



ANNUAL REPORT

& FINANCIAL STATEMENTS

FOR THE YEAR ENDED
31ST DECEMBER 2019

Annual Report & Financial Statements

For the year ended 31st December 2019

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Bank Information

BOARD OF DIRECTORS

Shanti V. Shah - Chairman
Nalinkumar M. Shah
Rupen M. Haria
Jayesh G. Shah *
Simon D. Gregory *
Alakh Kohli - (Appointed on 12th June 2019)

* British

COMPANY SECRETARY

Joseph Kamau
P.O. Box 44080 - 00100
Nairobi,
Kenya.

REGISTERED OFFICE

L.R. No.209/1326, Finance House, 2nd Floor
Koinange Street, Nairobi (CBD)
P.O. Box 44080 - 00100
Nairobi,
Kenya.

INDEPENDENT AUDITOR

RSM Eastern Africa LLP
Certified Public Accountants
1st Floor, Pacis Centre,
Slip Road, off Waiyaki Way, Westlands
P.O. Box 349 - 00606
Nairobi,
Kenya.

PRINCIPAL CORRESPONDENTS

Standard Chartered Bank, New York, United States of America
Standard Chartered Bank, London, United Kingdom
Standard Chartered Bank, Frankfurt, Germany
Axis Bank, Mumbai India
SBM, Mumbai, India

Chairman's Report



I am pleased to present the Bank's Annual Report and the Financial Statements for the year ended 31st December 2019.

Macro-economic Overview

Kenya's real GDP in 2019 is estimated to have grown by 5.9% driven by household consumption and investment on the demand side and service on the supply side (such as public administration, information technology, finance and insurance, transport and storage). GDP growth in 2019 was lower than the 6.5% growth in 2018 primarily contributed by reduced Government expenditure on large scale public infrastructure projects and unfavourable weather conditions. The exchange rate was stable, supported by a narrowing current account deficit, from 5.0% of GDP in 2018 to 4.9% in 2019. Foreign exchange reserves stood at USD 8.8 billion as at December 2019, providing 5.4 months of import cover well above the required minimum threshold of 4 months import cover. Inflation rates were also stable throughout the year oscillating within the CBK's target band of 5.00% +/- 2.50%. The average annual inflation in December 2019 was 5.20%.

Banking Sector Overview

Kenya's Banking sector continued to be impacted by interest cap laws that limited private sector credit growth and ultimately the banks' profitability. However, the interest cap law was repealed in November 2019 albeit with existing facilities, at the time of the repeal, remaining at the same contracted rate. M Oriental Bank Limited (MOBL) is in full compliance with the law.

Further, Kenya's Banking Sector continued to witness consolidation of banks through mergers and acquisitions to enhance resilience, stability and competitiveness. Continued investments in information and Communication Technologies (ICT) was also evident across the banking sector. MOBL will continue to make the necessary strategic

interventions to remain a relevant player in the banking sector and contribute meaningfully to the economic development of all the stakeholders.

MOBL's Performance Overview

MOBL achieved annual growth rate of 18% in balance sheet size to Kshs. 12.39 Bln as at 31st December 2019 from Kshs. 10.52 Bln as at end of previous year. This was primarily contributed by a growth of 24% in customer deposits from Kshs. 7.40 Bln as at end of December 2018 to Kshs. 9.19 Bln as at end of December 2019 demonstrating the trust and loyalty that the depositors have with the bank. The bank took conscious stance by the Bank to support our existing clients and have a cautious, judicious and merit-based approach to new advances resulting to a decline in net customer advances by 9% to Kshs. 6.81 Bln as at end of December 2019.

Our conscious stand to consolidate customer advances coupled with an increase in non-performing loans attributable to the general business environment challenges and reduction of Central Bank Rate eroded the interest margin in 2019 thereby contributing to a decline in profit before tax by 39 % from KSh.105 million in 2018 to Kshs. 64 million in 2019. A one off increase in deferred tax expenses resulting from derecognition of expired tax losses as explained in the financial statements resulted to a loss after tax of Kshs. 22 Mln in 2019 from a Profit after tax Kshs. 82 Mln in previous year.

Chairman's Report (continued)

The Bank's overall financial position remained sound and stable with sufficient capital adequacy and liquidity levels. It maintained healthy buffers on its capital ratios over the minimum regulatory requirement. Core Capital to Customer Deposit ratio as at end of 2019 stood at 28% against a statutory minimum requirement of 8%, core capital to total risk weighted assets stood at 33% against a regulatory minimum of 10.50% while total capital to total risk weighted assets stood at 34% against a regulatory minimum of 14.50%. This indicates that the Bank has the capacity support an almost threefold balance sheet size growth from the current levels while complying with minimum regulatory requirements. Similarly, the Bank's liquidity ratio stood at 55% as at close of 2019 against regulatory minimum requirement of 20%. The average liquidity ratio in 2019 was maintained at the same level.

Regulations

We are compliant with CBK prudential guidelines, the Banking Act and other business regulations.

Customer Engagement

We held various events across the branches for our clientele to interact with them and appreciate them for the continued business relationship, as part of our client engagement strategy.

Corporate Social Responsibility

We partnered with various organisations and religious bodies to bring positive change to the society by supporting needy students' education and environmental conservation initiatives. The highlight of our CSR was the Bank being a primary sponsor for the Sukuma Twende Trust Karura Night Walk, where over 40 of our staff participated in the walk led by our CEO.

BOD Changes

During the year, Mr. Alakh Kohli, the Chief Executive Officer was appointed to the Board of Directors as the Managing Director.

Outlook

The COVID 19 pandemic being experienced globally has brought lot of uncertainties that make it difficult to predict the future. MOBL is putting appropriate mitigation measures to ensure business continuity during these challenging times. I believe the Bank is well placed to face the future with confidence.

Appreciation

The strides that the Bank has made would not have been possible without the unwavering support from our customers. I take this opportunity on behalf of the BOD, management, staff and on my own behalf to express sincere gratitude to our customers.

I also thank my colleagues in the Board for their invaluable support and contribution.

Further, I wish to thank the entire staff and management team, under the very able leadership of the Managing Director & Chief Executive Officer for their drive, initiatives and commitment.

The Board joins me in extending our heartfelt thanks to;

- Central Bank of Kenya and their officials for their total support and guidance,
- Our external Auditors, RSM Eastern Africa up, for their guidance and understanding,
- Shareholders of the Bank for their confidence in the BOD and management.



Shanti V. Shah
Chairman

Board of Directors



Nalinkumar M. Shah
Director



Shanti V. Shah
Chairman



Rupen M. Haria
Director



Alakh Kohli
CEO



Simon D. Gregory
Director



Jayesh G. Shah
Director

Corporate Social Responsibility

The modern business environment has evolved to focus not just on the bottom line but in aligning the processes in a sustainable manner.

We are increasingly looking at ways in which our business meets the needs of our society by investing and partnering with developmental charitable organizations that champion the cause.

In the year under review, we enhanced our commitment to address environmental as well as societal challenges through strategic partnerships in order to mitigate the effects brought about with those challenges.

Through these partnerships we hope to meet the needs of the society we operate in as well as contribute towards the attainment of the sustainable developmental goals (SDG).

Projects Undertaken

- We planted over 10,000 tree seedlings at Marania, Mt. Kenya to help increase the country's forest cover.
- We continued our partnership with The Sukuma Twende Trust as we took part in the first ever moonwalk event at Karura Forest.
- We invested in education through our sponsorship of various schools such as St. John Girls and Legacy Schools in Kitale.
- We continued our partnership with the Catholic Diocese of Kitale in support of various community-based projects they are undertaking

Corporate Social Responsibility (continued)



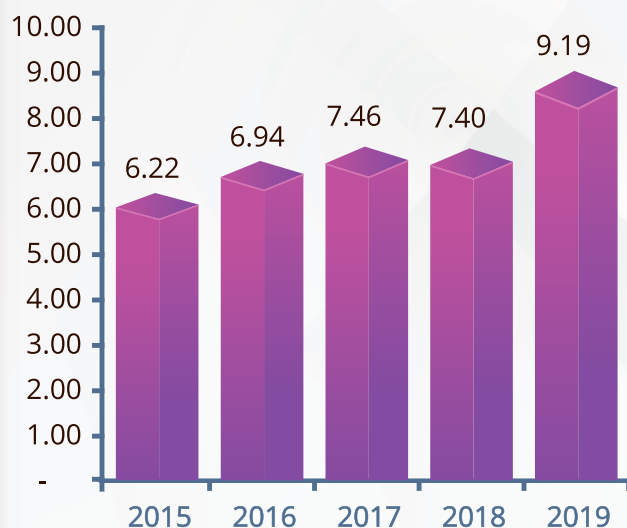
M Oriental Bank team headed by the C.E.O, Mr. Alakh Kohli, at the Bank's tent during Karura forest moon walk held in 2019.



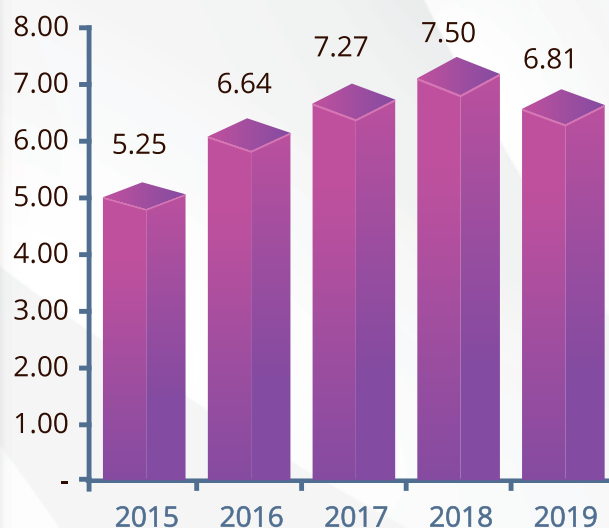
M Oriental Staff participating in Karura forest Moon Walk to support needy children education

Financial Highlights

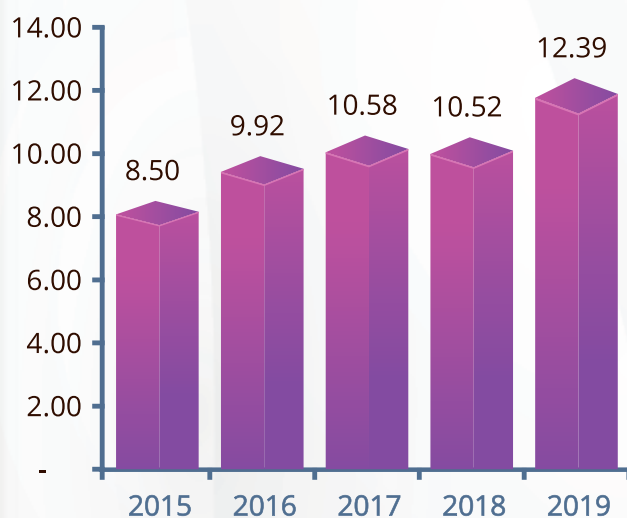
Customer Deposits in Kshs. Billions



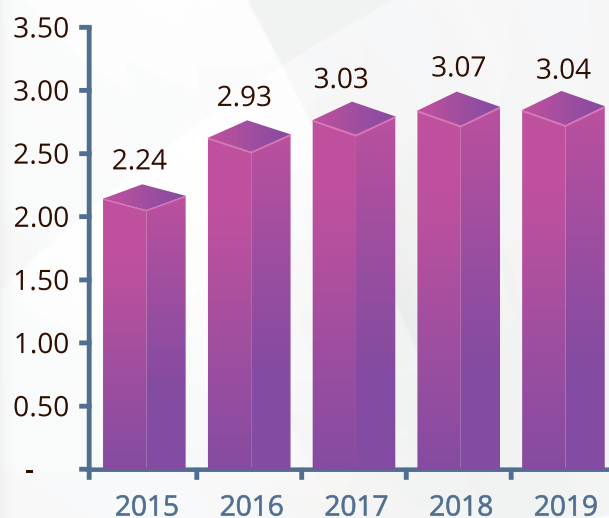
Net Loans & Advances in Kshs. Billions



Total Assets in Kshs. Billions



Shareholders' Fund in Kshs. Billions



Statement of Corporate Governance

Corporate governance involves a set of relationships between a broad group of stakeholders, including shareholders, Board of Directors, management, employees, customers, suppliers, regulators and the general public that guides the way companies are directed and controlled. The Board of Directors recognises importance of good corporate governance and is fully committed to achieving and sustaining the highest standards of corporate governance.

Shareholders

The shareholders' roles are firstly to appoint the Directors and hold the Board accountable and responsible for efficient and effective governance of the Bank. Secondly, they also appoint the independent auditor of the Bank.

Board of Directors

The Board meets regularly and had four sittings during the year 2019 as shown on page 10. Matters requiring urgent attention were resolved through circular resolutions. Apart from the regular Board meetings, communication between the Executive Management and the Board is on a continuous basis mainly by way of Board memoranda and electronic mail which are circulated to all Directors.

The Board has delegated the authority of day to day management to the CEO but retains the overall responsibility for financial and operating decisions as indicated on the statement of directors' responsibilities. The Board has access to the Company Secretary. To ensure effectiveness, the Board has set up various committees which operate within and in accordance with clearly set terms of reference. The committees report to the Board at periodic intervals and by circulation.

These committees are:-

1 Board Audit Committee

The role of the Board Audit Committee is to assist the board of directors in fulfilling its oversight responsibilities for the financial reporting process. It is also responsible for continually evaluating the effectiveness of internal control systems and regularly receives reports from internal and external auditors and management's corrective actions in response to the findings. The committee meets on a quarterly basis and its members are:

- i) Simon D. Gregory - Ag. Chairman
- ii) Nalinkumar M. Shah - Member
- iii) Rupen M. Haria - Member

2 Board Risk and Compliance Committee

The Board Risk and Compliance Committee monitors all risk exposures against defined thresholds and appetite. The committee also monitors legal and regulatory changes in the external environment and oversees compliance with relevant laws, regulations and directives. The committee meets on a quarterly basis and its members are:

- i) Jayesh G. Shah - Chairman
- ii) Nalinkumar M. Shah - Member
- iii) Rupen M. Haria-Member

3 Board Credit Committee

The function of this committee is to appraise and approve credit applications within the limits set by the Board and review of the quality of loans portfolio ensuring adequate loan loss provisions are held in line with the prudential guidelines. The committee also oversees and reviews the overall lending policies of the Bank. The committee meets as and when need arises. Members of this committee are:

- i) Jayesh G. Shah - Chairman
- ii) Shanti V. Shah - Member
- iii) Rupen M. Haria-Member
- iv) Nalinkumar M. Shah - Member

Statement of Corporate Governance (continued)

4 Board Appointment and Compensation Committee

The function of this committee is to oversee appointments and the compensation system's design and operation on behalf of the Board of Directors. The committee meets as and when the need arises. Members of this committee are:

- i) Rupen M. Haria - Chairman
- ii) Shanti V. Shah - Member
- iii) Jayesh G. Shah-Member

Board Evaluation

The Board has had regular communication on its composition and effectiveness. Through the communications, directors are called upon on the functions requiring their expertise. This is taken into account in peer review performance.

A Board assessment and peer review on performance was undertaken for the year ended 31st December 2019. This performance evaluation is an annual exercise aimed at ensuring that the Board remains efficient and effective while discharging its responsibilities.

A detailed report has been separately submitted to Central Bank of Kenya as per Prudential Guidelines.

Management Committees

For effective delegation the CEO has also set up various committees made up of senior officers of the Bank entrusted with different responsibilities which operate within prescribed Terms of Reference as approved by the Board. These Committees include Asset and Liabilities Committee (ALCO), Executive Credit Committee, Management Committee and Human Resource Committee.

Tabulated below are the committees, their membership, frequency of meetings and functions:

| | Asset and Liabilities Committee | Management Credit Committee | Executive Committee |
|-----------------------|--|--|--|
| Chairman | CEO | CEO | CEO |
| Members | Chief Manager - Credit Chief Operations Officer Financial Controller Manager - Treasury | Chief Manager - Credit Financial Controller Chief Operations Officer | Chief Operations Officer Financial Controller |
| Frequency of Meetings | Monthly | Monthly | Monthly |
| Main Functions | Management of Statement of Financial Position and Liquidity | Appraisal and approval of Credit Applications | Strategy decision making |

Statement of Corporate Governance (continued)

4 Board Appointment and Compensation Committee (continued)

Management Committees

The Bank is a public limited company and fully complies with the Banking Act and the Central Bank of Kenya Prudential Guidelines. The Bank distributes its annual report and financial statements and also publishes quarterly reports and notices in the national dailies to ensure that the shareholders are fully informed of the Bank's performance. No individual shareholder has direct or indirect control powers to control the institution and all shareholders have access to the Bank and its Company Secretary who responds to their correspondences. In accordance with the Companies Act, 2015 the shareholders have access to the shares register.

| Date of Meeting | S.V. Shah | N.M. Shah | R.M. Haria | S.D. Gregory | J.G. Shah | A. Kohli* |
|-------------------------|-----------|-----------|------------|--------------|-----------|-----------|
| 27/02/2019 | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |
| 12/06/2019 | ✓ | ✓ | ✓ | ✓ | ✓ | ✗ |
| 05/10/2019 | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| 29/11/2019 | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Total meetings attended | 4 | 4 | 4 | 4 | 3 | 2 |
| Percentage attendance | 100% | 100% | 100% | 100% | 75% | 50% |

A. Kohli*- Was as appointed to the BOD on 12th June 2019. Hitherto, he was attending the BOD meeting as an invitee.



Shanti V. Shah
Chairman



Alakh Kohli
Chief Executive Officer

Report of the Directors

The directors submit their report together with the audited financial statements for the year ended 31 December 2019, in accordance with Section 22 of the Banking Act and Section 653 of the Kenyan Companies Act, 2015, which disclose the state of affairs of M-Oriental Bank Limited ("the Bank").

Directorate

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

Principal Activities

The Bank is licensed under the Banking Act and provides banking, financial and related services.

Dividend

The directors do not recommend the declaration of a dividend for the year (2018: Nil).

Business Review

Business environment as exhibited by macro-economic indicators and GDP, local currency stability, and inflation rates was stable in 2019, partly attributable to good weather conditions and a relatively stable political environment. However, quarterly GDP reports as released by Kenya National Bureau of Statistics (KNBS) showed a slower economic growth in 2019 compared to 2018 on overall basis and in most sectors of the economy. The interest cap law was repealed in November 2019 albeit with existing facilities, at the time of the repeal, remaining at the same contracted rate, which has been followed by the Bank to ensure full compliance with the law. It is expected that the flexibility on interest rates going forward will spur private sector credit growth and ultimately the economy from year 2020 onwards. A conscious stance by the Bank to support our existing clients and have a cautious, judicious and merit based approach to new advances resulted in flat customer advances growth coupled with an increase in non performing advances levels attributable to business environment challenges and reduction of Central Bank Rate eroded the interest margin in 2019 thereby contributing to a decline in profit after tax by 127% from KSh 82.4 million in 2018 to a loss of KSh 21.9 million in 2019.

The Bank's accumulated losses increased from KSh 37.1 million to KSh 91.7 million as at 31st December 2019. Transactional business and bad debts collections are being given immense attention to compensate for the erosion on interest margin. The Bank held a deferred tax asset of KSh 214.3 million as at 31st December 2019 (2018: KSh 300 million), after derecognising past tax losses. Although the tax losses expired on 31st December 2019, the Bank made a two year extension application to the National Treasury but an approval is yet to be granted, hence the decision not to recognise deferred tax on the losses. If the extension is granted, it is expected that the Bank will be able to generate enough profits to offset the accumulated tax losses within the two years, especially through loan recoveries. The repeal of interest cap law will also boost the Bank's profitability by ensuring commensurate compensation of credit risk.

With 7 branches across most of the major towns in Kenya, 98 experienced and highly skilled staff members, M Oriental Bank is a highly respected financial institution which serves discerning customers across the country.

Report of the Directors (continued)

Statement as to disclosure to the Bank's Auditor

With respect to each director at the time this report was approved:

- a) There is, so far as the director is aware, no relevant audit information of which the Bank's auditor is unaware; and
- b) The director has taken all the steps that the director ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

Terms of Appointment of the Auditor

The directors approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees. The agreed auditor's remuneration of KSh 4,000,000 has been charged to profit or loss in the year.

By order of the board



Chairman



Nairobi 2020

Statement of Director's Responsibilities

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Bank as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Bank keeps proper accounting records that:

- a) Show and explain the transactions of the Bank;
- b) Disclose, with reasonable accuracy, the financial position of the Bank; and
- c) Enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.

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

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

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

Approved by the board of directors on **20th March 2020** and signed on its behalf by:



Chairman



Chief Executive Officer

Report of the Independent Auditor (continued)

To the Members of M-oriental Bank Limited (continued)

Opinion

We have audited the accompanying financial statements of M-Oriental Bank Limited, set out on pages 17 to 53, which comprise the statements of financial position as at 31st December 2019, the profit and loss account, statements of changes in equity and cash flows for the year then ended, and notes, including a summary of significant accounting policies.

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

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the 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 directors are responsible for the other information. Other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, other than that prescribed by the Kenyan Companies Act, 2015, as set out below.

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

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation and fair presentation of the 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.

Report of the Independent Auditor (continued)

To the Members of M-oriental Bank Limited (continued)

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 judgement and maintain professional scepticism throughout the audit. We also:

- ▶ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.
- ▶ Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- ▶ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Conclude on the appropriateness of management's 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 the 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 those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report of the Independent Auditor (continued)

To the Members of M-oriental Bank Limited (continued)

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

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 11 is consistent with the financial statements.

The signing partner responsible for the independent audit was CPA Elvis Ogeto, Practising Certificate No. 2303.

Certified Public Accountants

Nairobi

..... *RSM Eastern Africa LLP* 2020

...../2020

Profit and Loss Account for the Year Ended 31st December 2019

| | Note | 2019 KSh'000 | 2018 KSh'000 |
|---|------|------------------|------------------|
| Interest income | 5 | 1,117,726 | 1,174,132 |
| Interest expense | 6 | <u>(610,152)</u> | <u>(574,154)</u> |
| Net interest income | | <u>507,574</u> | <u>599,978</u> |
| Fee and commission income | 7 | 123,767 | 97,794 |
| Fee and commission expense | 7 | <u>(6,772)</u> | <u>(3,336)</u> |
| Net fee and commission income | | <u>116,995</u> | <u>94,458</u> |
| Net trading income | 8 | 9,634 | 11,493 |
| Changes in fair value of financial assets at fair value | 7 | (4,774) | (12,357) |
| Other income | 10 | <u>3,476</u> | <u>4,044</u> |
| Total income | | 632,905 | 697,616 |
| Employee benefits expense | | (221,544) | (226,879) |
| Other expenses | | (217,510) | (220,361) |
| Net impairment losses on loans and advances | 11 | <u>(129,398)</u> | <u>(145,063)</u> |
| Profit before tax expense | 12 | 64,453 | 105,313 |
| Tax expense | 13 | <u>(86,401)</u> | <u>(22,867)</u> |
| (Loss)/profit for the year attributable to the owners of the | | <u>(21,948)</u> | <u>82,446</u> |
| Earnings per share attributable to the owners of the Bank | | | |
| Basic and diluted (KSh per share) | 14 | <u>(0.18)</u> | <u>0.66</u> |

Statement of Financial Position at 31st December 2019

| | Note | 2019 KSh'000 | 2018 KSh'000 |
|---|------|-------------------|-------------------|
| ASSETS | | | |
| Cash and balances with Central Bank of Kenya | 15 | 1,059,687 | 1,161,044 |
| Loans and advances to banking institutions | 16 | 1,873,377 | 596,087 |
| Loans and advances to customers | 17 | 6,811,799 | 7,495,897 |
| Government securities at amortised cost | 18 | 2,145,839 | 538,131 |
| Other financial assets at amortised cost | 18 | - | 6,125 |
| Government securities at fair value through profit or loss | 19 | - | 200,137 |
| Other financial assets at fair value through profit or loss | 19 | 24,625 | 29,804 |
| Other receivables | 20 | 79,257 | 86,571 |
| Intangible assets | 21 | 5,348 | 8,041 |
| Property and equipment | 22 | 64,535 | 92,453 |
| Right - of - use assets | 23 | 114,985 | - |
| Deferred income tax | 24 | 214,324 | 300,725 |
| Total assets | | 12,393,776 | 10,515,015 |
| LIABILITIES | | | |
| Deposits from customers | 25 | 9,187,522 | 7,404,674 |
| Lease liabilities | 26 | 111,999 | - |
| Other payables | 27 | 51,084 | 45,222 |
| Total liabilities | | 9,350,605 | 7,449,896 |
| SHAREHOLDERS' EQUITY | | | |
| Share capital | 28 | 2,490,811 | 2,490,811 |
| Shareholders' contributions pending allotment | 28 | 9,189 | 9,189 |
| Share premium | 28 | 412,819 | 412,819 |
| Regulatory reserve | 29 | 222,004 | 189,373 |
| Accumulated losses | | (91,652) | (37,073) |
| Total shareholders' equity | | 3,043,171 | 3,065,119 |
| Total liabilities and shareholders' equity | | 12,393,776 | 10,515,015 |

The financial statements on pages 17 to 53 were approved for issue by the board of directors on **20th March 2020** and were signed on its behalf by:



Chairman



Chief Executive Officer

Statement of Changes in Equity for the Year Ended 31st December 2019

| | Note | Share capital KSh'000 | Shareholders' contributions pending allotment KSh'000 | Share premium KSh'000 | Regulatory reserve KSh'000 | Accumulated losses KSh'000 | Total KSh'000 |
|--|------|--------------------------|--|--------------------------|-------------------------------|-------------------------------|------------------|
| At 1st January 2018 | | 2,490,811 | 9,189 | 412,819 | 247,707 | (132,528) | 3,027,998 |
| Adjustment on initial application of IFRS 9: | | | | | | | |
| Excess allowance for credit losses | 17 | - | - | - | - | (64,750) | (64,750) |
| Deferred tax on the above | | - | - | - | - | 19,425 | 19,425 |
| Transfer to regulatory reserve prior | 29 | - | - | - | (64,750) | 64,750 | - |
| As restated | | 2,490,811 | 9,189 | 412,819 | 182,957 | (113,103) | 2,982,673 |
| Changes in equity in 2018 | | | | | | | |
| Profit for the year | | - | - | - | - | 82,446 | 82,446 |
| Transfer from regulatory reserve | 29 | - | - | - | 6,416 | (6,416) | - |
| At 31st December 2018 | | <u>2,490,811</u> | <u>9,189</u> | <u>412,819</u> | <u>189,373</u> | <u>(37,073)</u> | <u>3,065,119</u> |
| At 1st January 2019 | | 2,490,811 | 9,189 | 412,819 | 189,373 | (37,073) | 3,065,119 |
| Changes in equity in 2019 | | | | | | | |
| Loss for the year | | - | - | - | - | (21,948) | (21,948) |
| Transfer to regulatory reserve | 29 | - | - | - | 32,631 | (32,631) | - |
| At 31st December 2019 | | <u>2,490,811</u> | <u>9,189</u> | <u>412,819</u> | <u>222,004</u> | <u>(91,652)</u> | <u>3,043,171</u> |

Statement of Cash Flows for the Year Ended 31st December 2019

| | Note | 2019 KSh'000 | 2018 KSh'000 |
|--|------|-------------------------|-------------------------|
| Cash flows from operating activities | | | |
| Interest receipts | | 1,104,402 | 1,096,702 |
| Interest payments | | (607,071) | (564,044) |
| Net fees and commission receipts | | 116,995 | 94,458 |
| Net trading income | | 9,634 | 11,493 |
| Other sundry income | | 1,831 | 1,878 |
| Payments to employees and suppliers | | (387,137) | (452,358) |
| Cash flows generated from operating activities before changes in operating assets and liabilities | | 238,654 | 188,129 |
| (Increase)/decrease in operating assets and liabilities: | | | |
| • Cash reserve ratio | | (110,263) | 2,428 |
| • Financial assets at amortised cost | | (1,588,259) | 673,921 |
| • Financial assets at fair value | | 200,137 | (199,164) |
| • Loans and advances | | 554,700 | (350,911) |
| • Other receivables | | 20,650 | (13,765) |
| • Customer deposits | | 1,789,949 | (68,852) |
| • Other payables | | 9,447 | 4,092 |
| Net cash generated from operating activities | | <u>1,115,015</u> | <u>235,878</u> |
| Cash flows from investing activities | | | |
| Purchase of property and equipment | 22 | (7,394) | (11,238) |
| Purchase of intangible assets | 21 | (1,581) | (7,309) |
| Proceeds from disposal of property and equipment | | 66 | 2,042 |
| Proceeds from sale of financial assets at fair value | | 407 | 3,042 |
| Dividend received | | 1,577 | 640 |
| Net cash used in investing activities | | <u>(6,925)</u> | <u>(12,823)</u> |
| Cash flows from investing activities | | | |
| Lease liabilities payments - Principal | 26 | (32,238) | - |
| Lease liabilities payments - Interest | 26 | (10,182) | - |
| Net cash used in financing activities | | <u>(42,420)</u> | <u>-</u> |
| Net increase in cash and cash equivalents | | 1,065,670 | 223,055 |
| Cash and cash equivalents at start of year | | <u>1,383,821</u> | <u>1,160,766</u> |
| Cash and cash equivalents at end of year | 30 | <u><u>2,449,491</u></u> | <u><u>1,383,821</u></u> |

Notes

1 General Information

M-Oriental Bank Limited (the Bank) is domiciled in Kenya where it is incorporated under the Kenyan Companies Act, 2015 as a private company limited by shares. The address of its registered office and principal place of business is L.R. No. 209/1326, Finance House, Nairobi (CBD), P.O. Box 44080 - 00100, Nairobi, Kenya.

2 Summary Of Significant Accounting Policies

The significant accounting policies adopted in the preparation of these financial statements are set out below:

a) Basis of Preparation

The financial statements are prepared on a going concern basis and in compliance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. They are presented in Kenya Shillings, which is also the functional currency (see (c) below), rounded to the nearest thousand (KSh'000).

The financial statements comprise a profit and loss account (statement of profit or loss), statement of financial position (balance sheet), statement of changes in equity, statement of cash flows, and notes. Income and expenses are recognised in the profit and loss account.

Measurement Basis

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

Under the historical cost basis, assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation or, in some cases, at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

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 maximise the use of relevant observable inputs and minimise 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 take into account.

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

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

Level 2 fair value measurements are those derived from 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).

Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Transfers between levels of the fair value hierarchy are recognised by the Bank at the end of the reporting period during which the change occurred.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

b) New and Revised Standards

i) Adoption of New and Revised Standards

One new Standard, one new Interpretation and a number of Amendments to standards became effective for the first time in the financial year beginning 1st January 2019 and have been adopted by the Bank. Neither the Amendments nor the Interpretation have had an effect on the Bank's financial statements, but the new Standard has had an impact, as follows:

IFRS 16 Leases

From 1st January 2019, to comply with IFRS 16, Leases, which replaced IAS 17, Leases, the Bank now recognises lease liabilities relating to leases under which the Bank is the lessee that had previously been classified as operating leases (other than leases with less than 12 months to run from 1st January 2019 and leases of low value items). Such liabilities have been measured at 1st January 2019 at the present value of the remaining lease payments discounted using the Bank's incremental borrowing rate as at 1st January 2019. Corresponding right-of-use assets have been recognised, measured as if the Bank's new accounting policy (see Note 2(n)) had been applied since the commencement of each lease but discounted using the Bank's incremental borrowing rate as at 1st January 2019. There was no difference between the lease liabilities and right-of-use assets at 1 January 2019 (see Note 33). As permitted by the transition provisions in the new Standard, comparative amounts have not been restated.

ii) New and revised standards that have been issued but are not yet effective

The Bank has not applied any of the new or revised Standards and Interpretations that have been published but are not yet effective for the year beginning 1st January 2019, and the Directors do not plan to apply any of them until they become effective. Note 34 lists all such new or revised standards and interpretations, with their effective dates, none of which is expected to have a significant impact on the Bank's financial statements in the period of initial application.

c) Translation of Foreign Currencies

On initial recognition, all transactions are recorded in the functional currency (the currency of the primary economic environment in which the Bank operates), which is Kenya Shillings.

Transactions in foreign currencies during the year are converted into the functional currency using the exchange rate prevailing at the transaction date. Monetary assets and liabilities at the balance sheet date denominated in foreign currencies are translated into the functional currency using the exchange rate prevailing as at that date. The resulting foreign exchange gains and losses from the settlement of such transactions and from year-end translation are recognised on a net basis in the profit and loss account in the year in which they arise, except for differences arising on translation of non-monetary available-for-sale financial assets, which are recognised in other comprehensive income.

d) Revenue Recognition

Revenue is derived substantially from banking business and related activities and comprises interest income, fee and commission income and trading income, and is recognised only when it can be reliably measured and it is probable that the economic benefits associated with the transaction will flow to the Bank.

The specific revenue recognition policies for interest income, fee and commission income and trading income are set out in (e), (f) and (g) below.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

e) Net Interest Income and Expense

Interest income and expense on financial assets or liabilities are recognised in the profit and loss account using the effective interest 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 or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The effective interest rate is established on the initial recognition of the financial asset or liability and is not revised subsequently. When estimating the future cash flows all contractual cash flows from the financial asset or liability are taken into consideration with the exception of the estimates of future credit losses. This includes all fees paid or received between parties to the contract, transaction costs and discounts or premiums received or paid.

Once a credit-impaired financial asset has been written down to reflect the lifetime expected credit loss, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

f) Fee and Commission Income

Fee and commission income and expenses that are integral to the effective interest rate on financial assets or liabilities are included in the measurement of the effective interest rate. Other fee and commission income, including servicing fees, investment management fees and syndication fees are recognised over time as the related services are performed. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

g) Net Trading Income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes and foreign exchange differences.

Foreign exchange income is recognised at the time of effecting the transactions and includes income from spot and forward deals and translation gains/losses.

h) Offsetting

Items of assets and liabilities are not offset unless there is a legally enforceable right to set off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Items of income and expenses are presented on a net basis only for gains and losses arising from a group of similar transactions such as foreign exchange trading activities.

i) Income Taxes

Income tax expense is the aggregate amount charged / (credited) in respect of current tax and deferred tax in determining the profit or loss for the year. Tax is recognised in the profit and loss account except when it relates to items recognised in other comprehensive income, in which case it is also recognised in other comprehensive income, or to items recognised directly in equity, in which case it is also recognised directly in equity.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

i) Income Taxes (continued)

Current Tax

Current income tax is the amount of income tax payable on the taxable profit for the year, and any adjustment to tax payable in respect of prior years, determined in accordance with the Kenyan Income Tax Act.

Deferred Income Tax

Deferred tax is determined for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes, using tax rates and laws enacted or substantively enacted at the balance sheet date and expected to apply when the asset is recovered or the liability is settled.

The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets or liabilities.

Deferred tax liabilities are recognised for all taxable temporary differences except those arising on the initial recognition of an asset or liability, other than through a business combination, that at the time of the transaction affects neither the accounting nor taxable profit or loss.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised. Recognised and unrecognised deferred tax assets are reassessed at the end of each reporting period and, if appropriate, the recognised amount is adjusted to reflect the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

j) Share Capital and Share Premium

Ordinary shares are recognised at par value and classified as 'share capital' in equity. Any amounts received over and above the par value of the shares issued are classified as 'share premium' in equity.

k) Earnings Per Share

Basic earnings per share is calculated by dividing profit or loss attributable to ordinary equity holders of the Bank (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period.

Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary equity holders of the Bank and the weighted average number of ordinary shares outstanding for the after-tax effect of all dilutive potential ordinary shares.

l) Financial Instruments

Initial Recognition

Financial instruments are recognised when, and only when, the Bank becomes party to the contractual provisions of the instrument. All financial assets are recognised initially using the trade date accounting which is the date the Bank commits itself to the purchase or sale.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

1) Financial Instruments (continued)

Classification

The Bank classifies its financial instruments into the following categories:

- i) Financial assets that are held within a business model whose objective is to hold assets in order to collect contractual cash flows, and for which the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are classified and measured at amortised cost.
- ii) Financial assets that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and for which the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are classified and measured at fair value through other comprehensive income.
- iii) All other financial assets are classified and measured at fair value through profit or loss.
- iv) Notwithstanding the above, the Bank may:
 - a) On initial recognition of an equity investment that is not held for trading, irrevocably elect to classify and measure it at fair value through other comprehensive income
 - b) On initial recognition of a debt instrument, irrevocably designate it as classified and measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency.
 - v) Financial liabilities that are held for trading (including derivatives), financial guarantee contracts, or commitments to provide a loan at a below-market interest rate are classified and measured at fair value through profit or loss. The Bank may also, on initial recognition, irrevocably designate a financial liability as at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency.
 - vi) All other financial liabilities are classified and measured at amortised cost.

Financial instruments held during the year were classified as follows:

- Loans and advances, and investments in government securities were classified at amortised cost;
- Other investments in shares were classified as at fair value through profit or loss;
- Customer deposits other liabilities were classified as at amortised cost.

Initial Measurement

On initial recognition:

- i) Financial assets or financial liabilities classified as at fair value through profit or loss are measured at fair value.
- ii) All other categories of financial assets and financial liabilities are measured at the fair value plus or minus transaction costs that are incremental and directly attributable to the acquisition or issue of the instrument.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

1) Financial Instruments (continued)

Subsequent Measurement

Financial assets and financial liabilities after initial recognition are measured either at amortised cost, at fair value through other comprehensive income, or at fair value through profit or loss according to their classification.

Interest income, dividend income, and exchange gains and losses on monetary items are recognised in profit or loss.

Fair value is determined as set out in Note 1(a). Amortised cost is the amount at which the financial asset or liability is measured on initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

Impairment

The Bank recognises a loss allowance for expected credit losses on debt instruments that are measured at amortised cost or at fair value through other comprehensive income. The loss allowance is measured at an amount equal to the lifetime expected credit losses for loans and advances and for financial instruments for which:

- a) The credit risk has increased significantly since initial recognition; or
- b) There is observable evidence of impairment (a credit-impaired financial asset). If, at the reporting date, the credit risk on a financial asset other than a loan and advance has not increased significantly since initial recognition, the loss allowance is measured for that financial instrument at an amount equal to 12-month expected credit losses. All changes in the loss allowance are recognised in profit or loss as impairment gains or losses.

Lifetime expected credit losses represent the expected credit losses that result from all possible default events over the expected life of a financial instrument. 12-month expected credit losses represent the portion of lifetime expected credit losses that result from default events on a financial asset that are possible within 12 months after the reporting date.

Expected credit losses are measured in a way that reflects an unbiased and probability-weighted amount 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.

Derecognition/Write off

Financial assets are derecognised when the rights to receive cash flows from the financial asset have expired, when the Bank has transferred substantially all risks and rewards of ownership, or when the Bank has no reasonable expectations of recovering the asset.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged or cancelled or expires.

Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

l) Financial Instruments (continued)

Sale and Repurchase Agreements

Securities sold under sale and repurchase agreements (Repos) are retained in the financial statements with the counter party liability included in amounts due to banking institutions.

Treasury Bills purchased from the Central Bank of Kenya under agreements to resell (Reverse Repos) are not negotiable or discountable during their tenure and are presented as 'balances with Central Bank of Kenya' until they are repurchased.

The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreement using the effective interest method.

m) Regulatory Reserve

Banking institutions are required to comply with Central Bank of Kenya Prudential Guideline CBK/PG/04 - Risk Classification of Assets and Provisioning which sets out amongst other issues, provisioning guidelines for loans and advances to customers based on performance. Where the impairment provision calculated using CBK/PG/04 exceeds the impairment provision calculated in accordance with the Bank's accounting policy, the excess is shown as an appropriation of retained earnings, within equity.

n) Leases

Leases under which the Bank is the lessee

On the commencement date of each lease (excluding leases with a term, on commencement, of 12 months or less and leases for which the underlying asset is of low value) the Bank recognises a right-of-use asset and a lease liability.

The lease liability is measured at the present value of the lease payments that are not paid on that date. The lease payments include fixed payments, variable payments that depend on an index or a rate, amounts expected to be payable under residual value guarantees, and the exercise price of a purchase option if the Bank is reasonably certain to exercise that option. The lease payments are discounted at the interest rate implicit in the lease. If that rate cannot be readily determined, the Bank's incremental borrowing rate is used.

For leases that contain non-lease components, the Bank allocates the consideration payable to the lease and non-lease components based on their relative stand-alone components.

The right-of-use asset is initially measured at cost comprising the initial measurement of the lease liability, any lease payments made on or before the commencement date, any initial direct costs incurred, and an estimate of the costs of restoring the underlying asset to the condition required under the terms of the lease.

Subsequently the lease liability is measured at amortised cost, subject to remeasurement to reflect any reassessment, lease modifications, or revised fixed lease payments.

For leases with a term, on commencement, of 12 months or less and leases for which the underlying asset is of low value, the total lease payments are recognised in profit or loss on a straight-line basis over the lease period.

The above accounting policy has been applied from 1st January 2019. Note 33 sets out the equivalent policy applied in the previous year and the impact of the change in accounting policy.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

o) Post-Employment Benefit Obligations

The Bank operates a defined contribution retirement benefits plan for its employees, the assets of which are held in a separate trustee administered scheme managed by an insurance company. A defined contribution plan is a plan under which the Bank pays fixed contributions into a separate fund, and has no legal or constructive obligation 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 or prior periods. The Bank's contributions are charged to the profit and loss account in the year to which they relate.

The Bank and the employees also contribute to the National Social Security Fund (NSSF), a national defined contribution scheme. Contributions are determined by local statute and the Bank's contributions are charged to the profit and loss account in the year to which they relate.

p) Short Term Employee Benefits

The estimated monetary liability for employees' accrued annual leave entitlement at the balance sheet date is recognised as an employment cost accrual.

q) Property and Equipment

All categories of property, plant and equipment are initially recognised at cost and subsequently carried at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure directly attributable to the acquisition of the assets. Computer software, including the operating system, that is an integral part of the related hardware is capitalised as part of the computer equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. Repairs and maintenance expenses are charged to the profit and loss account in the year in which they are incurred.

Depreciation is calculated using the straight line method to write down the cost of each asset to its residual value over its estimated useful life.

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

r) Intangible Assets

Software licence costs and computer software that is not an integral part of the related hardware are initially recognised at cost, and subsequently carried at cost less accumulated amortisation and accumulated impairment losses. Costs that are directly attributable to the production of identifiable computer software products controlled by the Bank are recognised as intangible assets. Amortisation is calculated using the straight line method to write down the cost of each licence or item of software to its residual value over its estimated useful life.

Notes (continued)

2 Summary of Significant Accounting Policies (continued)

s) Impairment of Non-financial Assets

Non-financial assets that are carried at amortised cost are reviewed at the end of each reporting period for any indication that an asset may be impaired. If any such indication exists, an impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

t) Cash and Cash Equivalents

Cash and cash equivalents for the purposes of the cash flow statement comprise cash in hand, unrestricted balances with the Central Bank of Kenya, government securities and loans and advances to Banks with maturities of three months or less from the date of acquisition that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, less deposits from banking institutions. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya. Cash flows from Repo agreements are included as part of cash flows from operating activities.

u) Contingent Liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off balance sheet transactions and disclosed as contingent liabilities. Estimates of the outcome and of the financial effect of contingent liabilities is made by the management based on the information available up to the date the financial statements are approved for issue by the directors. Any expected loss is charged to the profit and loss account in the year in which it is determined.

3 Significant Judgements and Key Sources of Estimation Uncertainty

In the process of applying the accounting policies adopted by the Bank, the directors make certain judgements and estimates that may affect the amounts recognised in the financial statements. Such judgements and estimates are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the current circumstances. However, actual results may differ from those estimates. The judgements and estimates are reviewed at each financial reporting date to ensure that they are still reasonable under the prevailing circumstances based on the information available, and any revisions to such judgements and estimates are recognised in the year in which the revision is made.

a) Significant Judgements made in applying the Bank's Accounting Policies

The judgements made by the directors in the process of applying the Bank's accounting policies that have the most significant effect on the amounts recognised in the financial statements include:

- i) Whether it is probable that future taxable profits will be available against which temporary differences can be utilised (see Note 24);
- ii) Classification of loans and advances, including whether or not the loan or advance is impaired.
- iii) Classification of financial assets: whether the business model in which financial assets are held has as its objective the holding of such assets to collect contractual cash flows or to both collect contractual cash flows and sell the assets; and whether the contractual terms of financial assets give rise on specified dates to cash flows that are solely payments of principal and interest;
- iv) Whether credit risk on financial assets has increased significantly since initial recognition; and
- v) How to determine the incremental borrowing rate used in the discounting of lease liabilities.

Notes (continued)

3 Significant Judgements and Key Sources of Estimation Uncertainty (continued)

b) Key Sources of Estimation Uncertainty

Key assumptions about the future made by the directors that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include:

- i) Estimates made in determining the expected credit losses on financial assets. Such estimates include the determination of probabilities of default including the use of forward looking information, and of losses given default.
- ii) The Bank is exposed to various contingent liabilities in the normal course of business. Management evaluates the status of these exposures on a regular basis to assess the probability of the Bank incurring related liabilities. However, provisions are made in the financial statements only where, based on the management's evaluation, a reliable estimate of the obligation can be made.

4 Risk Management Objectives and Policies

a) Financial Risk Management

The Bank's activities expose it to a variety of financial risks including credit, liquidity and market risks. The Bank's overall risk management policies are set out by the board and implemented by the management and involve analysis, evaluation, acceptance and management of some degree of risk or a combination of risks. Taking risk is core to the banking business, and compliance and regulatory risks, operational risks and reputational risks are a normal consequence of such a business undertaking. The bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects of such risks on the bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The bank regularly reviews its risk management policies and systems to reflect changes in markets, products and services offered, and emerging best practice. The Bank, through its training programme and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The board has established a Board Risk and Compliance Committee and an Asset and Liability Committee (ALCO), which are responsible for developing and managing the Bank's risk management policies in their specified areas. All board committees have both executive and non-executive members and report regularly to the Board of Directors on their activities.

The Board Audit Committee, through the Internal Audit Department, is responsible for monitoring compliance with the Bank's risk management policies and procedures and for reviewing the appropriateness of the risk management framework in line with the risks faced by the Bank.

i) Credit Risk and expected Credit Losses

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation and arises principally from the Bank's loans and advances to customers, to banking institutions, and investment securities. Management and control of credit risk is centralised at the credit and treasury departments of the Bank.

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

i) Credit Risk and expected Credit Losses (continued)

Loans and Advances to Customers

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 against loans and advances in the form of mortgage interests over property, other registered securities over assets and guarantees. The following factors are considered when assessing credit risk of loans and advances to customers:

- The probability of default by borrowers on their contractual obligations;
- Current exposures to the borrowers and likely future developments, from which the Bank derives its exposure to risk; and
- The likely recovery ratio on the defaulted obligations.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. In addition, the Kenyan Banking Act also sets the maximum exposure to a single party or group. It also sets the maximum exposure to insiders and places a ceiling on the total lending to insiders. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product and industry sector are approved as and when required by the credit committee. The exposure to any one borrower is further restricted by sub-limits covering on and off balance sheet exposures in relation to trading items.

The Bank monitors default of individual borrowers by using internal rating methods, which are based on Central Bank of Kenya Prudential Guideline CBK/PG/04. As per the Prudential Guideline, loans and advances are graded into the following categories:

- Normal
- Watch
- Substandard
- Doubtful
- Loss

Management assesses the credit quality of each borrower, taking into account their financial position, past experience and other factors. Individual limits are set based on internal or external information and in accordance with guidelines set by the management. The utilisation of credit limits is regularly monitored and corrective action taken, where necessary.

The Bank also uses credit-related commitments as a control and mitigation measure for credit risk on loans and advances. The primary purpose of these instruments is to ensure that funds are available to a customer as and when required. Guarantees and letters of credit carry the same credit risk as loans and advances.

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.

In certain cases, the Bank, in an effort to recover a past due or impaired loan and advance, renegotiates the repayment terms with the individual customers. Restructuring activities include extended payment arrangements, approved external management plans, modification and deferral of payments.

Notes (continued)

4 Risk Management Objectives and Policies (continued)**a) Financial Risk Management (continued)****i) Credit Risk and expected Credit Losses (continued)**

Following restructuring, a previously overdue customer account is reset to a normal status and managed together with other similar accounts. Restructuring policies and practices are based on indicators or criteria which, in the judgment of the credit committee, indicate that payment will most likely continue. These policies are kept under continuous review.

Letters of credit are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct advance or loan.

Other Financial Assets

Credit risk on loans and advances to banking institutions is managed by dealing with institutions, taking into account internal ratings and placing limits on deposits that can be held with each institution.

Due to the inherent nature of Government securities, these are considered to have minimal credit risk.

Expected Credit Losses

The Bank applies a 'three-stage' model for impairment based on changes in credit quality since initial recognition, as summarised below:

Stage 1: Financial assets that is not credit impaired at initial recognition and for which credit risk has not increased significantly since initial recognition;

Stage 2: Financial assets for which credit risk has increased significantly since initial recognition, but is not yet deemed to be credit-impaired; and

Stage 3: Financial assets that are credit-impaired.

In accordance with the Bank's accounting policy, for assets in Stages 2 and 3 allowance is made for expected credit losses that result from all possible default events over the expected life of a financial instrument. For assets in Stage 1 allowance is made for that portion of lifetime expected credit losses that result from default events that are possible within 12 months after the reporting date.

In assessing whether the credit risk on a financial asset has increased significantly, the Bank compares the risk of default occurring on the financial asset as at the reporting date with the risk of default occurring on that financial asset as at the date of initial recognition. In doing so, the Bank considers reasonable and supportable information that is indicative of significant increases in credit risk since initial recognition and that is available without undue cost or effort. A downgrading of the Bank's internal credit rating (see above) would be considered as indicating a significant increase in credit risk. There is also a rebuttable assumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

For these purposes default is defined as having occurred if the borrower is in breach of contractual obligations, or if information is available internally or externally that suggests that the borrower is unlikely to be able to meet its obligations.

If the Bank does not have reasonable and supportable information to identify significant increases in credit risk and/or to measure lifetime credit losses when there has been a significant increase in credit risk on an individual instrument basis, lifetime expected credit losses are recognised on a collective basis. For such purposes, the Bank groups financial assets on the basis of shared credit risk characteristics, such as:

- Type of instrument
- Industry in which the borrower operates
- Nature of collateral.

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

i) Credit Risk and expected Credit Losses (continued)

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

- Significant financial difficulty of the borrower
- A breach of contract, such as a default or past due event
- It is probable that the borrower will enter bankruptcy
- The disappearance of an active market for the financial asset because of financial difficulties.

However, there is a rebuttable assumption that a financial asset that is 90 days past due is credit-impaired.

The gross carrying amount of financial assets with exposure to credit risk at the balance sheet follows:

Basis for measurement of loss allowance

| | 12-month expected credit losses | Lifetime expected credit losses | | |
|---|--|------------------------------------|--------------------|-------------------|
| | KSh'000 | Stage 2 KSh'000 | Stage 3 KSh'000 | Total KSh'000 |
| At 31st December 2019 | | | | |
| Cash and balances with Central Bank of Kenya | 1,059,687 | - | - | 1,059,687 |
| Loans and advances to banking institutions | 1,873,377 | - | - | 1,873,377 |
| Loans and advances to customers | 5,625,209 | 277,175 | 1,315,601 | 7,217,985 |
| Government securities at amortised cost | 2,145,839 | - | - | 2,145,839 |
| Other financial assets at fair value through profit or loss | 24,625 | - | - | 24,625 |
| Other receivables | 79,257 | - | - | 79,257 |
| Gross carrying amount | 10,807,994 | 277,175 | 1,315,601 | 12,400,770 |
| Loss allowance | (40,990) | (65,143) | (300,053) | (406,186) |
| Exposure to credit risk | <u>10,767,004</u> | <u>212,032</u> | <u>1,015,548</u> | <u>11,994,584</u> |
| At 31st December 2018 | | | | |
| Cash and balances with Central Bank of Kenya | 1,161,044 | - | - | 1,161,044 |
| Loans and advances to banking institutions | 596,087 | - | - | 596,087 |
| Loans and advances to customers | 6,627,019 | 507,304 | 705,105 | 7,839,428 |
| Government securities at amortised cost | 538,131 | - | - | 538,131 |
| Other financial assets at fair value through profit or loss | 29,804 | - | - | 29,804 |
| Other financial assets at amortised cost | 6,125 | - | - | 6,125 |
| Government securities at fair value through profit or loss | 200,137 | - | - | 200,137 |
| Other receivables | 86,571 | - | - | 86,571 |
| Gross carrying amount | 9,244,918 | 507,304 | 705,105 | 10,457,327 |
| Loss allowance | (36,886) | (55,968) | (250,677) | (343,531) |
| Exposure to credit risk | <u>9,208,032</u> | <u>451,336</u> | <u>454,428</u> | <u>10,113,796</u> |

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

i) Credit Risk and expected Credit Losses (continued)

The changes in the loss allowance during the year were as follows:

| | 12-month expected credit losses | Lifetime expected credit losses | | |
|---|--|------------------------------------|--------------------|------------------|
| | KSh'000 | Stage 2 KSh'000 | Stage 3 KSh'000 | Total KSh'000 |
| Year ended 31st December 2019 | | | | |
| At start of year | 36,886 | 55,968 | 250,677 | 343,531 |
| Changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses | 4,104 | 9,175 | 49,632 | 62,911 |
| Changes because of financial assets that were written off during the year | - | - | (256) | (256) |
| At end of year | <u>40,990</u> | <u>65,143</u> | <u>300,053</u> | <u>406,186</u> |
| Year ended 31st December 2018 | | | | |
| At start of year | 28,015 | 36,735 | 218,504 | 283,254 |
| Changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses | 8,871 | 19,233 | 38,480 | 66,584 |
| Changes because of financial assets that were written off during the year | - | - | (6,307) | (6,307) |
| At end of year | <u>36,886</u> | <u>55,968</u> | <u>250,677</u> | <u>343,531</u> |

| | 12-month expected | Lifetime expected | | |
|--|----------------------|----------------------|--------------------|------------------|
| | KSh'000 | Stage 2 KSh'000 | Stage 3 KSh'000 | Total KSh'000 |
| The loss allowances at the end of each year relate to the following financial assets: | | | | |
| At 31st December 2019 | | | | |
| Loans and advances to customers | <u>40,990</u> | <u>65,143</u> | <u>300,053</u> | <u>406,186</u> |
| Total | <u>40,990</u> | <u>65,143</u> | <u>300,053</u> | <u>406,186</u> |
| At 31st December 2018 | | | | |
| Loans and advances to customers | <u>36,886</u> | <u>55,968</u> | <u>250,677</u> | <u>343,531</u> |
| Total | <u>36,886</u> | <u>55,968</u> | <u>250,677</u> | <u>343,531</u> |

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

ii) Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Bank's reputation. This responsibility rests with the Assets and Liabilities Committee (ALCO).

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

The Bank does not maintain cash resources to meet all liabilities as they fall due as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank maintains a portfolio of short-term liquid assets, made up of loans and advances to banking institutions and balances with Central Bank of Kenya to manage the day-to-day liquidity requirements. Management reviews the liquidity ratio of liquid assets to customer deposits on a daily basis and performs scenario testing to ensure that sufficient liquidity is maintained to meet maturing deposits. The Bank fully complies with the Central Bank of Kenya's minimum Cash Reserve Ratio (5.25%) and liquidity ratio (20%) requirements, with the average liquidity maintained at 55% (2018: 33%) during the year. The Bank has not defaulted on its Cash Reserve Ratio requirements.

The liquidity ratio at the balance sheet date was:

| | 2019 KSh'000 | 2018 KSh'000 |
|-------------------|-----------------|-----------------|
| Liquid assets | 5,078,903 | 2,495,399 |
| Deposits | 9,187,522 | 7,404,674 |
| Other payables | 51,084 | 45,222 |
| Lease liabilities | 14,140 | - |
| Liquidity (%) | <u>55</u> | <u>33</u> |

The scenario testing at 31st December 2019 indicated a liquidity ratio of 43 % (2018: 22%) in the worst case scenario.

The table below analyses financial liabilities into the relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date.

| At 31st December 2019 | Up to 1 month KSh'000 | 1 - 3 months KSh'000 | 3 - 12 months KSh'000 | 1 - 5 years KSh'000 | Total KSh'000 |
|------------------------------------|-----------------------------|----------------------------|-----------------------------|---------------------------|------------------|
| Financial liabilities | | | | | |
| Deposits from customers | 4,636,801 | 4,031,303 | 519,419 | - | 9,187,523 |
| Other Payables | 51,084 | - | - | - | 51,084 |
| Lease Liabilities | <u>3,535</u> | <u>10,605</u> | <u>28,280</u> | <u>69,579</u> | <u>111,999</u> |
| Total financial liabilities | <u>4,691,420</u> | <u>4,041,908</u> | <u>547,699</u> | <u>69,579</u> | <u>9,350,606</u> |

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

ii) Liquidity Risk (continued)

| | Up to | 1 - 3 | 3 - 12 | 1 - 5 | |
|------------------------------------|------------------|------------------|----------------|------------|------------------|
| | months | months | months | years | Total |
| At 31st December 2018 | KSh'000 | KSh'000 | KSh'000 | KSh'000 | KSh'000 |
| Financial liabilities | | | | | |
| Deposits from customers | 3,944,563 | 2,734,636 | 725,200 | 275 | 7,404,674 |
| Other payables | 45,222 | - | - | - | 45,222 |
| Total financial liabilities | <u>3,989,785</u> | <u>2,734,636</u> | <u>725,200</u> | <u>275</u> | <u>7,449,896</u> |

iii) Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in market price and 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 objectives of market risk management is to manage and control market risk exposures within acceptable limits, while optimising the return on risk. Overall the management of market risk rests with the Assets and Liability Committee (ALCO).

The Treasury Department is responsible for the development of detailed risk management policies, subject to review and approval by the board, and for the day to day implementation of these policies.

Market risks arise mainly from trading and non-trading activities. Trading portfolios include those positions arising from market-making transactions where the Bank acts as a principal with clients or with the market. Non-trading portfolios primarily arise from the interest rate management of the entity's retail and commercial banking assets and liabilities. Non-trading portfolio risks also include foreign exchange risk and risks arising from the Bank's government and other investment securities carried at amortised cost.

Interest Rate Risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The management closely monitors the interest rate trends to minimise the potential adverse impact of interest rate changes.

The Bank is exposed to cash flow interest rate risk on its variable rate financial instruments carried at amortised cost (loans and advances, call deposits and savings accounts, and government securities carried at amortised cost). If market interest rates were to increase/decrease by one percentage point, with all other factors remaining constant, post-tax profit would be higher/lower by KSh 44,264,000 (2018:KSh 49,535,000) in respect of cash flow interest rate risk.

Currency Risk

The Bank operates wholly within Kenya and its assets and liabilities are reported in the local currency. It conducts trade with correspondent banks and takes deposits and lends in other currencies. The Bank's currency position and exposure are managed within the exposure guideline of 10% of the core capital as stipulated by the Central Bank of Kenya. This position is reviewed on a daily basis by the management.

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Financial Risk Management (continued)

iii) Market Risk (continued)

The significant currency positions are detailed below:

| At 31st December 2019 | US KSh'000 | GB £ KSh'000 | Euros KSh'000 | Indian Rupee KSh'000 | Others KSh'000 | Total KSh'000 |
|--|------------------|------------------|------------------|----------------------------|-------------------|------------------|
| Assets | | | | | | |
| Cash in hand | 9,263 | 508 | 8,338 | - | - | 18,110 |
| Cash and balances with Central Bank of Kenya | 24,870 | 52,036 | 833 | - | - | 77,739 |
| Deposits and balances due from banking institutions | 689,802 | 931,555 | 1,290 | 295 | - | 1,622,942 |
| Loans and advances to customers | 392,527 | 54,021 | 10,281 | - | - | 456,829 |
| Other foreign assets | - | - | - | - | - | - |
| Total Assets | <u>1,116,462</u> | <u>1,038,120</u> | <u>20,742</u> | <u>295</u> | <u>1</u> | <u>2,175,620</u> |
| Liabilities | | | | | | |
| Deposits from customers | 1,110,484 | 1,037,320 | 18,070 | - | - | 2,165,874 |
| Other foreign liabilities | 2,100 | - | - | - | - | 2,100 |
| Total Liabilities | <u>1,112,584</u> | <u>1,037,320</u> | <u>18,070</u> | <u>-</u> | <u>-</u> | <u>2,167,974</u> |
| Net Balance Sheet Position | <u>3,878</u> | <u>800</u> | <u>2,672</u> | <u>295</u> | <u>1</u> | <u>7,646</u> |
| At 31st December 2018 | | | | | | |
| Total assets | 927,295 | 241,338 | 21,715 | 1,166 | 1 | 1,191,515 |
| Total liabilities | 893,267 | 240,499 | 14,964 | - | - | 1,148,730 |
| Net Balance Sheet Position | <u>34,028</u> | <u>839</u> | <u>6,751</u> | <u>1,166</u> | <u>1</u> | <u>42,785</u> |
| Credit Commitments | <u>6,086</u> | <u>(2,580)</u> | <u>(3,493)</u> | <u>-</u> | <u>-</u> | <u>13</u> |

Had the Kenya Shilling weakened by 10% against each currency, with all other variables held constant, post-tax profit would have decreased by KSh 535,000 (2018:KSh 2,995,000). If the Kenya Shilling strengthened against each currency, the effect would have been the opposite.

b) Capital Management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of 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 while at the same time maximise the returns to the shareholders and benefit the other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Notes (continued)

4 Risk Management Objectives and Policies (continued)

b) Capital Management (continued)

The Bank monitors the adequacy of its capital using the minimum capital requirements and ratios established by Central Bank of Kenya. These ratios measure capital adequacy by comparing the Bank's core capital with total risk-weighted assets plus risk weighted off-balance sheet items, total deposit liabilities and total risk weighted off balance sheet items.

Assets are weighted according to broad categories of notional credit risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50% and 100%) are applied. For example cash in hand (domestic and foreign), balances held with Central Bank of Kenya including securities issued by the Government of Kenya have a zero risk weighting, which means that no capital is required to support the holding of these assets. Property, plant and equipment carries a 100% risk weighting. Based on these guidelines, such assets must be supported by capital equal to 100% of their carrying amount. Other asset categories have intermediate weightings.

Off-balance sheet credit related commitments such as guarantees and acceptances, performance bonds, documentary credit etc, are taken into account by applying different categories of credit risk conversion factors, designed to convert these items into balance sheet equivalents. The resulting credit equivalent amounts are then weighted for credit risk using the same percentages as for balance sheet assets. Core capital (Tier 1) consists of paid-up share capital, retained profits less investments in equity instruments of other financial institutions. Supplementary capital (Tier 2) includes general provisions appropriated from revenue reserves, up to a maximum of 1.25% of total risk weighted assets.

| | Balance sheet nominal amount | | Risk weighted amount | |
|---|---------------------------------|-------------------|-------------------------|------------------|
| | 2019 KSh'000 | 2018 KSh'000 | 2019 KSh'000 | 2018 KSh'000 |
| Cash in hand and balances with Central Bank of Kenya | 1,059,687 | 1,161,044 | - | - |
| Placements and deposits with banking institutions | 1,873,377 | 596,087 | 374,675 | 119,217 |
| Loans and advances to customers | 6,811,799 | 7,495,897 | 5,342,483 | 6,331,157 |
| Government securities at amortised cost | 2,145,839 | 538,131 | - | - |
| Government securities at fair value through profit or loss | - | 200,137 | - | - |
| Other financial assets at amortised cost | - | 6,125 | - | 6,125 |
| Other financial assets at fair value through profit or loss | 24,625 | 29,804 | 24,625 | 29,804 |
| Other receivables | 79,257 | 86,571 | 79,257 | 86,571 |
| Property, plant and equipment | 64,535 | 92,453 | 64,535 | 92,453 |
| Intangible assets | 5,348 | 8,041 | 5,348 | 8,041 |
| Right - of - use assets | 114,985 | - | 114,985 | - |
| Deferred tax asset | 214,324 | 300,725 | 214,324 | 300,725 |
| | <u>12,393,776</u> | <u>10,515,015</u> | <u>6,220,232</u> | <u>6,974,093</u> |
| Off-balance sheet positions | | | 205,439 | 230,608 |
| Total credit risk weighted assets | | | 6,425,671 | 7,204,701 |
| Less: market risk qualifying assets | | | 24,625 | 29,804 |
| Adjusted credit risk weighted assets | | | 6,401,046 | 7,174,897 |
| Market risk equivalent assets | | | 282,391 | 291,685 |
| Operation risk equivalent assets | | | 1,175,191 | 1,208,331 |
| Total risk weighted assets | | | <u>7,858,628</u> | <u>8,674,913</u> |

Notes (continued)

4 Risk Management Objectives and Policies (continued)

a) Capital Management (continued)

| | 2019 KSh'000 | | 2018 KSh'000 | |
|---|----------------------|-------------|----------------------------|-------------|
| Tier 1 capital | 2,606,843 | | 2,575,021 | |
| Tier 2 capital | 98,233 | | 108,436 | |
| Total capital | 2,705,076 | | 2,683,457 | |
| Total deposit liabilities | 9,187,522 | | 7,404,674 | |
| | Actual ratios | | Minimum requirement | |
| | 2019 | 2018 | 2019 | 2018 |
| | % | % | % | % |
| Core capital to total risk weighted assets | 33 | 30 | 10.5 | 10.5 |
| Total capital to total risk weighted assets | 34 | 31 | 14.5 | 14.5 |
| Core capital to deposit liabilities | 28 | 35 | 8.0 | 8.0 |

The Kenyan Banking Act also sets out the minimum core capital requirement of KSh 1 Billion (2018: KSh 1 Billion) which the bank fully complied with.

5 Interest Income

| | | |
|--|------------------|------------------|
| Loans and advances to customers | 868,758 | 964,182 |
| Interest income on impaired loans and advances | 69,030 | 82,034 |
| Placements with and loans and advances to banking institutions | 31,733 | 22,940 |
| Financial assets at amortised cost | 148,205 | 104,976 |
| | <u>1,117,726</u> | <u>1,174,132</u> |

6 Interest Expense

| | | |
|--|----------------|----------------|
| Customer deposits | 599,967 | 567,855 |
| Deposits from other banking institutions | 3 | 6,299 |
| Lease liabilities | 10,182 | - |
| | <u>610,152</u> | <u>574,154</u> |

7 Net Fee And Commission Income

| | | |
|-----------------------------|----------------|---------------|
| Fee and commission income: | | |
| Loans and advances | 103,125 | 77,504 |
| Other fees and commissions | 20,642 | 20,290 |
| | <u>123,767</u> | <u>97,794</u> |
| Fee and commission expense: | | |
| Other | (6,772) | (3,336) |
| | <u>116,995</u> | <u>94,458</u> |

Notes (continued)

8 Net Trading Income

Net foreign exchange trading income
Net foreign exchange loss

9 Changes in Fair Value Of Financial Assets at Fair Value through Profit or Loss

Equity investments

10 Other Income

Dividend income from financial assets at fair value through profit or loss
Profit/(loss) on sale of financial assets at fair value through profit or loss
Profit on disposal of property and equipment
Other sundry income

11 Net Impairment Losses on Loans and Advances

Net increase in specific provision charged to profit and loss account (Note 17(b))
Recoveries from loans and advances written off

Charge to the profit and loss account

12 Profit before Tax Expense**(a) Items Charged**

The following items have been charged in arriving at profit before tax expense:

Employee benefits expense (Note 12(b))
Depreciation of property and equipment
Depreciation of right - of - use assets
Operating lease rentals expense
Amortisation of intangible assets

(b) Employee Benefits Expense

Wages and salaries
Retirement benefit costs:
- Defined benefit scheme
- National Social Security Fund

The average number of persons employed during the year, by category, were:

Non-management
Management and administration

Total

| | 2019 KSh'000 | 2018 KSh'000 |
|--|-----------------|-----------------|
| Net foreign exchange trading income | 13,689 | 17,145 |
| Net foreign exchange loss | (4,055) | (5,652) |
| | <u>9,634</u> | <u>11,493</u> |
| Equity investments | <u>(4,774)</u> | <u>(12,357)</u> |
| Dividend income from financial assets at fair value through profit or loss | 1,577 | 640 |
| Profit/(loss) on sale of financial assets at fair value through profit or loss | 2 | (439) |
| Profit on disposal of property and equipment | 66 | 1,965 |
| Other sundry income | <u>1,831</u> | <u>1,878</u> |
| | <u>3,476</u> | <u>4,044</u> |
| Net increase in specific provision charged to profit and loss account (Note 17(b)) | 131,941 | 148,618 |
| Recoveries from loans and advances written off | <u>(2,543)</u> | <u>(3,555)</u> |
| Charge to the profit and loss account | <u>129,398</u> | <u>145,063</u> |
| Employee benefits expense (Note 12(b)) | 192,701 | 198,971 |
| Depreciation of property and equipment | 35,312 | 37,997 |
| Depreciation of right - of - use assets | 29,252 | - |
| Operating lease rentals expense | 5,129 | 40,706 |
| Amortisation of intangible assets | <u>4,274</u> | <u>4,122</u> |
| Wages and salaries | 185,936 | 194,728 |
| Retirement benefit costs: | | |
| - Defined benefit scheme | 6,530 | 3,959 |
| - National Social Security Fund | <u>235</u> | <u>284</u> |
| | <u>192,701</u> | <u>198,971</u> |
| Number | Number | |
| Non-management | 49 | 48 |
| Management and administration | <u>49</u> | <u>55</u> |
| Total | <u>98</u> | <u>103</u> |

Notes (continued)

13 Income Tax Expense

Current income tax
Deferred income tax (Note 25)

Income tax expense

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

Profit before income tax

Tax calculated at a rate of 30% (2018: 30%)

Tax effect of:

Income not subject to tax

Expenses not deductible for tax purposes

Prior period opening adjustment through equities

Prior year under over provision

Deferred tax on losses not recognised

Income tax expense

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| - | - |
| 86,401 | 22,867 |
| <u>86,401</u> | <u>22,867</u> |
| <u>86,401</u> | <u>22,867</u> |
| 64,453 | 105,313 |
| 19,336 | 31,594 |
| (6,218) | (7,830) |
| 2,153 | 183 |
| - | 19,425 |
| - | (20,505) |
| 71,130 | - |
| <u>86,401</u> | <u>22,867</u> |
| <u>86,401</u> | <u>22,867</u> |
| (21,948) | 82,446 |
| <u>124,541</u> | <u>124,541</u> |
| <u>124,541</u> | <u>124,541</u> |
| (0.18) | 0.66 |
| <u>(0.18)</u> | <u>0.66</u> |

14 Earnings Per Share

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of shares in issue during the year.

Net profit attributable to shareholders

Weighted average number of ordinary shares in issue during the year ('000)

Basic earnings per share

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

15 Cash and Balances with Central Bank of Kenya

Cash in hand (Note 30)

Balances with Central Bank of Kenya:

Restricted balances (Cash Reserve Ratio)

Unrestricted balances (Note 30)

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|------------------|
| 222,569 | 191,660 |
| 483,573 | 373,310 |
| 353,545 | 596,074 |
| <u>1,059,687</u> | <u>1,161,044</u> |
| <u>1,059,687</u> | <u>1,161,044</u> |

The Cash Reserve Ratio is non-interest bearing and is based on the value of customer deposits adjusted in accordance with Central Bank of Kenya requirements. As at 31st December 2019 the Cash Reserve Ratio requirement was 5.25% (2018: 5.25%) of all customer deposits. These funds are not available to finance the Bank's day to day operations.

Notes (continued)

16 Deposits and Balances Due from Banking Institutions (Note 30)

Balances with banking institutions in Kenya
Balances with banking institutions abroad

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|-----------------|
| 669,504 | 380,404 |
| <u>1,203,873</u> | <u>215,683</u> |
| <u>1,873,377</u> | <u>596,087</u> |

17 Loans and Advances to Customers**a) Loans and advances to customers**

Overdrafts
Commercial loans

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|------------------|
| 3,480,179 | 3,877,475 |
| <u>3,737,806</u> | <u>3,961,953</u> |
| 7,217,985 | 7,839,428 |
| <u>(406,186)</u> | <u>(343,531)</u> |
| <u>6,811,799</u> | <u>7,495,897</u> |

Gross loans and advances to customers

Less: Provision for impaired loans and advances (Note 17(b))

Net loans and advances**b) Impairment losses on loans and advances**

At 1st January
Net increase in provision for impairment charged to profit and loss account (Note 11)
Interest income on impaired loans and advances
Prior year provision for stage 1 & 2 book charged to retained earnings
Provisions utilised during the year for write off

| | |
|----------------|----------------|
| 343,531 | 218,504 |
| 131,941 | 148,618 |
| (69,030) | (82,034) |
| - | 64,750 |
| <u>(256)</u> | <u>(6,307)</u> |
| <u>406,186</u> | <u>343,531</u> |

At 31st December

c) Concentration of risk

Economic sector risk concentrations within the loans and advances portfolio are as follows:

| | 2019 KSh'000 | 2019 % | 2018 KSh'000 | 2018 % |
|--|------------------|------------|------------------|------------|
| Manufacturing | 1,443,285 | 20 | 1,809,927 | 23 |
| Wholesale, retail trade and hotels | 3,697,380 | 51 | 3,940,254 | 50 |
| Transport and communications | 190,853 | 3 | 172,007 | 2 |
| Agriculture | 214,090 | 3 | 245,403 | 3 |
| Business services | 85,513 | 1 | 162,217 | 2 |
| Building, construction and real estate | 1,275,601 | 18 | 1,181,775 | 15 |
| Social, community and personal service | <u>311,263</u> | <u>4</u> | <u>327,845</u> | <u>5</u> |
| | <u>7,217,985</u> | <u>100</u> | <u>7,839,428</u> | <u>100</u> |

Notes (continued)

18 Financial Assets at Amortised Cost

Government Securities - Treasury bills
Government Securities - Treasury bonds

Corporate Bonds

Maturing:
- Within 1 year
- Over 1 year

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|-----------------|
| 1,103,863 | 187,845 |
| <u>1,041,976</u> | <u>350,286</u> |
| <u>2,145,839</u> | <u>538,131</u> |
| <u>-</u> | <u>6,125</u> |

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|-----------------|
| 1,548,160 | 180,474 |
| <u>597,678</u> | <u>175,937</u> |
| <u>2,145,838</u> | <u>356,411</u> |

Included in the above are financial assets with a carrying amount of KSh 100,000,000 (2018: KSh 176,000,000) that is held by the Central Bank of Kenya under lien as security for Letters of Credit.

The fair value of the Treasury Bonds and Corporate Bonds carried at amortised cost at the balance sheet date, based on quoted prices (unadjusted) in active markets for identical assets was KSh 1,160,000,000 (2018: KSh 336,000,000) and Nil (2018: KSh 6,000,000) respectively.

19 Financial Assets at Fair Value through Profit or Loss

Government securities - Treasury bonds

Equities

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| <u>-</u> | <u>200,137</u> |
| <u>24,625</u> | <u>29,804</u> |

The fair values of the treasury bonds and equity investments are based on quoted prices (unadjusted) in active markets for identical assets (Level 1).

20 Other Receivables

Clearing account
Prepayments
Other receivables

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| 37,852 | 54,654 |
| 36,786 | 23,450 |
| <u>4,619</u> | <u>8,467</u> |
| <u>79,257</u> | <u>86,571</u> |

Notes (continued)

21 Intangible Assets (Software Costs)**Cost**

At 1st January

Additions

At 31st December

Amortisation

At 1st January

Charge for the year

At 31st December

Net book amount

The annual amortisation rate used is 33.3%.

| | 2019 KSh'000 | 2018 KSh'000 |
|---------------------|-----------------|-----------------|
| At 1st January | 24,024 | 16,715 |
| Additions | 1,581 | 7,309 |
| At 31st December | 25,605 | 24,024 |
| At 1st January | 15,983 | 11,861 |
| Charge for the year | 4,274 | 4,122 |
| At 31st December | 20,257 | 15,983 |
| Net book amount | 5,348 | 8,041 |

22 Property and Equipment**At 1st January 2018**

Cost or valuation

Accumulated depreciation

Net carrying amount

Year ended 31st December 2018

Opening carrying amount

Additions

Disposals

Depreciation charge

Depreciation on disposals

Closing carrying amount

At 31st December 2018

Cost

Accumulated depreciation

Net carrying amount

Year ended 31st December 2019 Cost

Opening carrying amount

Additions

Depreciation charge

At 31st December 2019**At 31st December 2019**

Cost

Accumulated depreciation

Net carrying amount

| | Computers, copiers & fax KSh'000 | Motor vehicles KSh'000 | Furniture, fittings & equipment KSh'000 | Total KSh'000 |
|------------------------------------|---|------------------------------|--|------------------|
| At 1st January 2018 | | | | |
| Cost or valuation | 19,890 | 8,988 | 271,960 | 300,838 |
| Accumulated depreciation | (16,105) | (8,485) | (156,959) | (181,549) |
| Net carrying amount | 3,785 | 503 | 115,001 | 119,289 |
| Year ended 31st December 2018 | | | | |
| Opening carrying amount | 3,785 | 503 | 115,001 | 119,289 |
| Additions | 695 | 3,530 | 7,013 | 11,238 |
| Disposals | - | (4,840) | (190) | (5,030) |
| Depreciation charge | (1,597) | (655) | (35,745) | (37,997) |
| Depreciation on disposals | - | 4,794 | 159 | 4,953 |
| Closing carrying amount | 2,883 | 3,332 | 86,238 | 92,453 |
| At 31st December 2018 | | | | |
| Cost | 20,585 | 7,678 | 278,783 | 307,046 |
| Accumulated depreciation | (17,702) | (4,346) | (192,545) | (214,593) |
| Net carrying amount | 2,883 | 3,332 | 86,238 | 92,453 |
| Year ended 31st December 2019 Cost | | | | |
| Opening carrying amount | 2,883 | 3,332 | 86,238 | 92,453 |
| Additions | 205 | - | 7,189 | 7,394 |
| Depreciation charge | (1,211) | (883) | (33,218) | (35,312) |
| At 31st December 2019 | 1,877 | 2,449 | 60,209 | 64,535 |
| At 31st December 2019 | | | | |
| Cost | 20,790 | 7,678 | 285,972 | 314,440 |
| Accumulated depreciation | (18,913) | (5,229) | (225,763) | (249,905) |
| Net carrying amount | 1,877 | 2,449 | 60,209 | 64,535 |

Notes (continued)

22 Property and Equipment (continued)

The annual depreciation rates used are as follows:

| | Rate - % |
|-----------------------------------|----------|
| Furniture, fittings and equipment | 10 - 25 |
| Computers, copiers & faxes | 25 |
| Motor vehicles | 25 |

23 Right - of - Use Assets

At 1st January 2019
 Transferred from prepaid operating lease rentals (see below)
 Effect of change of accounting policy (Note 33)

Additions
 Depreciation charge

Carrying amount at 31st December 2019

Land and
buildings
KSh'000

125,377

-

18,860

(29,252)

114,985

Under the previous accounting policy prepaid operating lease rentals were recognised at historical cost and subsequently amortised over the lease period. The carrying amount of prepaid operating lease rentals of KSh 144,236,504 at 1st January 2019 has been reclassified as right-of-use assets.

The Bank leases various offices. The leases of offices and warehouses are typically for periods of between 3 and 7 years, with no options to renew. None of the leases contains any restrictions or covenants other than the protective rights of the lessor or carries a residual value guarantee.

In the statement of cash flows, the amount for payments for right-of-use assets represents:

Lease liabilities payments - Principal
 Lease liabilities payments - Interest
 Cash flow

For information on the related lease liabilities, see Note 26.

2019
KSh'000

32,238

10,182

22,056

24 Deferred Income Tax

Deferred income tax is calculated using the enacted tax rate of 30% (2018: 30%). Deferred tax assets and liabilities, and the deferred tax (charge) in the profit and loss account is attributable to the following items:

Year ended 31st December 2019**Deferred income tax asset**

| | At 1st January 2019 KSh'000 | Prior period adjustment KSh'000 | (Charge) to profit & loss KSh'000 | At 31st December 2019 KSh'000 |
|--|-----------------------------------|---------------------------------------|---|--|
| Property and equipment | 22,487 | - | 3,723 | 26,210 |
| Intangible assets | 351 | - | 269 | 620 |
| Right - of - use assets | - | - | (34,496) | (34,496) |
| Lease liabilities | - | - | 33,600 | 33,600 |
| Staff leave accrual | 1,400 | - | (54) | 1,346 |
| Provisions for impaired loans and advances | 168,170 | - | 18,874 | 187,044 |
| Tax losses carried forward | 108,317 | - | (37,187) | 71,130 |
| Net deferred tax asset before allowance | 300,725 | - | (15,271) | 285,454 |
| Deferred tax on losses not recognised | - | - | (71,130) | (71,130) |
| Net deferred tax asset | 300,725 | - | (86,401) | 214,324 |

Notes (continued)

24 Deferred Income Tax (continued)

Year ended 31st December 2018

Deferred Income Tax Asset

| | At 1st January 2018 KSh'000 | Prior period adjustment KSh'000 | (Charge) to profit & loss KSh'000 | At 31st December 2018 KSh'000 |
|--|-----------------------------------|---------------------------------------|---|--|
| Property and equipment | 19,063 | - | 3,424 | 22,487 |
| Intangible assets | 33 | - | 318 | 351 |
| Staff leave accrual | 1,451 | - | (51) | 1,400 |
| Provisions for impaired loans and advances | 127,895 | 19,425 | 20,850 | 168,170 |
| Tax losses carried forward | 155,725 | - | (47,408) | 108,317 |
| | <u>304,167</u> | <u>19,425</u> | <u>(22,867)</u> | <u>300,725</u> |

The Bank has an express approval from the National Treasury to carry the tax losses forward for a further five (5) years, effective 30th June 2014. Further extension to the Cabinet Secretary, National Treasury through the Kenya Revenue Authority which was granted on 31st August 2018, which expired on 31st December 2019. The directors have made an application for the further extension to the Cabinet Secretary, National Treasury through the Kenya Revenue Authority which is yet to be granted or denied.

| Arising in: | Tax losses KSh | Expiring: |
|-------------|--------------------|--------------------|
| 2010 | <u>237,100,382</u> | 31st December 2019 |

The deferred tax asset on tax losses carried forward has not been recognised as they were due to expire on 31st December 2019 and no extension has been granted.

25 Deposits from Customers

| | 2019 KSh'000 | 2018 KSh'000 |
|-----------------------------|------------------|------------------|
| Call deposits | 775 | 876 |
| Current and demand accounts | 667,082 | 618,326 |
| Savings accounts | 487,544 | 418,572 |
| Term deposits | <u>8,032,121</u> | <u>6,366,900</u> |
| | <u>9,187,522</u> | <u>7,404,674</u> |

The economic sector concentrations within the customer deposits portfolio were as follows:

| | 2019 KSh'000 | 2019 % | 2018 KSh'000 | 2018 % |
|-------------------------|------------------|------------|------------------|------------|
| Individuals | 6,455,473 | 70 | 4,812,805 | 65 |
| Non-profit institutions | 219,535 | 2 | 212,413 | 3 |
| Private companies | 2,158,383 | 24 | 2,190,417 | 30 |
| Insurance companies | <u>354,131</u> | <u>4</u> | <u>189,039</u> | <u>2</u> |
| | <u>9,187,522</u> | <u>100</u> | <u>7,404,674</u> | <u>100</u> |

Included in customer deposits were deposits amounting to KSh 2,225,147,000 (2018: KSh 851,612,000) that were held as collateral for loans and advances.

Notes (continued)

26 Lease Liabilities

Lease liabilities

The total cash outflow for leases in the year was:

Payments of principal portion of the lease liability
Interest paid on lease liabilities

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| <u>111,999</u> | <u>-</u> |
| 2019 KSh'000 | 2018 KSh'000 |
| 32,238 | - |
| <u>10,182</u> | <u>-</u> |
| <u>42,420</u> | <u>-</u> |

In 2018 the Bank recognised lease assets and lease liabilities only for those leases that were classified as finance leases under the accounting policy at that time. The assets and liabilities were not included in the books of accounts. For adjustments recognised on adoption of IFRS 16 on 1st January 2019, see Note 33.

For more information on the nature of the leases entered into and the related right-of-use assets, see Note 23.

27 Other Payables

Outstanding bankers cheques
Staff leave accrual
Sundry creditors

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| 9,769 | 11,805 |
| 4,487 | 4,668 |
| <u>36,828</u> | <u>28,749</u> |
| <u>51,084</u> | <u>45,222</u> |

28 Share Capital

At 1st January 2019 and
31st December 2019

| No. of ordinary shares | Issued and paid up capital KSh '000 | Share premium KSh '000 | Shareholders' contributions pending allotment KSh'000 |
|------------------------------|--|------------------------------|--|
| <u>124,540,569</u> | <u>2,490,811</u> | <u>412,819</u> | <u>9,189</u> |

The total number of authorised ordinary shares is 175,000,000 (2018: 175,000,000) with a par value of KSh 20 each.

The share premium account arose on issue of shares at a premium and is not distributable.

Shareholders' contributions pending allotment

The shareholders' contributions pending allotment relates to amounts received from shareholders in the past which the Bank does not have sufficient details to make an allotment.

Notes (continued)

29 Regulatory Reserve

At 1st January
 Adjustment on initial application of IFRS 9
 Transfer from retained earnings

At 31st December

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| 189,373 | 247,707 |
| - | (64,750) |
| <u>32,631</u> | <u>6,416</u> |
| <u>222,004</u> | <u>189,373</u> |

The regulatory reserve represents an appropriation from retained earnings to comply with the Central Bank of Kenya's prudential regulations. The balance represents the excess of impairment provisions determined in accordance with prudential regulations over the impairment provisions recognised in accordance with the bank's accounting policy. The reserve is not distributable.

30 Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following:
 Cash in hand (Note 15)
 Unrestricted cash balances with Central Bank of Kenya (Note 15)
 Placements with and loans and advances to banking institutions (Note 16)

| 2019 KSh'000 | 2018 KSh'000 |
|------------------|------------------|
| 222,569 | 191,660 |
| 353,545 | 596,074 |
| <u>1,873,377</u> | <u>596,087</u> |
| <u>2,449,491</u> | <u>1,383,821</u> |

31 Off Balance Sheet Contingencies and Commitments**a) Contingent Liabilities**

In common with the banking business, the Bank conducts business involving acceptances, guarantees, performance bonds and letters of guarantees. The majority of these facilities are offset by corresponding obligations from third parties. At the year end, the contingencies were as follows:

Letters of credit and acceptances
 Guarantees

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| 93,064 | 98,745 |
| <u>272,589</u> | <u>365,803</u> |
| <u>365,653</u> | <u>464,548</u> |

Nature of contingent liabilities

- i) **An acceptance** is an undertaking by a bank to pay a bill of exchange, drawn on a customer, on a specified due date. The Bank expects most acceptances to be presented and reimbursement by the customer is normally immediate.
- ii) **Letters of credit** commit the Bank to make payments to third parties, on production of documents, which are subsequently reimbursed by customers.
- iii) **Guarantees** are generally written by a Bank to support the 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.

Based on the estimate of the financial effect of the contingencies and the corresponding obligations from third parties, no material loss is anticipated.

Notes (continued)

31 Off Balance Sheet Contingencies and Commitments (continued)**Contingent Liabilities (continued)****b) Pending Litigation and Claims**

Pending litigation and claims

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| 474,266 | 474,266 |

The Bank had a number of pending claims and litigation cases at end of the year. The directors, having taken necessary professional consultations, are of the opinion that the above claims are unlikely to lead to any material financial loss to the Bank.

c) Commitments

Undrawn formal stand-by facilities, credit lines and other commitments to lend at 31st December 2019 totalled Ksh 744,988,000 (2018: KSh 890,060,000).

Commitments to lend are agreements to lend to customers 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 facilities by giving reasonable notice to the customer.

d) Operating Lease Commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

Not later than 1 year
Later than 1 year and not later than 5 years

| 2019 KSh'000 | 2018 KSh'000 |
|-----------------|-----------------|
| - | 35,052 |
| - | 51,966 |
| - | 87,018 |

32 Related Party Transactions

Included in loans and advances and customer deposits are amounts advanced to/received from certain directors and companies in which directors are involved either as shareholders or directors (related companies). In addition, contingent liabilities (Note 31) include guarantees and letters of credit of KSh 10,444,000 (2018: KSh 6,875,000) which have been issued to related companies.

The following transactions were carried out with related parties:

a) Outstanding Loans and Advances

At 1st January
Advances during the year
Interest charged during the year
Repayments during the year

At 31st December

Contingent liabilities

| Directors 2019 KSh'000 | 2018 KSh'000 | Related Companies 2019 KSh'000 | 2018 KSh'000 |
|------------------------------|-----------------|---|-----------------|
| - | - | 1,092,252 | 752,906 |
| 398,715 | - | 1,925,868 | 2,647,058 |
| 27,757 | - | 154,478 | 114,829 |
| (159,996) | - | (2,145,533) | (2,422,541) |
| 266,476 | - | 1,027,065 | 1,092,252 |
| - | - | 10,444 | 6,875 |

Notes (continued)

32 Related Party Transactions (continued)**a) Outstanding Loans and Advances (continued)**

As at 31 December 2019, loans and advances to staff amounted to KSh.36,099,000 (2018: KSh 40,127,000).

The loans and advances to related parties are performing and are fully secured. No provisions have been recognised in respect of the loans and advances to directors, related parties or staff.

b) Deposits

| | Directors 2019 KSh'000 | 2018 KSh'000 | Related Companies 2019 KSh'000 | 2018 KSh'000 |
|-----------------------------------|------------------------------|-----------------|---|-----------------|
| At 1st January | 457,368 | 124,805 | 14,836 | 13,093 |
| Deposits received during the year | 4,605,173 | 3,901,619 | 2,666,420 | 2,119,593 |
| Interest paid during the year | 23,706 | 16,833 | 4,001 | 1,805 |
| Withdrawals during the year | (4,665,869) | (3,585,889) | (2,439,749) | (2,119,655) |
| At 31st December | 420,378 | 457,368 | 245,508 | 14,836 |

c) Directors' remuneration (key management compensation)

Directors' remuneration

• Fees 5,146 5,775

33 Effect of change of Accounting Policy - Leases

As explained in Note 2(b)(i), the Bank changed its accounting policy for leases where the Bank is a lessee. The new policy is described in Note 2(n). As permitted by the transition provisions in the new Standard, comparative amounts have not been restated. The Bank's accounting policy for leases under which the Bank was a lessee, up to 31st December 2018, as follows:

Leases of assets where a significant proportion 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 the profit and loss account on a straight-line basis over the lease period. Prepaid operating lease rentals are recognised as assets and are subsequently amortised over the lease period.

The measurement of assets and liabilities that were recognised as finance leases under the previous accounting policy has continued unchanged, but the assets have been introduced from rental expenses to Right-of-use assets (see Notes 22 and 24). Right-of-use assets and lease liabilities in respect of operating leases (excluding leases with a term, on commencement, of 12 months or less and leases for which the underlying asset is of low value) in force at 1st January 2019 have been recognised in accordance with the transition requirements of IFRS 16, as described in Note 2(b)(i). The resulting adjustment passed at 1st January 2019 as a result of applying IFRS 16, was as follows:

| | KSh'000 |
|--|-----------|
| Lease liabilities | 144,237 |
| Right-of-use assets | (144,237) |
| Deferred tax | - |
| Net adjustment to retained earnings at 1st January 2019 | - |

In addition, assets held under finance leases and previously included under property, plant and equipment have been transferred from property, plant and equipment to Right-of-use assets, and amounts previously recognised as Prepaid operating lease rentals have been transferred from Prepaid operating lease payments to right-of-use assets.

Notes (continued)

34 New and Revised Financial Reporting Standards

The Bank has not applied the following new and revised standards and interpretations that have been published but are not yet effective for the year beginning 1st January 2019.

► **Amendments to IFRS 10 and IAS 28 titled Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued in September 2014)**

The amendments, applicable from a date yet to be determined, address a current conflict between the two standards and clarify that a gain or loss should be recognised fully when the transaction involves a business, and partially if it involves assets that do not constitute a business.

► **IFRS 17 Insurance Contracts (issued in May 2017)**

The new standard, effective for annual periods beginning on or after 1st January 2021, establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued. The objective is to ensure that entities provide relevant information in a way that faithfully represents those contracts. The Bank does not issue insurance contracts.

► **Amendments to IFRS 3 titled Definition of a Business (issued in October 2018)**

The amendments, applicable to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1st January 2020 and to asset acquisitions that occur on or after the beginning of that period, clarify the definition of a business, with the objective of assisting entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition.

► **Amendments to IAS 1 and IAS 8 titled Definition of Material (issued in October 2018)**

The amendments, applicable to annual periods beginning on or after 1 January 2020, clarify the definition of material and how it should be applied by including in the definition guidance that previously featured elsewhere in IFRS.

► **Amendments to IFRS 9, IAS 39 and IFRS 7 titled Interest Rate Benchmark Reform (issued in September 2019)**

The amendments, applicable to annual periods beginning on or after 1 January 2020, modify some specific hedge accounting requirements to provide relief from the potential effects of the uncertainty caused by the IBOR reform. The amendments also require companies to provide additional information about their hedging relationships which are directly affected by these uncertainties.

The following new and revised standards have become effective for the first time in the financial year beginning 1st January 2019:

► **IFRS 16 Leases (issued in January 2016)**

The new standard, effective for annual periods beginning on or after 1st January 2019, introduces a new lessee accounting model, and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

Notes (continued)

34 New and Revised Financial Reporting Standards (continued)

► IFRIC 23 Uncertainty over Income Tax Treatments (issued in June 2017)

The Interpretation, applicable to annual periods beginning on or after 1st January 2019, clarifies how to apply the recognition and measurement requirements of IAS 12 when there is uncertainty over income tax treatments.

► Amendments to IFRS 9 titled Prepayment Features with Negative Compensation (issued in October 2017)

The amendments, applicable to annual periods beginning on or after 1 January 2019, allow entities to measure prepayable financial assets with negative compensation at amortised cost or fair value through other comprehensive income if a specified condition is met.

► Amendments to IAS 28 titled Long-term Interests in Associates and Joint Ventures (issued in October 2017)

The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that an entity applies IFRS 9, rather than IAS 28, in accounting for long-term interests in associates and joint ventures.

► Amendments to IFRS 3 - Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017

The amendments, applicable to annual periods beginning on or after 1st January 2019, provide additional guidance on applying the acquisition method to particular types of business combination.

► Amendments to IFRS 11 - Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017

The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that when an entity obtains joint control of a business that is a joint operation, it does not remeasure its previously held

► Amendments to IAS 12 - Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017

The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that all income tax consequences of dividends should be recognised when a liability to pay a dividend is recognised, and that these income tax consequences should be recognised in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions to which they are linked.

► Amendments to IAS 23 - Annual Improvements to IFRSs 2015–2017 Cycle, issued in December 2017

The amendments, applicable to annual periods beginning on or after 1st January 2019, clarify that the costs of borrowings made specifically for the purpose of obtaining a qualifying asset that is substantially completed can be included in the determination of the weighted average of borrowing costs for other qualifying assets.

Notes (continued)

34 New and Revised Financial Reporting Standards (continued)

► Amendments to IAS 19 titled Plan Amendment, Curtailment or Settlement (issued in February 2018)

The amendments, applicable to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1st January 2019, requires an entity to use updated actuarial assumptions to determine current service cost and net interest for the remainder of the annual reporting period after the plan amendment, curtailment or settlement when the entity remeasures its net defined benefit liability (asset) in the manner specified in the amended standard.



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