
Depreciation on property and equipment (Note 18)	15,268	13,021
Amortisation of prepaid operating lease (Note 19)	966	965
Depreciation on right – of – use asset (Note 20)	6,106	-
Amortisation of intangible assets (Note 21)	10,765	8,855
Rent expense	8,584	13,437
Auditors' remuneration	3,780	4,780
Other operating expenses	106,467	108,193
	<u>362,628</u>	<u>333,984</u>

8 Employee benefits

The following items are included within employees' benefits expense:

Staff salaries	193,980	167,458
Retirement benefits cost	8,123	8,797
National Social Security Fund	146	140
Medical costs	9,475	8,175
Other staff costs	(1,032)	163
	<u>210,692</u>	<u>184,733</u>

The average number of employees during the year was 61 (2018: 58)

9 Income tax expense / (credit)

Current income tax	17,986	9,864
Deferred income tax (Note 17)	38,029	(11,963)
	<u>56,015</u>	<u>(2,099)</u>

The tax on the Bank's loss or profit before income tax differs from the theoretical amount that would arise using the statutory income tax rate as follows:

Profit before income tax	59,629	512
	<u>59,629</u>	<u>512</u>
Tax calculated at the statutory income tax rate of 30% (2018: 30%)	17,889	154
Tax effect of:		
Expenses not deductible for tax purposes	46,353	3,323
Interest income on infrastructure bonds not subject to tax	(8,227)	(5,576)
	<u>56,015</u>	<u>(2,099)</u>

Notes (continued)

10 Earnings per share

Basic earnings per share are calculated on the profit attributable to shareholders of Shs 3,614,000 (2018: Shs 2,611,000) and on the weighted average number of ordinary shares outstanding during the period.

	2019	2018
Net profit attributable to shareholders (Shs '000)	3,614	2,611
	<hr/>	<hr/>
Number of ordinary shares in issue (Note 26)	25,341,547	25,341,547
	<hr/>	<hr/>
Basic earnings per share (Shs)	0.14	0.10
	<hr/>	<hr/>

There were no potentially dilutive shares outstanding at 31 December 2019 and 2018. Diluted earnings per share is therefore the same as basic earnings per share.

11 Dividends per share

At the forthcoming annual general meeting a dividend in respect of the year ended 31 December 2019 of Shs 0.20 per share amounting to a total of Shs 5,068,000 is to be proposed (2018: final dividend proposed of Shs 5,068,000).

The payment of dividends is subject to withholding tax at a rate of either 0%, 5% or 10% depending on the tax status of the respective shareholder.

12 Cash and balances with Central Bank of Kenya

	2019 Shs'000	2018 Shs'000
Cash in hand	58,569	99,401
Local currency balances with Central Bank of Kenya	296,885	224,503
Foreign currency balances with Central Bank of Kenya	165,643	29,999
	<hr/>	<hr/>
	521,097	353,903
	<hr/>	<hr/>

13 Government securities at amortized cost

Treasury bills and bonds:		
Maturing after 90 days of the date of acquisition	<hr/> 1,172,971	<hr/> 1,467,979

Treasury bills and bonds are debt securities issued by the Republic of Kenya.

Notes (continued)

14 Deposits and balances due from banking institutions

	2019 Shs'000	2018 Shs'000
Foreign currency balances with foreign banks	286,243	448,254
Local currency deposits	51	52,800
	<hr/>	<hr/>
	286,294	501,054
	<hr/>	<hr/>

15 Other assets and prepayments

Uncleared effects	27,651	25,338
Stationery stocks	2,010	1,619
Prepayments	8,671	9,712
Other debtors	98,301	72,432
Less: provision for insurance receivable	-	(25,000)
	<hr/>	<hr/>
	136,633	84,101
	<hr/>	<hr/>

16 Loans and advances to customers

Commercial loans	3,833,439	1,154,783
Overdraft	1,733,618	1,117,711
SME	242,873	299,785
Personal loans	270,016	139,363
Mortgages	72,167	65,668
	<hr/>	<hr/>
Gross loans and advances (net of suspense interest)	6,152,113	2,777,310
Less: Provision for impairment of loans and advances		
- Stage 1	47,084	4,259
- Stage 2	3	237
- Stage 3	140,270	212,416
	<hr/>	<hr/>
	187,357	216,912
	<hr/>	<hr/>
Net loans and advances (net of provisions and suspense interest)	5,964,756	2,560,398
	<hr/>	<hr/>

Notes (continued)

16 Loans and advances to customers (continued)

i) Loans and advances to customers at amortized cost

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Gross carrying amount as at 1 January 2019	1,621,448	147,155	1,008,707	2,777,310
Changes in the gross carrying amount				
- Transfer from stage 1 to stage 2	179,558	(179,558)	-	-
- Transfer from stage 1 to stage 3	(95,564)		95,564	-
- Transfer from stage 2 to stage 3	-	(65,150)	65,150	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Transfer from stage 3 to stage 1	-	-	-	-
- Transfer from stage 2 to stage 1	-	-	-	-
- Write-offs	-	-	-	-
Net remeasurement of loan balance	19,964	117,977	(95,526)	42,415
New financial assets originated or purchased	4,098,975	-	770	4,099,745
Financial assets that have been derecognized	(609,083)	(2,004)	(156,270)	(767,357)
Gross carrying amount as at 31 December 2019	5,215,298	18,420	918,395	6,152,113

ii) Provisions – Loans and advances to customers

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Provisions as at 1 January 2019	4,259	237	212,416	216,912
- Transfer from stage 1 to stage 2	(5)	5	-	-
- Transfer from stage 1 to stage 3	(1)		1	-
- Transfer from stage 2 to stage 3	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Transfer from stage 2 to stage 1	797	(797)	-	-
- Write-offs	-	-	-	-
Net remeasurement of loss allowance	9,009	595	(53,666)	(44,062)
New financial assets originated or purchased	35,920	-	-	35,920
Financial assets that have been derecognized	(2,895)	(37)	(18,481)	(21,413)
Provisions as at 31 December 2019	47,084	3	140,270	187,357

Notes (continued)

16 Loans and advances to customers (continued)

Movements in provisions for impairment of loans and advances are as follows:

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Year ended 31 December 2019				
At 1 January 2019	4,259	237	212,416	216,912
Write-off in the year	-	-	(133,964)	(133,964)
Increase /(decrease) in impairment provision	42,825	(234)	61,818	104,409
At 31 December 2019	47,084	3	140,270	187,357
Charge/(credit) to profit or loss				
Increase /(decrease) in impairment provision	42,825	(234)	61,818	104,409
	42,825	(234)	61,818	104,409

All loans are written down to their estimated recoverable amount. The amount of non-performing loans (net of impairment losses) at 31 December 2019 was Shs 811,565,000 (2018: Shs 793,360,000)

There were no receivables under hire purchase contracts in 2019 and 2018.

Notes (continued)

16 Loans and advances to customers (continued)

Loan book movement

The tables below describe the movement in loan balances during 2019

Corporate segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,242,139	138,616	891,579	2,272,334
Transfer to 12 months ECL	53,730	(53,730)	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(58,716)	(65,150)	123,866	-
Net remeasurement of loan balance	211,490	(4,687)	(138,386)	68,417
Net financial assets originated or purchased	3,568,664	-	602	3,569,266
Financial assets derecognized	(495,797)	-	(128,146)	(623,943)
Balance at 31 December	4,521,510	15,049	749,515	5,286,074

Personal segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	87,606	1,216	4,746	93,568
Transfer to 12 months ECL	1,190	(1,190)	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(20,196)	-	20,196	-
Net remeasurement of loan balance	(23,757)	-	8,084	(15,673)
Net financial assets originated or purchased	283,809	-	-	283,809
Financial assets derecognized	(29,363)	(26)	(2,088)	(31,477)
Balance at 31 December	299,289	-	30,938	330,227

SME segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	209,250	7,323	83,540	300,113
Transfer to 12 months ECL	126,803	(126,803)	-	-
Transfer to Lifetime ECL not credit impaired	(2,164)	2,164	-	-
Transfer to Lifetime ECL credit impaired	(16,652)	-	16,652	-
Net remeasurement of loan balance	(158,875)	122,664	37,797	1,586
Net financial assets originated or purchased	207,119	-	-	207,119
Financial assets derecognized	(63,304)	(1,977)	(26,037)	(91,318)
Balance at 31 December	302,177	3,371	111,952	417,500

Staff segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	82,453	-	29,011	111,464
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of loan balance	(8,894)	-	(3,021)	(11,915)
Net financial assets originated or purchased	39,382	-	-	39,382
Financial assets derecognized	(20,619)	-	-	(20,619)
Balance at 31 December	92,322	-	25,990	118,312

Notes (continued)

16 Loans and advances to customers (continued)

Total loans and advances	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,621,448	147,155	1,008,876	2,777,479
Transfer to 12 months ECL	181,723	(181,723)	-	-
Transfer to Lifetime ECL not credit impaired	(2,164)	2,164	-	-
Transfer to Lifetime ECL credit impaired	(95,564)	(65,150)	160,714	-
Net remeasurement of loan balance	19,964	117,977	(95,526)	42,415
Net financial assets originated or purchased	4,098,974	-	602	4,099,576
Financial assets derecognized	(609,083)	(2,003)	(156,271)	(767,357)
Balance at 31 December	5,215,298	18,420	918,395	6,152,113

Loss allowance

The following tables show reconciliations from the opening to the closing balance of the loss allowance by Segment.

Corporate segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,771	200	147,046	149,017
Transfer to 12 months ECL	199	(199)	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	7,679	(1)	(49,837)	(42,159)
Net financial assets originated or purchased	24,048	-	-	24,048
Financial assets derecognized	(1,400)	-	-	(1,400)
Balance at 31 December	32,297	-	97,209	129,506

Personal segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	202	-	1,141	1,343
Transfer to 12 months ECL	199	(199)	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	(61)	199	2,663	2,801
Net financial assets originated or purchased	8,004	-	-	8,004
Financial assets derecognized	(164)	-	-	(164)
Balance at 31 December	8,180	-	3,804	11,984

Notes (continued)

16 Loans and advances to customers (continued)

SME segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	455	38	32,608	33,101
Transfer to 12 months ECL	199	(199)	-	-
Transfer to Lifetime ECL not credit impaired	(5)	5	-	-
Transfer to Lifetime ECL credit impaired	(1)	-	1	-
Net remeasurement of Loss allowance	1,739	197	23,817	25,753
Net financial assets originated or purchased	2,310	-	-	2,310
Financial assets derecognized	(187)	(38)	(18,481)	(18,706)
Balance at 31 December	4,510	3	37,945	42,458

Staff segment	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,831	-	620	2,451
Transfer to 12 months ECL	199	(199)	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	(348)	199	692	543
Net financial assets originated or purchased	1,558	-	-	1,558
Financial assets derecognized	(1,143)	-	-	(1,143)
Balance at 31 December	2,097	-	1,312	3,409

Total ECL for loans and advances	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	4,259	237	181,416	185,912
Transfer to 12 months ECL	796	(796)	-	-
Transfer to Lifetime ECL not credit impaired	(5)	5	-	-
Transfer to Lifetime ECL credit impaired	(1)	1	-	-
Net remeasurement of Loss allowance	9,009	594	(22,665)	(13,062)
Net financial assets originated or purchased	35,920	-	-	35,920
Financial assets derecognized	(2,894)	(38)	(18,481)	(21,413)
Balance at 31 December	47,084	3	140,270	187,357

Non-financial guarantees	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	29	-	-	29
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	-	-	-	-
Net financial assets originated or purchased	-	-	-	-
Financial assets derecognized	-	-	-	-
Balance at 31 December	29	-	-	29

Notes (continued)

16 Loans and advances to customers (continued)

Loan commitments	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,129	-	-	1,129
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	-	-	-	-
Net financial assets originated or purchased	-	-	-	-
Financial assets derecognized	-	-	-	-
Balance at 31 December	1,129	-	-	1,129

Total off-balance sheet	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Balance at 1 January	1,158	-	-	1,158
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	-	-	-	-
Net financial assets originated or purchased	-	-	-	-
Financial assets derecognized	-	-	-	-
Balance at 31 December	1,158	-	-	1,158

ECL of Shs 1,925,718 (2018 – Shs 1,925,718) and Shs 855,582 (2018 – Shs 855,582) has been recorded for Government securities at amortized cost and balances due from other banking institutions.

Notes (continued)

17 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2018: 30%).
The movement on the deferred income tax account is as follows:

	2019 Shs'000	2018 Shs'000
At start of year	113,060	100,446
(Expense) /Credits to the statement of comprehensive income (Note 9)	(38,029)	11,963
Changes on initial application of IFRS 9	-	651
Changes on initial application of IFRS 16	275	-
At end of year	75,306	113,060

The deferred income tax asset and deferred income tax credit in the statement of comprehensive income and equity are attributable to the following items:

	1 January 2019 Shs'000	Credited/ (charged) to SOCI Shs'000	Credited/ (charged) to equity Shs'000	31 December 2019 Shs'000
Deferred income tax asset				
Provisions	76,381	(17,948)	275	58,708
Accelerated tax depreciation	4,031	(2,233)	-	1,798
Tax losses	32,598	(32,598)	-	-
Accrued interest on customer deposits	-	14,578		14,578
Lease liability	-	8,861		8,861
Deferred income tax liability				
Unrealized exchange gain	50	(967)	-	(917)
Right of use asset	-	(7,722)	-	(7,722)
Net deferred income tax asset	113,060	(38,029)	275	75,306
	1 January 2018 Shs'000	Credited/ (charged) to SOCI Shs'000	Credited/ (charged) to equity Shs'000	31 December 2018 Shs'000
Deferred income tax asset				
Provisions	76,673	(943)	651	76,381
Accelerated tax depreciation	4,369	(338)	-	4,031
Tax losses	23,035	9,563	-	32,598
Deferred income tax liability				
Unrealized exchange gain	(3,631)	3,681	-	50
Net deferred income tax asset	100,446	11,963	651	113,060

The opening balance of deferred income tax asset was adjusted by a debit of Shs 275,000 in 2019 relating to changes on initial application of IFRS 16.

Notes (continued)

18 Property and equipment

	Buildings	Leasehold Improvements	Motor vehicles	Fixtures, fittings and equipment	Capital work in progress	Total
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Year ended 31 December 2018						
Cost						
At 1 January 2018	235,984	14,949	6,467	135,348	-	392,748
Additions	-	-	-	3,100	-	3,100
At 31 December 2018	235,984	14,949	6,467	138,448	-	395,848
Depreciation						
At 1 January 2018	79,759	13,579	6,467	117,872	-	217,677
Charge for the year	4,721	1,143	-	7,157	-	13,021
At 31 December 2018	84,480	14,722	6,467	125,029	-	230,698
Net book value						
At 31 December 2018	151,504	227	-	13,419	-	165,150
Year ended 31 December 2019						
Cost						
At 1 January 2019	235,984	14,949	6,467	138,448	-	395,848
Additions	-	7,809	-	9,725	7,582	25,116
At 31 December 2019	235,984	22,758	6,467	148,173	7,582	420,964
Depreciation						
At 1 January 2019	84,480	14,722	6,467	125,029	-	230,698
Charge for the year	4,721	1,218	-	9,329	-	15,268
At 31 December 2019	89,201	15,940	6,467	134,358	-	245,966
Net book value						
At 31 December 2019	146,783	6,818	-	13,815	7,582	174,998

Notes (continued)

19 Prepaid operating lease rentals

	2019 Shs'000	2018 Shs'000
At start of year	73,444	74,409
Amortization charge for the year	(966)	(965)
	<hr/>	<hr/>
At end of year	72,478	73,444
	<hr/>	<hr/>
Cost	93,715	93,715
Accumulated amortization	(21,237)	(20,271)
	<hr/>	<hr/>
	72,478	73,444
	<hr/>	<hr/>

20 Right of Use Assets

	2019 Shs'000	2018 Shs'000
At start of the year	20,484	-
Additions	11,363	-
Depreciation charge for the year (Note 7)	(6,106)	-
	<hr/>	<hr/>
At end of year	25,741	-
	<hr/>	<hr/>

The bank leases various office buildings in the normal course of business. The leases for buildings are typically for a period of between 5 and 6 years, with option to renew at the end of the term. None of these leases contains any restrictions or covenants other than the protective rights of the lessor or carries a residual value guarantee.

	2019 Shs'000	2018 Shs'000
21 Intangible assets		
At start of the year	41,775	30,316
Additions	5,000	20,314
Amortisation charge for the year	(10,765)	(8,855)
	<hr/>	<hr/>
At end of year	36,010	41,775
	<hr/>	<hr/>

22 Deposits and balances due to banking institutions

	2019 Shs'000	2018 Shs'000
Overnight deposits from banks	300,000	-
	<hr/>	<hr/>

Notes (continued)

23 Deposits from customers	2019	2018
	Shs'000	Shs'000
Current accounts and demand deposits	939,084	521,810
Savings and transaction accounts	254,442	270,246
Fixed deposit accounts	5,644,319	3,354,605
	<hr/>	<hr/>
	6,837,845	4,146,661
	<hr/>	<hr/>
24 Other liabilities and accrued expenses		
Bills payable	6,300	2,347
Outstanding banker's drafts	343	363
Other	129,390	52,901
	<hr/>	<hr/>
	136,033	55,611
	<hr/>	<hr/>
25 Lease liabilities	2019	2018
Branch Leases	Shs'000	Shs'000
At start of the year	21,399	-
Additions	11,363	-
Interest charge for the year	3,591	-
Rent payments in the year (net of VAT)	(6,815)	-
	<hr/>	<hr/>
At end of year	29,538	-
	<hr/>	<hr/>
26 Share capital	Number of	Ordinary
	Shares	shares
		Shs'000
At 1 January 2018, 1 January 2019 and 31 December 2019	25,341,547	506,831
	<hr/>	<hr/>

The total authorised number of ordinary shares is 37,500,000 with a par value of Shs 20 per share. All issued shares are fully paid.

Notes (continued)

	2019 Shs'0000	2018 Shs'0000
27 Regulatory reserve		
At start of year	88,721	13,784
Transfer (to) /from retained earnings	(81,264)	75,265
Changes on initial application of IFRS 9	-	(328)
	<hr/>	<hr/>
At end of year	7,457	88,721
	<hr/>	<hr/>

The regulatory reserve represents an appropriation from retained earnings to comply with the Central Bank of Kenya's Prudential Guidelines. The balance in the reserve represents the excess of impairment provisions determined in accordance with the Prudential Guidelines over the IFRS impairment provisions. The reserve is non-distributable.

28 Off balance sheet financial instruments, contingent liabilities and commitments

In common with other Banks, the Bank conducts business involving acceptances, guarantees, performance bonds and indemnities. The majority of these facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for the purchase and sale of foreign currencies, whose nominal amounts are not reflected in the balance sheet.

	2019 Shs'000	2018 Shs'000
Contingent liabilities		
Acceptances and letters of credit	12,986	24,829
Guarantee and performance bonds	726,680	245,678
Currency Bought & Sold	376,078	-
	<hr/>	<hr/>
	1,115,744	270,507
	<hr/>	<hr/>

Nature of contingent liabilities

An acceptance is an undertaking by a Bank to pay a bill of exchange drawn on a customer. The Bank expects most acceptances to be presented, and reimbursement by the customer is normally immediate. Letters of credit commit the Bank to make payments to third parties, on production of documents, which are subsequently reimbursed by customers.

Guarantees are generally written by a Bank to support performance by a customer to third parties. The Bank will only be required to meet these obligations in the event of the customer's default.

	2019 Shs'000	2018 Shs'000
Commitments		
Undrawn formal stand-by facilities, credit lines and other commitments to lend	2,308,983	650,412
Foreign exchange forward contracts to sell currency	-	-
	<hr/>	<hr/>

Notes (continued)

28 Off balance sheet financial instruments, contingent liabilities and commitments (continued)

Nature of commitments

Commitments to lend are agreements to lend to a customer in future subject to certain conditions. Such commitments are normally made for a fixed period. The Bank may withdraw from its contractual obligation for the undrawn portion of agreed overdraft limits by giving reasonable notice to the customer.

Foreign exchange forward contracts are agreements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate.

Bank facility

The Bank has a Domestic Foreign Currency Cheque Clearing facility (DFCC) with the Central Bank of Kenya. The Bank has given USD 133,000 in favour of Central Bank of Kenya to secure this facility.

29 Analysis of cash and cash equivalents as shown in the cash flow statement

	2019	2018
	Shs'000	Shs'000
Cash and balances with Central Bank of Kenya (Note 12)	521,097	353,903
Deposits and balances due from banking institutions (Note 14)	286,294	501,054
Less: overnight deposits due to banks	(300,000)	-
Less: cash reserve requirement	(325,699)	(175,800)
	<hr/>	<hr/>
	181,692	679,157
	<hr/>	<hr/>

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including: cash and balances with Central Bank of Kenya, deposits and balances due from or to banking institutions, treasury bills and other eligible bills. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya

Banks are required to maintain a prescribed minimum average cash balance with the Central Bank of Kenya that is not available to finance the Bank's day-to-day activities. At year end, the amount was determined as 5.25% (2018: 5.25%) of the average outstanding customer deposits over a cash reserve cycle period of one month.

Notes (continued)

30 Related party disclosures

In the normal course of business, the Bank issues / operates loans, advances and other facilities, current accounts and placements of foreign currencies with entities connected to some of the Bank's directors and/ or shareholders as follows:

(i) Loans and advances to related parties

Advances to customers include loans to directors, loans to companies connected to directors or their families and loans to employees as follows;

	2019 Shs'000	2018 Shs'000
At start of the year	100,436	82,234
Advances during the year	346,457	87,236
Repayments during the year	(44,238)	(69,034)
	<hr/>	<hr/>
At end of year	402,655	100,436
	<hr/>	<hr/>
Advances to Bank employees at end of year	93,260	86,029
	<hr/>	<hr/>
Interest income earned on advances to employees, directors or entities controlled by directors	25,232	8,802
	<hr/>	<hr/>
(ii) Guarantees to directors of the Bank (and their families) and companies controlled by directors:		
At start of the year	990	1,090
Issues	14,086	-
Retirement	-	(100)
	<hr/>	<hr/>
At end of year	15,076	990
	<hr/>	<hr/>
(iii) Deposits from related parties		
Deposits from staff and directors or entities controlled by directors	978,016	888,403
	<hr/>	<hr/>
Interest expense paid on deposits by directors or entities connected to directors	48,117	39,878
	<hr/>	<hr/>

Notes (continued)

30 Related party disclosures (continued)

(iv) Other transactions

In the normal course of business, the Bank paid insurance premium to an entity associated with the Bank as follows:

	2019 Shs'000	2018 Shs'000
Insurance premium paid	12,673	3,632
	<hr/>	<hr/>

(v) Key management compensation

Salaries and other short-term employment benefits	63,839	61,041
Other long-term benefits	3,672	3,477
	<hr/>	<hr/>
	67,511	64,518
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The Bank has a compensation policy that is market oriented and is effective in ensuring that required skills are always available. The policy ensures compensation consistency within business units. The policy also provides employment stability, healthcare benefits and provident fund plan to employees. Bank's policy honours any Collective Bargaining Agreements that are applicable. The policy is non-discriminatory in nature.

(vi) Directors' remuneration

	2019 Shs'000	2018 Shs'000
Fees and other emoluments	32,653	22,500
	<hr/>	<hr/>

Directors' remuneration is determined by the Bank's Board. To attract and retain directors, the Bank has a structure that is competitive in the industry and that is within the Bank's ability to pay.

31 Other Contingencies

In 2016, the Bank suffered fraud losses at its Nyerere Rd branch in Mombasa. All verified claims have been refunded to the respective customers. The loss relating to the refunds has been accounted for in these financial statements. No provisions have been made in relation to the unverified claims from customers as the directors believe that the eventual loss from the unverified claims will not result in a material cash outflow to the Bank.

The Bank lodged a claim with its insurers for the fraud loss above. The total claim was for Shs 104 million (2018: Shs 104 million). The asset has not been recognized in these financial statements as the insurance company has not confirmed settlement of the entire claim (as at 31st December 2019 the insurance company had proposed to settle Shs 40.5 million).

Notes (continued)

32 Subsequent events

The world is currently experiencing a significant challenge emanating from the COVID-19 pandemic. Globally and locally, the authorities are attempting to stop the spread of the virus with the introduction of various measures, including complete lock down of some countries.

The Kenyan Government has introduced certain economic stimulus proposals to ease the burden on business and the citizens as a whole. At Bank level, we are following the developments, particularly the impact on business, staff, customers and all other stakeholders. Preliminary measures and business continuity plans to mitigate adverse impact are being activated and will be closely monitored. The Bank will continually assess them on an ongoing basis and adopt changes as events unfold. The directors note that the effects of COVID-19 pandemic will impact the Bank's business and financial results in 2020 but the full impact is yet to be ascertained.

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