SBM BANK (KENYA) LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED

31 DECEMBER 2019

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GROUP DIRECTORS

Director's name	Nationality	Position	Date of appointment	Date of resignation	Percentage of individual shareholding in the Bank as at 31 December 2019	Percentage of individual shareholding in the Bank as at 31 December 2018	Number of board meetings attended
Kee Chong Li Kwong Wing	Mauritian	Non-Executive Director (Chairman)	10-May-17	-	-	-	4
Moezz Mir	Kenyan	Executive Director/Chief Executive Officer	01-Nov-18	-	-	-	4
Jotham Mutoka	Kenyan	Executive Director/Deputy CEO & CBDO	10-Aug-17	-	-	-	4
Sharad Rao	Kenyan	Non-Executive Director	10-May-17	-	-	-	4
Azim Currimjee	Mauritian	Non-Executive Director	10-May-17	-	-	-	4
Medha Gunputh	Mauritian	Non-Executive Director	10-May-17	-	-	-	4
James McFie	Kenyan	Non-Executive Director	10-May-17	-	-	-	4
Flora Mutahi	Kenyan	Non-Executive Director	10-May-17	-	-	-	3
Andrew Bainbridge	British	Non-Executive Director	06-Feb-19	-	-	-	3
Nayen Koomar Ballah	Mauritian	Non-Executive Director	10-May-17	-	-	-	1

REGISTERED OFFICE AND HEAD OFFICE

Riverside Mews Building
Riverside Drive
P.O. Box 34886 – 00100
Nairobi, Kenya

PRINCIPAL SHAREHOLDERS AS AT 31 DECEMBER 2019
SBM Africa Holdings Limited - 100%

PRINCIPAL OFFICERS AS AT 31 DECEMBER 2019

Moezz Mir	- Chief Executive Officer
Jotham Mutoka	- Deputy CEO and Chief Business Development Officer
Arigala Smiles	- Chief Operating Officer
Andrew Munyao	- Chief Finance Officer
Allan Mwangi	- Chief Compliance Officer
Edgar Mwandawiro	- Chief Risk Officer
Pauline Macharia	- Chief Customer Experience Officer
George Odete	- Company Secretary and Head of Legal

COMPANY SECRETARY

George Odete
Certified Public Secretary
P.O. Box 34886 -00100
Nairobi, Kenya.

LEGAL ADVISORS

Anjarwalla & Khanna Advocates
ALN House, Eldama ravine Close, off Eldama Ravine Road
Westlands,
P.O. Box 200-00606
Nairobi, Kenya

PRINCIPAL VALUERS

Knight Frank Kenya Limited
Kenya Valuers & Estates Agents Limited
Tysons Limited
Kenya Loss Assessors & Surveyors Limited
Regent Auto Valuers
Ardhiworth (Real Estate) Limited

PRINCIPAL CORRESPONDENT BANKS

Citibank New York	- United States of America
Citibank London	- United Kingdom
Standard Chartered Bank, London	- United Kingdom
Standard Chartered Bank, New York	- United States of America
SBM Bank, India	- India
Standard Chartered Bank, Frankfurt	- Germany
Standard Chartered Bank, Tokyo	- Japan
Standard Bank of South Africa	- South Africa
SBM Bank (Mauritius) Limited	- Mauritius
Development Credit Bank	- India
Rand Merchant Bank	- South Africa
Central Bank of Kenya	- Kenya

AUDITOR

Ernst & Young LLP
Kenya-Re Towers, Upper-hill
Off Ragati Road
P.O. Box 44286 – 00100,
Nairobi, Kenya

BRANCH NETWORK

Head Office
Riverside Mews Building
Riverside Drive
P.O. Box 34886 - 00100,
Nairobi, Kenya
Email: atyourservice@sbmbank.co.ke

City Centre Branch
Jubilee Insurance Exchange Building, Ground Floor
Kaunda Street
P.O. Box 34886, 00100, Nairobi
Email: citycentre@sbmbank.co.ke

Hurlingham Branch
Landmark Plaza
Argwings Kodhek
42426-00100, Nairobi
Email: hurlingham@sbmbank.co.ke

Thika Branch
Nelleon Plaza
Kenyatta Road
P.O. Box 14087-00800,
Thika
Email: thika@sbmbank.co.ke

Donholm Branch
Eastgate Plaza
Outering Road
P.O. Box 78765-00507,
Nairobi
Email: donholm@sbmbank.co.ke

Kisumu Branch
Tuffoam Mall
Jomo Kenyatta Highway
P.O. Box 1983-40100,
Kisumu
Email: kisumu@sbmbank.co.ke

Diamond Plaza Branch
Diamond Plaza
Masari Road
P.O. Box 49434-00100,
Nairobi
Email: diamondplaza@sbmbank.co.ke

Riverside Branch
Riverside Mews Building
Riverside Drive
P.O. Box 34886 - 00100,
Nairobi, Kenya
Email: riversidemews@sbmbank.co.ke

Village Market Branch
Greenhills Investments Limited
Limuru Road
P.O. Box 300-621,Nairobi
Email: villagemarket@sbmbank.co.ke

Corner House Branch
Corner House, Ground Floor
Kimathi Street
P.O. Box 34886 - 00100,
Nairobi, Kenya
Email: customercarecornerhouse@sbmbank.co.ke

Nakuru Branch
Spikes Centre
Kenyatta Avenue
P.O. Box 932-20100,
Nakuru
Email:nakuru@sbmbank.co.ke

Ngara Branch
Peace Towers
Ngara Road
P.O. Box 14078-00100,
Nairobi
Email: ngara@sbmbank.co.ke

Eldoret Branch
Utamaduni House
Kenyatta Street
P.O. Box 6007-30100,
Eldoret
Email: eldoret@sbmbank.co.ke

Windsor, Ridgeways Branch
Ridgeways Mall
Kiambu road
P.O. Box 45403-00100,
Nairobi
Email: windsor@sbmbank.co.ke

BRANCH NETWORK (continued)

Malindi Branch
Oasis Mall Plaza
Lamu Road
P.O. Box 1817-80200,
Malindi
Email: malindi@sbmbank.co.ke

Nyali Branch
Nyali Centre
Links Road
P.O. Box 34363-80118,
Mombasa
Email: nyali@sbmbank.co.ke

Strathmore Branch
Strathmore Research and Consultancy Centre,
Ole Sengale
P.O. Box 59857-00100,
Nairobi
Email:strathmore@sbmbank.co.ke

NOCK, Ngong Road Xpress
National Oil Service Station
Ngong Road
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Nairobi
Email: customercarengongxpress@sbmbank.co.ke

Sameer Park Branch
Sameer Business Park
Mombasa Road
P.O. Box 3365-00500,
Nairobi
Email: sameerpark@sbmbank.co.ke

Rongai Branch
Masaai Mall, Ongata Rongai
Magadi road
P.O. Box 78780-00507,
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Mombasa, Old Town Branch
Opposite Central Police Station
Makadara Road
P.O. Box 87087-00801
Mombasa
Email: everyoneoldtown@sbmbank.co.ke

Upperhill Branch
KMA Plaza
Chyulu Road/Mara Road
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Buruburu Branch
Kenol Kobil Petrol Station
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Nairobi
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Kisii Branch
Royal Tower
Hospital Road
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Kisii
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SBM Elite Branch
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Mtwapa Branch
Mtwapa Shopping Mall
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Mombasa
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Machakos Branch
Kitanga House
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BRANCH NETWORK (continued)

Lunga Lunga Branch
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Madaraka Xpress Branch
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Kimathi Branch
Ansh Plaza
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Lavington Branch
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James Gichuru Road
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Karen Branch
Watermark Business Park
Ndege Road - off Karen/Langata Road
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Kasuku Xpress Branch
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Kericho Branch
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Kilimani, Adlife Plaza Branch
Adlife Plaza
Ringroad Kilimani
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Kilifi Xpress Branch
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Nakuru Xpress Branch
Westside Mall
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BRANCH NETWORK (continued)

Limuru Road Xpress Branch
Total Service Station
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Nairobi
Email: customercarelimuruxpress@sbmbank.co.ke

Ngong Branch
Milele Mall
Ngong Road
P.O.Box 27573-00506,
Ngong
Email: customercarengongmilele@sbmbank.co.ke

Westlands Branch
Shimmers Plaza
Ground Floor, Westlands Road
P.O. Box 66092-00800, Nairobi
Nairobi
Email: westlands@sbmbank.co.ke

Diani Branch
Baharini Plaza
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Diani
Email: diani@sbmbank.co.ke

Eastleigh Branch
Ismariot Hotel
General Waruinge Street, Ground Floor
P.O.Box 69230-00100,
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Gikomba Xpress Branch
Slodarity Area,
Gikomba Market,
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Industrial Area Branch
Dar-es-Salaam Road
Industrial Area
P.O. Box 18605-00500,
Nairobi
Email: indarea@sbmbank.co.ke

Mombasa, Nyerere Rd Branch
SBM Building
Nyerere Road
P.O. Box 9538-80100,
Mombasa
Email: nyerereavenue.mombasa@sbmbank.co.ke

Kilimani, Lenana Rd Branch
1st Floor, 197 Lenana Place
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Nairobi
Email: lenanaroad.kilimani@sbmbank.co.ke

Mombasa Moi Avenue Branch
Ground Floor, Jubilee House
Moi Avenue
P.O. Box 83580 - 80100,
Mombasa
Email: moiavenue.mombasa@sbmbank.co.ke

Mombasa, Jubilee Arcade Branch
Ground Floor, Jubilee Arcade
Moi Avenue
P.O. Box 83580 - 80100,
Mombasa
Email: customercarejubileearcade@sbmbank.co.ke

BOARD COMMITTEES

The Board committees as at the date of this report comprise

Board Audit Committee	Board Credit Committee	Board Risk Management Committee	Remuneration and Nomination Committee
Composition			
The Committee comprises four independent non-executive directors and one non-executive director.	The Committee comprises four independent non-executive directors.	The Committee comprises two independent non-executive directors and two non-executive directors.	The Committee comprises three independent non-executive directors and two non-executive directors.
Main function			
The Committee meets to review the external auditor's plans and reports, Group internal audit reports and any proposals/reports that affect the Group's internal control environment and corporate risk management/exposure and compliance.	The Committee reviews and oversees the overall lending position of the Bank, reviews and updates the Bank's credit policy from time to time, considers credit facilities applications, monitors and classifies all loans and advances as recommended by Central Bank of Kenya prudential guidelines and ensures adequate provisions, and ensures effective procedures and resources to identify and manage irregular credits, minimize credit loss and maximize recoveries.	The Committee ensures quality risk management of the Bank that at least encompasses all the risks as specified by the Central Bank of Kenya risk management guidelines. It reviews and assesses the effectiveness of all existing risk and compliance management policies and controls. The Committee also seeks professional advice on technical matters that are of importance in improving the risk management and compliance functions of the Bank.	The Committee is mandated to recruit the Bank's directors, review the structure, size and composition of the Board, identify, nominate and recommend the candidates to fill Board vacancies and ensure effective succession planning for both the Board and Senior Management. The Committee is also mandated to recruit all senior staff members of the Bank and set their remuneration package. It rewards and motivates all senior staff members who show exemplary performance in their duties. The Committee oversees job analysis of all senior Bank positions to ensure that they are handled by people that have the relevant skills.
Frequency of meetings per annum			
4	10	4	4

BOARD COMMITTEES (CONTINUED)

Board Audit Committee	Board Credit Committee	Board Risk Management Committee	Remuneration and Nomination Committee
Chairperson			
James McFie *(Independent non-executive Director)*	Flora Mutahi *(Independent non-executive Director)*	Sharad Rao *(Independent non-executive Director)*	Sharad Rao *(Independent non-executive Director)*
Members			
Flora Mutahi *(Independent non-executive director)*	Sharad Rao *(Independent non-executive director)*	Kee Chong Li Kwong Wing *(Non-executive director)*	Kee Chong Li Kwong Wing *(Non-executive director)*
Sharad Rao *(Independent non-executive director)*	Azim Currimjee *(Independent non-executive director)*	Nayen Koomar Ballah *(Non-executive director)*	James McFie *(Independent non-executive director)*
Azim Currimjee *(Independent non-executive director)*	James McFie *(Independent non-executive director)*	Azim Currimjee *(Independent non-executive director)*	Flora Mutahi *(Independent non-executive director)*
Medha Gunputh *(Non-executive director)*			Medha Gunputh *(Non-executive director)*

Corporate Governance is the process by which companies are directed, controlled and held to account. SBM Bank (Kenya) Limited and its subsidiaries adopt the best practice in Corporate Governance and are committed to continuously improve.

The Bank's Board is responsible for development of Corporate Governance practice and ensuring compliance by the Bank and its subsidiaries. It does this through board committees and by having in place business principles and practice, internal control and risk management processes that seek to ensure efficient utilization of resources and increase in stakeholders' confidence.

The key features of the current Corporate Governance practices are as follows:

Board of Directors

The current Board of Directors consists of two executive directors and eight non-executive directors, four of whom are independent. The directors are chosen for their business knowledge and wide range of skills and experience.

The Board is responsible for setting the direction of the Group by establishing strategic objectives, key policies and approval of the budgets/plans. It meets at least quarterly, on pre-set dates, to review and monitor the implementation of strategies/business plans, review quarterly financial results, approve financial reports and maintain effective control over strategic, financial, operational and compliance issues.

To enable the Board to function effectively, directors are given appropriate and timely information which, in the case of board meetings, consist of comprehensive board papers covering regular business progress reports and discussion papers on specific matters.

Board evaluation

Each year the Board is required by the Central Bank of Kenya to review its mix of skills and experience and other qualities in order to assess its effectiveness in discharging its duties. The Board carried out a Board evaluation exercise in the course of 2019.

Committees of the Board

1. Board Audit Committee
2. Board Credit Committee
3. Risk Management Committee
4. Remuneration and Nomination Committee

Matters regarding Corporate Governance, where the Bank is involved, which were previously addressed by the Bank's Corporate Governance & Conduct Review Committee, are now addressed directly by the Board of Directors.

Internal controls

The Board has the ultimate responsibility for monitoring and reviewing the effectiveness of the Group's internal control procedures and continuously improving upon them.

The systems are designed to manage, rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material financial misstatements or loss. The systems are designed to:

- Identify and manage business risks;
- Identify and adopt best business practice;
- Maintain compliance with appropriate legislation;
- Maintain proper accounting records;
- Provide reliable financial information; and
- Safeguard assets.

The Board satisfies itself that the internal control framework is operating effectively through:

- Having terms of reference for the Board and each of its committees;
- A clear organisational structure with documented delegation of authority;
- Defined procedures for the approval of major transactions;
- Establishment and monitoring of the internal control framework by the management; and,
- Review of the internal and external audit reports.

Conflict of interest

The directors are required to act in the best interest of the Group at all times. It is the Group's policy to ensure that directors avoid putting themselves in positions whereby their interests conflict with those of the Group. Any business transacted with the Group's directors and/or their companies must be at arm's length.

The Board has adopted a policy, which also applies to management and staff, which ensures that they disclose all possible conflict of interest sources and are required to exclude themselves in decisions where conflict of interest may arise.

Directors' emoluments and loans

The aggregate amount of emoluments paid to directors for services rendered during the year is disclosed in Notes 12 and 36 to the financial statements.

Neither at the end of the financial year, nor at any time during the year, did there exist any arrangement to which the Group is a party, under which directors acquired benefits by means of acquisition of the Group's shares. Aggregate amount of loans advanced to directors is summarized in note 36 to the financial statements.

Corporate social responsibility

The Group recognizes its social responsibilities to improve the well-being of the society and is committed to being a responsible citizen and believes in giving back to society.

The directors submit their annual report together with the audited financial statements for the year ended 31 December 2019 which show the state of affairs of SBM Bank (Kenya) Limited (the "Bank") and its subsidiaries (together the "Group").

1. INCORPORATION

The Group is domiciled in Kenya where it consists of entities incorporated as private companies limited by shares under the Kenyan Companies Act, 2015. The subsidiaries are disclosed in note 20. The address of the registered office is set out on page 2.

2. DIRECTORATE

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

3. PRINCIPAL ACTIVITIES OF THE GROUP

The principal activities of the Group are the provision of banking, financial, insurance brokerage and related services. The Bank is licensed under the Kenyan Banking Act, Cap 488 and provides banking, financial and related services.

4. DIVIDENDS

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

5. RESULTS

	Group		Bank	
	2019	2018	2019	2018
	KShs '000	KShs '000	KShs '000	KShs '000
Profit before tax	1,180,311	964,054	1,179,985	955,731
Tax (charge)/credit	(276,209)	360,151	(276,111)	360,151
Profit for the year	904,102	1,324,205	903,874	1,315,882

6. BUSINESS REVIEW

The Group recorded a pre-tax profit of KShs. 1.18 billion compared to KShs. 964 million in 2018. Results in 2018 included a gain on business combination of KShs. 2.79 billion net of taxes. In addition, 2019 was the first full year of operation after the business combination that was completed on 18th August 2018.

At the backdrop of the macroeconomic environment and the maturity of moratorium deposits in August 2019, the Group closed the year with a total asset of KShs. 72.5 billion. This is an increase of KShs. 1.9 billion from KShs. 70.6 billion reported in 2018.

As at close of the year the Group operated 52 branches spread across the country with customer deposits valued at KShs. 50.5 billion. Net loans and advances increased by 27% from KShs. 12.2 billion in 2018 to KShs. 15.5 billion. The growth was attributable to new loans granted during the year as well as the continuous efforts on recovery of the non-performing credit facilities. The decrease in investment in Government securities of 1% was as a result of funding the loan draw downs. Overall over 85% of the Bank assets were retained in interest earning assets, the balance mainly being accounted for by cash and cash equivalents held for day to day bank operations.

The Group delivered total operating income of KShs. 3.5 billion with funded income accounting for 80%. Net Fees and commissions income was KShs. 330 million while income arising from dealing in foreign currencies aggregated to KShs. 260 million. This performance was driven by customer transactions on the Bank alternative channels which include Mfukoni, online banking, agency banking, card business and salary processing system (SPS). During the year the bank launched Union Pay card which has gained a lot of traction in the market.

6. BUSINESS REVIEW (continued)

The Group total operating costs for the year of KShs. 4.3 billion mainly constituted workforce costs which accounted for 48%. Depreciation and amortization charge to income statement stood at KShs. 887 million of which KShs 307 million relates to depreciation on right-of-use assets on adoption of IFRS 16, while costs incurred on administrative activities was KShs. 1.4 billion.

The Bank's core capital as at end of 2019 was KShs. 7.8 billion and was in compliance with all the Central Bank of Kenya (CBK) ratios. Core capital to risk weighted assets ratio was 23% compared to CBK minimum of 10.5%. Liquidity ratio of the bank stood at 77.2% compared to minimum of 20%. Both ratios imply that the Bank has a wide headroom for more business.

7. STATEMENT AS TO DISCLOSURE TO THE GROUP'S AUDITOR

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

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

8. TERMS OF APPOINTMENT OF THE AUDITOR

Ernst & Young LLP continues in office in accordance with the company's Articles of Association and Section 719 of the Kenyan Companies Act, 2015. The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also 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 KShs 9,500,000 has been charged to profit or loss in the year.

By order of the Board

....

Company Secretary

25th March, 2020

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Group and Bank as at the end of the financial year and of their profit or loss for that year.

It also requires the directors to ensure that the Bank and its subsidiaries keep proper accounting records that: (a) show and explain the transactions of the Bank and the subsidiaries; (b) disclose, with reasonable accuracy, the financial position of the Bank and the subsidiaries; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Kenyan 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 judgments that are reasonable in the circumstances.

Having made an assessment of the Bank's and the subsidiaries' 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 and its subsidiaries' 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 25th March, 2020 and signed on its behalf by:

Moezz Mir	James McFie
Director	Director

EY
Building a better working world

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Certified Public Accountants
Kenya Re Towers
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LLP/2015/52

REPORT OF THE INDEPENDENT AUDITORS
TO THE SHAREHOLDERS OF
SBM BANK (KENYA) LIMITED

REPORT ON THE AUDIT OF THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

Opinion

We have audited the accompanying consolidated and separate financial statements of SBM Bank (Kenya) Limited (the "Bank") and its subsidiaries (together, the "Group") set out on pages 19 to 145 which comprise the consolidated and separate statements of financial position as at 31 December 2019, and the consolidated and separate statements of profit or loss and other comprehensive income, the consolidated and separate statements of changes in equity and the consolidated and separate statements of cash flows for the year then ended, and notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Group and the Bank as at 31 December 2019 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated and Separate Financial Statements* section of our report. We are independent of the Group and the Bank in accordance with the International Code of Ethics for Professional Accountants (including Independence Standards) (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated and separate financial statements in Kenya, and we have fulfilled our other 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.

Key Audit Matters

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

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

Building a better working world

Key audit matter	How our audit addressed the key audit matter
Expected credit losses on financial assets, including off balance sheet amounts	
As described in Note 3.9 on Impairment of Financial Assets and note 5.2 on Credit Risk, the impairment losses on financial assets as at 31 December 2019 were determined by application of IFRS 9 - Financial Instruments based on the Expected Credit Losses model. The Bank's financial assets comprise loans and advances to customers, Government securities, Corporate Bonds, Cash and cash equivalents and off-balance sheet items. We considered this to be a key audit matter because significant judgement is involved in determining the credit losses on financial instruments. The key areas of judgement included: • the interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Bank's expected credit loss model; • the identification of exposures with a significant deterioration in credit quality; • assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward-looking macroeconomic factors (e.g. inflation rate and lending rate); and, • the need to apply additional overlays to reflect current or future external factors that are not captured by the expected credit loss model. Refer to Note 6.1 in the financial statements for critical accounting judgements and key sources of estimation uncertainty and Note 13 of the financial statements for impairment disclosures.	Our audit procedures included the following: • We obtained an understanding of the Bank's process for estimating the ECL, and tested key controls over the process • We tested the completeness of financial assets included in the ECL model to determine whether all assets were included in the calculations by evaluating the assets on the statement of financial position and whether they met the definition of a financial asset. • We assessed the: - data used to determine the impairment losses for completeness and accuracy by selecting a sample from the model ready data that was used to perform the ECL procedures and, specific data fields in this sample were tested to source systems to validate the accuracy of data flow from source systems into the modelling environment. - expected credit loss model, including model build and approval, ongoing monitoring/validation, model governance and mathematical accuracy • We assessed and tested the material modelling assumptions as well as overlays with a focus on the: - key modelling assumptions adopted by the Bank; - basis for and data used to determine overlays; and - sensitivity of the collective provisions to changes in modelling assumptions using the following procedures: • We assessed the documentation and materials provided for appropriateness of the modelling techniques, including inputs, assumptions, methodology and performance, against accounting and regulatory guidelines, the Group's policies and industry practices. • We also carried out an independent reperformance of the model building steps to assess that the methodology and key assumptions align to the approved model documentation and final model in use. • We performed a year-to-date analysis of movements in the exposure and impairment results across stages and the various product groups. • We reviewed documentation relating to the different parts of the model lifecycle, including model development, validation, implementation, and monitoring reports. • We held discussions with the Bank's credit team on the model's conceptual soundness. • We re-run the model development, validation and implementation code, and reconciled the results with those obtained or reported by the Bank. • We reconciled the modelling approach with our understanding of methodology • We performed additional tests, including impact assumptions sensitivity and input sensitivities. • In addition, we assessed the adequacy of the disclosures in the financial statements.

Other Information

The directors are responsible for the other information. The other information comprises Group information, Corporate Governance and the Report of the Directors as required by the Kenyan Companies Act, 2015. The other information does not include the consolidated and separate financial statements and our auditor's report thereon.

Our opinion on the consolidated and separate financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.

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Other Information (continued)

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.

Responsibilities of the Directors for the Consolidated and Separate *Financial Statements*

The directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements 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 consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

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

The directors are responsible for overseeing the Group's financial reporting processes.

Auditor's Responsibilities for the Audit of the Consolidated and Separate *Financial Statements*

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

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

- Identify and assess the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's and the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's and 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 consolidated and separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group and/or the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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REPORT ON OTHER MATTERS PRESCRIBED BY THE KENYAN COMPANIES ACT, 2015

In our opinion, the information given in the report of the directors on pages 12 - 13 is consistent with the financial statements.

The engagement partner responsible for the audit resulting in this independent auditor's report is CPA Churchill Atinda - P/No. P. 1425.

Nairobi, Kenya

31st March, 2020

	Notes	2019 KShs' 000	2018 KShs' 000
Interest income		6,269,300	2,518,551
Interest expense		(3,494,472)	(1,462,570)
Net interest income	8	2,774,828	1,055,981
Fee and commission income*		344,750	155,246
Fee and commission expense		(14,965)	(5,587)
Net fee and commission income	9	329,785	149,659
Other income			
Profit arising from dealing in foreign currencies		260,461	178,004
Bargain purchase gain	10(a)	-	2,790,776
Other operating income*	10(b)	115,312	50,473
Dividend income	10(c)	-	174
		375,773	3,019,427
Non-interest income		705,558	3,169,086
Operating income		3,480,386	4,225,067
Personnel expenses	11	(2,105,134)	(1,023,647)
Other expenses	12(a)	(1,441,812)	(991,829)
Depreciation on property and equipment	12(b)	(312,732)	(124,230)
Amortisation of intangible assets	12(b)	(266,633)	(144,242)
Depreciation on right-of-use-asset	12(b)	(307,194)	-
Other gains/(losses)	12(c)	100,094	(3,265)
Non-interest expense		(4,333,411)	(2,287,213)
(Loss)/profit before credit loss expense		(853,025)	1,937,854
Net decrease/(increase) in impairment losses on financial instruments*	13(c)	2,033,336	(973,800)
Profit before income tax		1,180,311	964,054
Tax (charge)/credit	14(b)	(276,209)	360,151
Profit for the year		904,102	1,324,205
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified to profit or loss in subsequent periods (net of tax):			
Net gain/(loss) on government securities designated at fair value through other comprehensive income	18(c)	35,795	(14,703)
Items that will not be reclassified subsequently to profit or loss (net of tax):			
Decrease in revaluation of property	21	-	(62,631)
Total other comprehensive income		35,795	(77,334)
Total comprehensive income for the year		939,897	1,246,871
Earnings per share			
Basic and diluted earnings	15	0.02	0.03

*In 2018, card income of KShs 29,672,000 was disclosed in note 10 (b), Other operating income. The amount has been reclassified and is now disclosed in note 9, Net fees and commissions income, due to the nature of income. Further, in 2018, a write back of impairment losses on loans and advances of KShs 568,463,000 was disclosed in note 10 (b), Other operating income. The amount has been reclassified and is now disclosed in note 13, Net impairment charge on financial assets, due to the nature of the amount.

	Notes	2019 KShs' 000	2018 KShs' 000
Interest income		6,269,300	2,518,551
Interest expense		(3,494,472)	(1,462,570)
Net interest income	8	2,774,828	1,055,981
Fee and commission income*		344,750	143,577
Fee and commission expense		(14,920)	(5,072)
Net fee and commission income	9	329,830	138,505
Other income			
Profit arising from dealing in foreign currencies		260,461	178,004
Bargain purchase gain	10(a)	-	2,790,776
Other operating income*	10(b)	113,585	50,504
Dividend income	10(c)	-	174
		374,046	3,019,458
Non-interest income		703,876	3,157,963
Operating income		3,478,704	4,213,944
Personnel expenses	11	(2,103,803)	(1,022,795)
Other expenses	12(a)	(1,441,812)	(975,626)
Depreciation on property and equipment	12(b)	(312,707)	(124,199)
Amortisation of intangible assets	12(b)	(266,633)	(144,242)
Depreciation on right-of-use-asset	12(b)	(307,194)	-
Other gains/(losses)	12(c)	100,094	(17,551)
Non-interest expense		(4,332,055)	(2,284,413)
(Loss)/Profit before credit loss expense		(853,351)	1,929,531
Net decrease/(increase) in impairment losses on financial instruments*	13(c)	2,033,336	(973,800)
Profit before income tax		1,179,985	955,731
Tax (charge)/credit	14(b)	(276,111)	360,151
Profit for the year		903,874	1,315,882
OTHER COMPREHENSIVE INCOME			
Items that may be reclassified to profit or loss in subsequent periods (net of tax):			
Net gain/(loss) on government securities designated at fair value through other comprehensive income	18(c)	35,795	(14,703)
Items that will not be reclassified subsequently to profit or loss (net of tax):			
Decrease in revaluation of property	21	-	(60,074)
Total other comprehensive income		35,795	(74,777)
Total comprehensive income for the year		939,669	1,241,105
Earnings per share			
Basic and diluted earnings	15	0.02	0.03

*In 2018, card income of KShs 29,672,000 was disclosed in note 10 (b), Other operating income. The amount has been reclassified and is now disclosed in note 9, Net fees and commissions income due to the nature of income. Further, in 2018, a write back of impairment losses on loans and advances of KShs 568,463,000 was disclosed in note 10 (b), Other operating income. The amount has been reclassified and is now disclosed in note 13, Net impairment charge on financial assets, due to the nature of the amount.

SBM BANK (KENYA) LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2019

	Notes	2019 KShs' 000	2018 KShs' 000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions*	16(a)	5,704,659	8,137,819
Placements with other banking institutions*	16(b)	3,120,687	3,024,424
Loans and advances to customers	17	15,463,582	12,206,233
Financial assets at fair value through profit and loss	7	1,552,811	926,112
Government securities	18	42,821,042	43,339,371
Investment securities	19	297,607	301,677
Tax recoverable	14(c)	-	62,783
Other assets	25	1,086,732	757,922
Property and equipment	21	1,178,425	1,466,332
Intangible assets	22	203,385	431,389
Right-of-use assets	23	720,207	-
Deferred tax asset	24	378,060	-
Total assets		72,527,197	70,654,062
LIABILITIES			
Deposits from banks*	26	11,515	-
Customers' deposits	27	50,546,108	51,028,451
Tax payable	14(c)	591,907	-
Other liabilities	29	2,210,758	2,627,485
Due to group companies	30	-	36,390
Amounts due to Central Bank of Kenya	28	9,743,979	9,104,981
Financial liabilities at fair value through profit and loss	7	1,552,811	926,112
Deferred tax liability	24	-	421
Total liabilities		64,657,078	63,723,840
EQUITY			
Share capital	31(a)	2,165,500	2,165,500
Share premium	31(c)	6,701,945	6,701,945
Preference share capital	31(d)	100,000	100,000
Accumulated losses		(1,143,707)	(2,022,520)
Fair value reserve of financial assets at fair value through comprehensive income	31(e)	21,092	(14,703)
Statutory credit risk reserve	31(f)	25,289	-
Total equity		7,870,119	6,930,222
Total equity and liabilities		72,527,197	70,654,062

* Total cash and cash equivalents held amounted to KShs 6,295,682,000 (2018: KShs 8,626,581,000).

The financial statements were approved by the Board of Directors on ...25th March.......... 2020 and signed on its behalf by: -

Moezz Mir
Director

James Boyd McFie

James McFie
Director

SBM BANK (KENYA) LIMITED
BANK STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2019

	Notes	2019 KShs' 000	2018 KShs' 000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions*	16(a)	5,704,659	8,137,819
Placements with other banking institutions*	16(b)	3,120,687	3,024,424
Loans and advances to customers	17	15,463,645	12,209,536
Financial assets at fair value through profit and loss	7	1,552,811	926,112
Government securities	18	42,821,042	43,339,371
Investment securities	19	297,556	301,626
Tax recoverable	14(c)	-	60,108
Other assets	25	1,085,561	756,751
Property and equipment	21	1,172,721	1,460,603
Intangible assets	22	203,385	431,389
Right-of-use assets	23	720,207	-
Deferred tax asset	24	377,082	-
Total assets		72,519,356	70,647,739
LIABILITIES			
Deposits from banks*	26	11,515	-
Customers' deposits	27	50,561,335	51,043,920
Tax payable	14(c)	594,484	-
Other liabilities	29	2,178,056	2,627,485
Due to group companies	30	-	6,335
Amounts due to Central Bank of Kenya	28	9,743,979	9,104,981
Financial liabilities at fair value through profit and loss	7	1,552,811	926,112
Deferred tax liability	24	-	1,399
Total liabilities		64,642,180	63,710,232
EQUITY			
Share capital	31(a)	2,165,500	2,165,500
Share premium	31(b)	6,701,945	6,701,945
Preference share capital	31(c)	100,000	100,000
Accumulated losses		(1,136,650)	(2,015,235)
Fair value reserve of financial assets at fair value through comprehensive income	31(d)	21,092	(14,703)
Statutory credit risk reserve	31(e)	25,289	-
Total equity		7,877,176	6,937,507
Total equity and liabilities		72,519,356	70,647,739

* Total cash and cash equivalents held amounted to KShs 6,295,682,000 (2018: KShs 8,626,581,000).

The financial statements were approved by the Board of Directors on 25th March 2020 and signed on its behalf by: -

Moezz Mir
Director

James McFie
Director

31 DECEMBER 2019

	Share capital	Preference share capital	Share premium	Retained earnings	Fair value reserve of financial assets at FVOCI*	Statutory Credit risk reserve	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
	Note 31(a)	*Note 31(d)*	*Note 31(c)*		*Note 31(e)*	*Note 31(f)*	
As at start of year	2,165,500	100,000	6,701,945	(2,022,520)	(14,703)	-	6,930,222
Profit for the year	-	-	-	904,102	-	-	904,102
Other comprehensive income	-	-	-	-	35,795	-	35,795
Total comprehensive income for	-	-	-	904,102	35,795	-	939,897
Transfer to statutory loan loss	-	-	-	(25,289)	-	25,289	-
As at end of year	2,165,500	100,000	6,701,945	(1,143,707)	21,092	25,289	7,870,119

*FVOCI - Fair value through other comprehensive income

SBM BANK (KENYA) LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2019

31 DECEMBER 2018

	Share capital	Shareholders' contribution pending allotment	Preference share capital	Share premium	Retained earnings	Statutory credit risk reserve	Fair value reserve of financial assets at FVOCI*	Revaluation reserve	Total
	KShs '000 *Note 31(a)*	KShs '000 *Note 31(b)*	KShs '000 *Note 31(d)*	KShs '000 *Note 31(c)*	KShs '000	KShs '000 *Note 31(f)*	KShs '000 *Note 31(e)*	KShs '000	KShs '000
As at start of year	2,045,570	618,000	100,000	1,572,222	(2,810,569)	6,256	-	62,631	1,594,110
Impact of adopting IFRS 9	-	-	-	-	(542,412)	-	-	-	(542,412)
Restated opening balance under IFRS 9	2,045,570	618,000	100,000	1,572,222	(3,352,981)	6,256	-	62,631	1,051,698
Transfer to share capital [note 31(b)]	14,116	(618,000)	-	603,884	-	-	-	-	-
Issue of share capital [note 31(a)]	105,814	-	-	4,525,839	-	-	-	-	4,631,653
Profit for the year	-	-	-	-	1,324,205	-	-	-	1,324,205
Other comprehensive income	-	-	-	-	-	-	(14,703)	(62,631)	(77,334)
Total comprehensive income for the year	-	-	-	-	1,324,205	-	(14,703)	(62,631)	1,246,871
Transfer from statutory credit risk reserve	-	-	-	-	6,256	(6,256)	-	-	-
As at end of year	2,165,500	-	100,000	6,701,945	(2,022,520)	-	(14,703)	-	6,930,222

*FVOCI - Fair value through other comprehensive income

31 DECEMBER 2019	Share capital	Preference share capital	Share premium	Retained earnings	Fair value reserve of financial assets at FVOCI*	Statutory Credit risk reserve	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
	Note 31(a)	*Note 31(d)*	*Note 31(c)*		*Note 31(e)*	*Note 31(f)*	
As at start of year	2,165,500	100,000	6,701,945	(2,015,235)	(14,703)	-	6,937,507
Profit for the year	-	-	-	903,874	-	-	903,874
Other comprehensive income	-	-	-	-	35,795	-	35,795
Total comprehensive income for the year	-	-	-	903,874	35,795	-	939,669
Transfer to statutory loan loss reserve	-	-	-	(25,289)	-	25,289	-
As at end of year	2,165,500	100,000	6,701,945	(1,136,650)	21,092	25,289	7,877,176

*FVOCI - Fair value through other comprehensive income

31 DECEMBER 2018	Share capital	Shareholders' contribution pending allotment	Preference share capital	Share premium	Retained earnings	Statutory credit risk reserve	Fair value reserve of financial assets at FVOCI*	Revaluation reserve	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
	Note 31(a)	*Note 31(b)*	*Note 31(d)*	*Note 31(c)*		*Note 31(f)*	*Note 31(e)*		
As at start of year	2,045,570	618,000	100,000	1,572,222	(2,794,961)	6,256	-	60,074	1,607,161
Impact of adopting IFRS 9	-	-	-	-	(542,412)	-	-	-	(542,412)
Restated opening balance under IFRS 9	2,045,570	618,000	100,000	1,572,222	(3,337,373)	6,256	-	60,074	1,064,749
Transfer to share capital [note 31(b)]	14,116	(618,000)	-	603,884	-	-	-	-	-
Issue of share capital [note 31(a)]	105,814	-	-	4,525,839	-	-	-	-	4,631,653
Profit for the year	-	-	-	-	1,315,882	-	-	-	1,315,882
Other comprehensive income	-	-	-	-	-	-	(14,703)	(60,074)	(74,777)
Total comprehensive income for the year	-	-	-	-	1,315,882	-	(14,703)	(60,074)	1,241,105
Transfer from statutory credit risk reserve	-	-	-	-	6,256	(6,256)	-	-	-
As at end of year	2,165,500	-	100,000	6,701,945	(2,015,235)	-	(14,703)	-	6,937,507

*FVOCI - Fair value through other comprehensive income

	Notes	2019 KShs '000	2018 KShs '000
Net cash flows utilized in operating activities	35(a)	(1,935,332)	(15,174,631)
Cash flows from investing activities			
Cash and cash equivalents from business combination	7(b)	-	17,370,405
Dividends from investment securities	10(b)	-	174
Purchase of property and equipment	21	(61,134)	(53,443)
Purchase of intangible assets	22	(38,629)	(1,110)
Proceeds from disposal of property and equipment		10,743	-
Net cash flows (utilized in)/generated from investing activities		(89,020)	17,316,026
Cash flows from financing activities			
Proceeds from issue of share capital	31(a)	-	105,814
Share premium from issue of share capital	31(c)	-	4,525,839
Refund/(repayment) of amounts from/due to Central Bank of Kenya	28	16,147	(43,413)
Repayment of principal portion of lease liability	23	(262,630)	-
Repayment of interest	23	(60,064)	-
Net cash flows (utilized in)/generated from financing activities		(306,547)	4,588,240
As at the beginning of the year		8,626,581	1,896,946
Effect of exchange rate changes on cash and cash equivalents		9,248	580
Net (decrease)/increase in cash and cash equivalents		(2,340,147)	6,729,055
As at the end of the year	35(b)	6,295,682	8,626,581

	Notes	2019 KShs '000	2018 KShs '000
Net cash flows utilised in operating activities	35(a)	(1,935,332)	(15,174,863)
Cash flows from investing activities			
Cash and cash equivalents from business combination	7(b)	-	17,370,405
Dividends from investment securities	10(b)	-	174
Purchase of property and equipment	21	(61,134)	(53,443)
Purchase of intangible assets	22	(38,629)	(1,110)
Proceeds from disposal of property and equipment		10,743	-
Net cash flows (utilized in)/generated from investing activities		(89,020)	17,316,026
Cash flows from financing activities			
Proceeds from issue of share capital	31(a)	-	105,814
Share premium from issue of share capital	31(c)	-	4,525,839
Refund/(Repayment) of amounts due to Central Bank of Kenya	28	16,147	(43,413)
Repayment of principal portion of lease liability	23	(262,630)	-
Repayment of interest portion on lease liability	23	(60,064)	-
Net cash flows (utilized in)/generated from financing activities		(306,547)	4,588,240
As at the beginning of the year		8,626,581	1,897,198
Effect of exchange rate changes on cash and cash equivalents		9,248	580
Net (decrease)/increase in cash and cash equivalents		(2,340,147)	6,728,823
As at the end of the year	35(b)	6,295,682	8,626,581

1. REPORTING ENTITY

SBM Bank (Kenya) Limited ("the Bank") is incorporated as a limited company in Kenya under the Kenyan Companies Act, 2015, and is domiciled in Kenya. The Bank is regulated by the Central Bank of Kenya. The address of its registered office is as shown on page 1.

The consolidated financial statements for the year ended 31 December 2019 comprise the Bank and its subsidiaries, Finsure Insurance Brokers Limited, Rover Investment Limited, Richardson Properties Limited and Kentbury Investments Limited (together referred to as the "Group" and individually as the "Bank") which provide banking, financial, insurance brokerage and related services in Kenya.

The Bank operates from 53 locations within Kenya which include the head office, branches and card division.

2. BASIS OF PREPARATION

2.1. Statement of compliance

The consolidated and separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and in the manner required by the Kenyan Companies Act, 2015.

For Kenyan Companies Act, 2015 reporting purposes, the balance sheet is represented by the statement of financial position and the profit and loss account by the statement of profit or loss and other comprehensive income in these financial statements.

2.2. Basis of measurement

The financial statements of the Group have been prepared on the historical cost basis except for buildings, investment properties, and financial assets carried at fair value in the statement of financial position.

2.3. Functional and presentation currency

These consolidated and separate financial statements are presented in Kenya Shillings (KShs), which is the Group's functional currency.

Items included in the financial statements are measured using the currency of primary economic environment in which the entity operates i.e. Kenya Shillings. Financial information presented in Kenya Shillings has been rounded to the nearest thousand (KShs '000), except as otherwise indicated.

2.4. Significant accounting judgments and key sources of estimation uncertainty

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions. It also requires directors to exercise judgment in the process of applying the Group's accounting policies. Although these estimates are based on the directors' best knowledge of current events and circumstances, actual results may differ from those estimates. Note 6 on 'significant accounting judgements, estimates and assumptions' highlights the areas that involve a higher level of judgement, or where the estimates or assumptions used are significant to the financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of the Bank and its subsidiaries as at 31 December 2019. Control is achieved by the Group over an investee if and only if the Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee); and
- Exposure, or rights, to variable returns from its involvement with the investee; and,
- The ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee including:

- The contractual arrangement(s) with other vote holders of the investee
- Rights from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed off during the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary
- Derecognises the carrying amount of any non-controlling interests
- Derecognises the cumulative translation differences recorded in equity
- Recognises the fair value of the consideration received
- Recognises the fair value of any investment retained
- Recognises any surplus or deficit in profit or loss
- Reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities

3.2. Business combinations, goodwill or bargain purchase gain

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

3.2. Business combinations, goodwill or bargain purchase gain (continued)

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IFRS 9 Financial Instruments, is measured at fair value with the changes in fair value recognised in the statement of profit or loss in accordance with IFRS 9. Other contingent consideration that is not within the scope of IFRS 9 is measured at fair value at each reporting date with changes in fair value recognised in profit or loss.

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests and any previous interest held over the net identifiable assets acquired and liabilities assumed). If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit (CGU) and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

3.3. Revenue recognition

Income is derived substantially from banking, insurance brokerage business and renting of property.

Revenue from contracts with customers is recognised when control of goods and services are transferred to the customers at an amount that reflects the consideration to which the Group expects to be entitled in exchange for the goods and services. The Group has generally concluded that it is the principal in its revenue arrangements.

3.3.1. Recognition of interest income

3.3.1.1. The effective interest (EIR) method

Interest income is recorded using the effective interest (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at fair value through profit and loss (FVPL). Interest income on interest bearing financial assets measured at fair value through other comprehensive income (FVOCI) under IFRS 9, similarly are also recorded by using the EIR method. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

The EIR (and therefore, the amortised cost of the asset) is calculated by taking into account any discount or premium on acquisition, fees and costs that are an integral part of the EIR. The Bank recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the loan. Hence, it recognises the effect of potentially different interest rates charged at various stages, and other characteristics of the product life cycle (including prepayments, penalty interest and charges).

If expectations of fixed rate financial assets' or liabilities' cash flows are revised for reasons other than credit risk, then changes to future contractual cash flows are discounted at the original EIR with a consequential adjustment to the carrying amount. The difference from the previous carrying amount is booked as a positive or negative adjustment to the carrying amount of the financial asset or liability on the balance sheet with a corresponding increase or decrease in Interest revenue/expense calculated using the effective interest method.

3.3.1.1. The effective interest (EIR) method (continued)

For floating-rate financial instruments, periodic re-estimation of cash flows to reflect the movements in the market rates of interest also alters the effective interest rate, but when instruments were initially recognized at an amount equal to the principal, re-estimating the future interest payments does not significantly affect the carrying amount of the asset or the liability.

3.3.1.2. Interest and similar income/expense

When a financial asset becomes credit-impaired and is, therefore, regarded as 'Stage 3', the Bank calculates interest income by applying the effective interest rate to the net amortised cost of the financial asset. If the financial asset cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis.

For purchased or originated credit-impaired (POCI) financial assets, the Bank calculates interest income by calculating the credit-adjusted EIR and applying that rate to the amortised cost of the asset. The credit-adjusted EIR is the interest rate that, at original recognition, discounts the estimated future cash flows (including credit losses) to the amortised cost of the POCI assets.

Interest income on all trading assets and financial assets mandatorily required to be measured at FVPL is recognized using the contractual interest rate in net trading income and Net gains/(losses) on financial assets at fair value through profit or loss, respectively.

3.3.2. Fee and commission income

The Bank earns fee and commission income from a diverse range of financial services it provides to its customers. Fee and commission income is recognized at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for providing the services.

The performance obligations, as well as the timing of their satisfaction, are identified, and determined, at the inception of the contract. The Bank's revenue contracts do not typically include multiple performance obligations, as explained further here below.

When the Bank provides a service to its customers, consideration is invoiced and generally due immediately upon satisfaction of a service provided at a point in time or at the end of the contract period for a service provided over time.

The Bank has generally concluded that it is the principal in its revenue arrangements because it typically controls the services before transferring them to the customer.

3.3.2.1. Fee and commission income from services where performance obligations are satisfied over time

Performance obligations satisfied over time are those which the customer simultaneously receives and consumes the benefits provided by the Bank's performance as the Bank performs. These include the following:

Loan commitment fees:

These are fixed annual fees paid by customers for loan and other credit facilities with the Bank, but where it is unlikely that a specific lending arrangement will be entered into with the customer and the loan commitment is not measured at fair value. The Bank promises to provide a loan facility for a specified period. As the benefit of the services is transferred to the customer evenly over the period of entitlement, the fees are recognised as revenue on a straight-line basis. Payment of the fees is due and received monthly in arrears.

Interchange fees:

The Bank provides its customers with debit and credit card processing services (i.e., authorisation and settlement of transactions executed with the Bank's credit cards) where it is entitled to an interchange fee for each transaction (i.e., when a credit cardholder purchases goods and services from merchants using the Bank's credit card). These services represent a single performance obligation comprised of a series of distinct daily services that are substantially the same and have the same pattern of transfer over the contract period. The fees vary based on the number of transactions processed and are structured as either a fixed rate per transaction processed or at a fixed percentage of the underlying cardholder transaction. The variable interchange fees are allocated to each distinct day, based on the number and value of transactions processed that day, and the allocated revenue is recognised as the entity performs.

3.3.2.2. Fee and commission income from providing services where performance obligations are satisfied at a point in time

Services provided where the Bank's performance obligations are satisfied at a point in time are recognised once control of the services is transferred to the customer. This is typically on completion of the underlying transaction or service or, for fees or components of fees that are linked to a certain performance, after fulfilling the corresponding performance criteria. These include custody fees, fees and commissions arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement/participation or negotiation of the acquisition of shares or other securities, or the purchase or sale of businesses, brokerage and underwriting fees.

Custody fees:
The Bank earns a fixed annual fee for providing its customers with custodial services, which include the safekeeping deposit lockers and purchase or sale of investment securities. These services represent a single performance obligation. Payment for these fees is due and received upfront.

Brokerage fees and commission:
The Bank buys and sells securities on behalf of its customers and receives a fixed commission for each transaction. The Bank's performance obligation is to execute the trade on behalf of the customer and revenue is recognised once each trade has been executed (i.e., on the trade date). Payment of the commission is typically due on the trade date. The Bank pays certain sales commission to agents for each contract that they obtain for some of its brokerage services. The Bank has elected to apply the optional practical expedient for costs to obtain a contract which allows it to immediately expense such sales commission because the amortisation period of the asset that it otherwise would have used is one year or less.

3.3.3. Net trading income
Net trading income includes all gains and losses from changes in fair value and the related interest income or expense and dividends, for financial assets and financial liabilities held for trading. This includes any ineffectiveness recorded on hedging transactions.

3.3.4. Net loss on financial assets and liabilities designated at fair value through profit or loss
Net loss on financial instruments at FVPL represents non-trading derivatives held for risk management purposes used in economic hedge relationship but not qualifying for hedge accounting relationships, financial assets and financial liabilities designated as at FVPL and also non-trading assets measured at FVPL, as required by or elected under IFRS 9. The line item includes fair value changes, interest, dividends and foreign exchange differences.

3.3.5. Net loss on derecognition of financial assets measured at amortised cost or FVOCI (Fair Value through Other Comprehensive Income)
Net loss on derecognition of financial assets measured at amortised cost includes loss (or income) recognized on sale or derecognition of financial assets measured at amortised costs calculated as the difference between the book value (including impairment) and the proceeds received.

3.3.6. Dividends
Dividend income is recognised when the right to receive income is established.

3.4. Financial instruments – initial recognition
3.4.1. Date of recognition
Financial assets and liabilities, with the exception of loans and advances to customers and balances due to customers, are initially recognised on the trade date, i.e., the date on which the Bank becomes a party to the contractual provisions of the instrument. This includes regular way trades, i.e., purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Bank recognises balances due to customers when funds are transferred to the customer.

3.4.2. Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described hereunder. Financial instruments are initially measured at their fair value, except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank accounts for the Day 1 profit or loss, as described below.

3.4.3. Day 1 profit or loss

When the transaction price of the instrument differs from the fair value at origination and the fair value is based on a valuation technique using only inputs observable in market transactions, the Bank recognises the difference between the transaction price and fair value in net trading income. In those cases, where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

3.4.4. Measurement categories of financial assets and liabilities

The Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost, as explained in note 3.6.1
- Fair value through other comprehensive income (FVOCI), as explained in note 3.6.4 and 3.6.5
- Fair value through profit and loss (FVPL), as explained in note 3.6.7

The Bank classifies and measures its derivative and trading portfolio at FVPL. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied.

3.5. Determination of fair value

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as summarised below:

Level 1 financial instruments:	Those where the inputs used in the valuation are unadjusted quoted prices from active markets for identical assets or liabilities that the Bank has access to at the measurement date. The Bank considers markets as active only if there are sufficient trading activities with regards to the volume and liquidity of the identical assets or liabilities and when there are binding and exercisable price quotes available on the balance sheet date.
Level 2 financial instruments:	Those where the inputs that are used for valuation and are significant, are derived from directly or indirectly observable market data available over the entire period of the instrument's life. Such inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical instruments in inactive markets and observable inputs other than quoted prices such as interest rates and yield curves, implied volatilities, and credit spreads. In addition, adjustments may be required for the condition or location of the asset or the extent to which it relates to items that are comparable to the valued instrument. However, if such adjustments are based on unobservable inputs which are significant to the entire measurement, the Bank will classify the instruments as Level 3.
Level 3 financial instruments:	Those that include one or more unobservable input that is significant to the measurement as whole.

3.5. Determination of fair value (continued)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price), regardless of whether that price is directly observable or estimated using a valuation technique.

In order to show how fair values have been derived, financial instruments are classified based on a hierarchy of valuation techniques, as explained above.

The Bank's fair value methodology and the governance over its models includes a number of controls and other procedures to ensure appropriate safeguards are in place to ensure its quality and adequacy. All new product initiatives (including their valuation methodologies) are subject to approvals by various functions of the Bank including the risk and finance functions. The responsibility of ongoing measurement resides with the business and product line divisions.

Once submitted, fair value estimates are also reviewed and challenged by the Risk and Finance functions. Fair value estimates are validated by;

- Benchmarking prices against observable market prices or other independent sources
- Re-performing model calculations
- Evaluating and validating input parameters

Model calibrations are challenged on a quarterly basis or when significant events in the relevant markets occur.
When relying on third-party sources (e.g., broker quotes, or other micro or macro-economic inputs), the Risk and Finance functions are also responsible for;

- Verifying and challenging the approved list of providers
- Understanding the valuation methodologies and sources of inputs and verifying their suitability for IFRS reporting requirements

For assets and liabilities that are recognized in the financial statements on a recurring basis, the group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.
External valuers are involved for valuation of significant assets such as properties.

The Bank evaluates the levelling at each reporting period on an instrument-by-instrument basis and reclassifies instruments when necessary, based on the facts at the end of the reporting period.

3.6. Financial assets and liabilities

3.6.1. Due from banks, loans and advances to customers, Financial investments at amortised cost

The Bank measures due from banks, Loans and advances to customers and other financial investments at amortised cost only if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

The details of these conditions are outlined below.

Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective:

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model but incorporates such information when assessing newly originated or newly purchased financial assets going forward. The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

3.6.1. Due from banks, Loans and advances to customers, Financial investments at amortised cost

The SPPI test

As a second step of its classification process the Bank assesses the contractual terms of the financial asset to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than *de minimis* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

3.6.2. Derivatives recorded at fair value through profit or loss

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e., the 'underlying').
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Bank enters into derivative transactions with various counterparties. These include interest rate swaps, futures, credit default swaps, cross-currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities.

Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Fully collateralised derivatives that are settled net in cash on a regular basis through Central Bank clearing house are only recognised to the extent of the overnight outstanding balance. Changes in the fair value of derivatives are included in net trading income unless hedge accounting is applied.

Embedded derivatives

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

Derivatives embedded in financial liability or a non-financial host are separated from the host and accounted for as separate derivatives if: the economic characteristics and risks are not closely related to the host; a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative (as defined above); and the hybrid contract is not measured at fair value through profit or loss. Embedded derivatives are measured at fair value with changes in fair value recognised in profit or loss. Reassessment only occurs if there is either a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required or a reclassification of a financial asset out of the fair value through profit or loss category.

Financial assets are classified in their entirety based on the business model and SPPI assessments as outlined in note 3.6.1 above.

3.6.3. Financial assets or financial liabilities held for trading

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

Included in this classification are debt securities, equities, short positions and customer loans that have been acquired principally for the purpose of selling or repurchasing in the near term.

3.6.4. Debt instruments at FVOCI

The Bank classifies debt instruments at FVOCI when both of the following conditions are met:

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

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognised in OCI. Interest income and foreign exchange gains and losses are recognised in profit or loss in the same manner as for financial assets measured at amortised cost. The ECL calculation for Debt instruments at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to
the profit and loss upon derecognition of the assets.
Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first–in first–out basis. On derecognition, cumulative gains or losses previously recognised in OCI are reclassified from OCI to profit or loss.

3.6.5. Equity instruments at FVOCI

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by-instrument basis.

Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

3.6.6. Debt issued and other borrowed funds

After initial measurement, debt issued and other borrowed funds are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issued funds, and costs that are an integral part of the EIR. A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

The Bank has issued financial instruments with equity conversion rights, write-down and call options. When establishing the accounting treatment for these non-derivative instruments, the Bank first establishes whether the instrument is a compound instrument and classifies such instrument's components separately as financial liabilities, financial assets, or equity instruments in accordance with IAS 32. Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercising the option may appear to have become economically advantageous to some holders. When allocating the initial carrying amount of a compound financial instrument to the equity and liability components, the equity component is assigned as the residual amount after deducting from the entire fair value of the instrument, the amount separately determined for the liability component. The value of any derivative features (such as a call options) embedded in the compound financial instrument, other than the equity component (such as an equity conversion option), is included in the liability component. Once the Bank has determined the split between equity and liability, it further evaluates whether the liability component has embedded derivatives that must be separately accounted for (as outlined in Note 3.6.2 above).

3.6.7. Financial assets and financial liabilities at fair value through profit or loss

Financial assets and financial liabilities in this category are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- The liabilities are part of a group of financial liabilities, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The liabilities contain one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited.

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using the contractual interest rate as explained in Note 3.3.1.2. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

3.6.8. Financial guarantees, letters of credit and undrawn loan commitments

The Bank issues financial guarantees, letters of credit and loan commitments. Financial guarantees are initially recognised in the financial statements (within Provisions) at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and an ECL allowance.

The premium received is recognised in the income statement in Net fees and commission income on a straight line basis over the life of the guarantee. Undrawn loan commitments and letters of credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. Similar to financial guarantee contracts, these contracts are in the scope of the ECL requirements. The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position.

The Bank occasionally issues loan commitments at below market interest rates. Such commitments are subsequently measured at the higher of the amount of the ECL allowance (as explained in Notes 3.9 and 5.1) and the amount initially recognised less, when appropriate, the cumulative amount of income recognised as outlined in Note 9.

3.7. Reclassification of financial assets and liabilities

The Bank does not reclassify its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank acquires, disposes of, or terminates a business line. Financial liabilities are never reclassified.

3.8. Derecognition of financial assets and liabilities

3.8.1. Derecognition due to substantial modification of terms and conditions

The Bank derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI.

When assessing whether or not to derecognise a loan to a customer, amongst others, the Bank considers the following factors:

- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty
- If the modification is such that the instrument would no longer meet the SPPI criterion

If the modification does not result in cash flows that are substantially different, as set out below, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded. For financial liabilities, the Bank considers a modification substantial based on qualitative factors and if it results in a difference between the adjusted discounted present value and the original carrying amount of the financial liability of, or greater than, ten percent. For financial assets, this assessment is based on qualitative factors.

3.8.2. Derecognition other than for substantial modification

3.8.2.1. Financial assets

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

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

- The Bank has transferred its contractual rights to receive cash flows from the financial asset; or
- It retains the rights to the cash flows, but has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass–through' arrangement

Pass-through arrangements are transactions whereby the Bank retains the contractual rights to receive the cash flows of a financial asset (the 'original asset'), but assumes a contractual obligation to pay those cash flows to one or more entities (the 'eventual recipients'), when all of the following three conditions are met:

- The Bank has no obligation to pay amounts to the eventual recipients unless it has collected equivalent amounts from the original asset, excluding short-term advances with the right to full recovery of the amount lent plus accrued interest at market rates
- The Bank cannot sell or pledge the original asset other than as security to the eventual recipients
- The Bank has to remit any cash flows it collects on behalf of the eventual recipients without material delay.
  In addition, the Bank is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents, including interest earned, during the period between the collection date and the date of required remittance to the eventual recipients.

3.8.2. Derecognition other than for substantial modification (continued)

3.8.2.1. Financial assets (continued)

A transfer only qualifies for derecognition if either:

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

The Bank considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.
When the Bank has neither transferred nor retained substantially all the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Bank's continuing involvement, in which case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Bank could be required to pay.

If continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the continuing involvement is measured at the value the Bank would be required to pay upon repurchase. In the case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

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

3.9. Impairment of financial assets

3.9.1. Overview of the ECL principles

The Bank records an allowance for expected credit loss for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts, in this section all referred to as 'financial instruments'. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit losses or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit losses (12mECL) as outlined in Note 3.9.2.
The Bank's policies for determining if there has been a significant increase in credit risk are set out in Note 5 under Credit risk management.

The 12mECL is the portion of LTECLs that represent the ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

Both LTECL and 12mECL are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments. The Bank's policy for grouping financial assets measured on a collective basis is explained in Note 5.1.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument. This has been explained in Note 5.2.3.5.

3.9. Impairment of financial assets (continued)

3.9.1. Overview of the ECL principles (continued)

The Bank thus groups its loans into Stage 1, Stage 2, Stage 3 and POCI, as described below:

Stage 1:	When loans are first recognised, the Bank recognises an allowance based on 12mECL. Stage 1 loans also include facilities where the credit risk has improved and the loan has been reclassified from Stage 2.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, where the credit risk has improved and the loan has been reclassified from Stage 3.
Stage 3:	Loans considered credit-impaired (as outlined in Note 5.2.3.) The Bank records an allowance for the LTECL.
POCI:	Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and interest income is subsequently recognised based on a credit-adjusted EIR. The ECL allowance is only recognised or released to the extent that there is a subsequent change in the expected credit losses.

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

3.9.2. The calculation of ECL

The Bank calculates ECL based on a probability-weighted scenario to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

PD	The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio. The concept of PD is further explained in Note 5.2.3.2.
EAD	The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments. The EAD is further explained in Note 5.2.3.3.
LGD	The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, including from the realisation of any collateral or credit enhancements that are integral to the loan and not required to be recognised separately. It is usually expressed as a percentage of the EAD. The LGD is further explained in Note 5.2.3.4

When estimating the ECL, the Bank considers three scenarios (a base case/baseline, an upside or optimistic scenario and a downside or pessimistic scenario). These scenarios were used to create forecasted probabilities of default Optimistic and Pessimistic scenarios were as a result of adjusting the best estimate (Base case) using the standard deviations of the above aforementioned Macroeconomic factors. Management judgement was applied in determining the likelihood of each of the three macroeconomic scenarios using the following weights:

- Base case (baseline) – 90% weight
- Upside (optimistic) – 5% weight
- Downside (pessimistic) – 5% weight

When relevant, the assessment of multiple scenarios also incorporates how defaulted loans are expected to be recovered, including the probability that the loans will cure and the value of collateral or the amount that might be received for selling the asset.

With the exception of credit cards and other revolving facilities, the maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Bank has the legal right to call it earlier.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value.

3.9.2. The calculation of ECL (continued)

The mechanics of the ECL method are summarised below:

Stage 1:	The 12mECL is calculated as the portion of LTECL that represent the ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR. This calculation is made for each of the four scenarios, as explained above.
Stage 2:	When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.
Stage 3:	For loans considered credit-impaired. the Bank recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.
POCI:	POCI assets are financial assets that are credit impaired on initial recognition. The Bank only recognises the cumulative changes in lifetime ECL since initial recognition, based on a probability-weighting of the four scenarios, discounted by the credit adjusted EIR.
Loan commitments and letters of Credit:	When estimating LTECL for undrawn loan commitments, the Bank estimates the expected portion of the loan commitment that will be drawn down over its expected life. The ECL is then based on the present value of the expected shortfalls in cash flows if the loan is drawn down, based on a probability-weighting of the four scenarios. The expected cash shortfalls are discounted at an approximation to the expected EIR on the loan. For credit cards and revolving facilities that include both a loan and an undrawn commitment, ECL is calculated and presented together with the loan. For loan commitments and letters of credit, the ECL is recognised within Provisions.
Financial guarantee contracts:	The Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the ECL provision. For this purpose, the Bank estimates ECL based on the present value of the expected payments to reimburse the holder for a credit loss that it incurs. The shortfalls are discounted by the risk-adjusted interest rate relevant to the exposure. The calculation is made using a probability-weighting of the four scenarios. The ECL related to financial guarantee contracts are recognised within Provisions.

3.9.3. Debt instruments measured at fair value through OCI

The ECL for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the assets.

3.9.4. Purchased or originated credit impaired financial assets (POCI)

For POCI financial assets, the Bank only recognises the cumulative changes in LTECL since initial recognition in the loss allowance.

3.9.5. Credit cards and other revolving facilities

The Bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with sufficient notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over an estimated time frame that reflects its expectations of customer behaviour, the likelihood of default and its future risk mitigation procedures, which could include reducing or cancelling the facilities.

The ongoing assessment of whether a significant increase in credit risk has occurred for revolving facilities is similar to other lending products. This is based on shifts in the customer's internal credit grade, as explained in Note 5.2.3.2., but greater emphasis is also given to qualitative factors such as changes in usage.

The interest rate used to discount the ECL for credit cards is based on the average effective interest rate that is expected to be charged over the expected period of exposure to the facilities. This estimation takes into account that many facilities are repaid in full each month and are consequently not charged interest.

The calculation of ECL, including the estimation of the expected period of exposure and discount rate is made, on an individual basis. The Bank's policy for grouping financial assets
measured on a collective basis is explained in Note 5.2.3.6.

3.9.6. Forward looking information

In its ECL models, the Bank relies on the following macroeconomic factors;

- Interbank rate
- 364-day Treasury bill rate
- Public debt to GDP rate

The selection of these factors was based on elimination upon assessment of a possible broad range of forward looking macroeconomic factors. Through multiple regression modelling and backward elimination, management determined that above factors affected the bank's NPL ratios.

The three scenarios mentioned in note 3.9.2 above were then used to create forecasted probabilities of default. The optimistic and pessimistic scenarios were as a result of adjusting the best estimate (Base case) using the standard deviations of the macroeconomic factors.

3.9.7. Credit enhancements: collateral valuation and financial guarantees

To mitigate its credit risks on financial assets, the Bank seeks to use collateral, where possible. The collateral comes in various forms, such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. Collateral, unless repossessed, is not recorded on the Bank's statement of financial position.

Cash flows expected from credit enhancements which are not required to be recognised separately by IFRS standards and which are considered integral to the contractual terms of a debt instrument which is subject to ECL, are included in the measurement of those ECL. On this basis, the fair value of collateral affects the calculation of ECL. Collateral is generally assessed, at a minimum, at inception and re-assessed on a quarterly basis. However, some collateral, for example, cash or securities relating to margining requirements, is valued daily.

3.9.7. Credit enhancements: collateral valuation and financial guarantees (continued)

To the extent possible, the Bank uses active market data for valuing financial assets held as collateral. Other financial assets which do not have readily determinable market values are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as mortgage brokers, or based on housing price indices.

Guarantees held are included in the measurement of loan ECLs when either they are specified in the contractual terms of the loan or else are integral to the loan, in that they formed part of the basis on which the loan was extended.

Guarantees that are not integral to the loan's contractual terms are accounted as separate units of accounts subject to ECL. Credit default swaps are not considered to be integral to a loan's contractual terms and are accounted as derivative financial instruments.

3.10. Collateral repossessed

The Bank's policy is to determine whether a repossessed asset can be best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset. Assets for which selling is determined to be a better option are transferred to assets held for sale at their fair value (if financial assets) and fair value less cost to sell for non-financial assets at the repossession date in, line with the Bank's policy.
In its normal course of business, the Bank engages external agents to recover funds from the repossessed assets, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the balance sheet.

3.11. Write-offs

Financial assets are written off either partially or in their entirety only when the Bank has no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. All amounts to be written off are subjected to Board approval upon recommendation by management. Prior to any recommendation for write-off, the Bank's management team will have satisfied themselves that there is no reasonable expectation of recovery by looking at the following possible circumstance deemed indicators of non-recoverability;

- Insolvency: Where the debtor is the subject of bankruptcy, individual voluntary arrangement, liquidation, company voluntary arrangement & administration order or administrative receivership proceedings or has ceased to trade amongst others.
- Where the debt is unenforceable whether through a court order or lapse of the statute of limitations
- Where balances are uneconomical to collect
- Where the debtor is deceased and the estate is unable to repay

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

3.12. Forborne and modified loans

The Bank sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Indicators of financial difficulties include defaults on covenants, or significant concerns raised by the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Bank's policy to monitor forborne loans to help ensure that future payments continue to be likely to occur.

3.12. Forborne and modified loans (continued)

Derecognition decisions and classification between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

When the loan has been renegotiated or modified but not derecognised, the Bank also reassesses whether there has been a significant increase in credit risk, as set out in Note 5.2.3.5. The Bank also considers whether the assets should be classified as Stage 3.

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

Once an asset has been classified as forborne, it will remain forborne for a minimum 6-month probation period. A customer will need to demonstrate consistently good payment behavior over this period of time before the exposure is no longer considered to be in default/credit impaired or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECLs. Prior to this, all the customer's facilities have to be performing and no contract should be more than 30 days past due.

3.13. Hedge accounting

As a part of its risk management, the Bank has identified a series of risk categories with corresponding hedging strategies using derivative instruments, as set out in Note 48.6.3.

The Bank elected, as a policy choice permitted under IFRS 9, to continue to apply hedge accounting in accordance with IAS 39. When a hedging relationship meets the specified hedge accounting criteria set out in IAS 39, the Bank applies one of three types of hedge accounting: fair value hedges; cash flow hedges; or hedges of a net investment in a foreign operation.

Transactions that are entered into in accordance with the Bank's hedging objectives but do not qualify for hedge accounting, are referred to in these financial statements as economic hedge relationships.

At inception, the Bank formally documents how the hedging relationship meets the hedge accounting criteria. It also records the economic relationship between the hedged item and the hedging instrument, including the nature of the risk, the risk management objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship at inception and on an ongoing basis.

In order to qualify for hedge accounting, a hedge relationship must be expected to be highly effective on a prospective basis and it needs to be demonstrated that it was highly effective in the previous designated period (i.e., one month). A hedge is considered to be highly effective if the changes in fair value or cash flows attributable to the hedged risk are expected to be offset by the hedging instrument in a range of 80% to 125%. It is also necessary to assess, retrospectively, whether the hedge was highly effective over the previous one-month period. The hedge accounting documentation includes the method and results of the hedge effectiveness assessments.

To calculate the changed in fair value of the hedged item attributable to the hedged risk, the Bank uses the hypothetical derivative method. The hypothetical derivative method involves establishing a notional derivative that would be the ideal hedging instrument for the hedged exposure (normally an interest rate swap or forward contract with no unusual terms and a zero fair value at inception of the hedge relationship). The fair value of the hypothetical derivative is then used as a proxy for the net present value of the hedged future cash flows against which changes in value of the actual hedging instrument are compared to assess effectiveness and measure ineffectiveness.

When the hedged item is a forecast transaction, the Bank also assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the income statement. In addition to the above information, hedge documentation for such transactions also describes the nature and specifics of the forecast transactions and explains the Bank's rationale as to why it has concluded the transactions to be highly probable.

3.13. Hedge accounting (continued)

Fair value hedges

In accordance with its wider risk management, it is the Bank's strategy to apply fair value hedge accounting to keep interest rate sensitivities within its established limits. Applying fair value hedge accounting enables the Bank to reduce fair value fluctuations of fixed rate financial assets as if they were floating rate instruments linked to the attributable benchmark rates. From a hedge accounting point of view, the bank designates the hedged risk as the exposure to changes in the fair value of a recognised financial asset or liability or an unrecognised firm commitment, or an identified portion of such financial assets, liabilities or firm commitments that is attributable to a particular risk and could affect profit or loss. The Bank only hedges changes due to interest rates such as benchmark rates (e.g., the Goodland Interbank Offer Rate), which are typically the most significant component of the overall fair value change. The Bank assesses hedge effectiveness by comparing fair value movements of the hedging instruments and the hedged items attributable to changes in these benchmark rates using the hypothetical derivative method as set out above. Within its risk management and hedging strategies, the Bank differentiates between micro and macro fair value hedging strategies, as set out under the relevant subheadings below.

In accordance with its hedging strategy, the Bank matches the principal of the hedging instruments to the principal of the hedged items, including prepayment expectations. The Bank uses pay fixed/receive floating interest rate swaps to hedge its fixed rate debt instruments and loans and pay floating/receive fixed interest rate swaps to hedge its fixed rate liabilities.

Hedge ineffectiveness can arise from:

- Differences in timing of cash flows of hedged items and hedging instruments
- Different interest rate curves applied to discount the hedged items and hedging instruments
- Derivatives used as hedging instruments having a non-nil fair value at the time of designation
- The effect of changes in counterparties' credit risk on the fair values of hedging instruments or hedged items

Additionally, for portfolio (macro) fair value hedges of the Bank's fixed rate mortgage portfolio, ineffectiveness also arises from the disparity between expected and actual prepayments (prepayment risk).

For its mortgage portfolio, as explained in Note 3.13.2, the Bank follows a dynamic hedging strategy.
Whilst the Bank's overall hedging strategy remains to reduce fair value fluctuations of fixed rate financial mortgages as if they were floating rates instruments linked to the attributable benchmark rates. As such, in order to reflect the dynamic nature of the hedged portfolio, the period for which the Bank designates these hedges is only one month. From an operational point of view, the Bank de-designates the previous hedge relationships and replaces them with new ones on a monthly basis.

For designated and qualifying fair value hedges, irrespective of whether they are micro or macro fair value hedges, the cumulative change in the fair value of a hedging derivative is recognised in the income statement in Net trading income. In addition, the cumulative change in the fair value of the hedged item attributable to the hedged risk is recognised in the income statement in Net trading income, and also recorded as part of the carrying value of the hedged item in the statement of financial position. For portfolio fair value hedges, the change is presented as a separate line item in the Statement of financial position.

3.13.1. Micro fair value hedges

A fair value hedge relationship is a 'Micro fair value hedge' when the hedged item (or group of items) is a distinctively identifiable asset or liability hedged by one or a few hedging instruments. The financial instruments hedged for interest rate risk in a micro fair value hedge relationship include fixed rate corporate and small business loans, fixed rate debt instruments at FVOCI and fixed rate issued long-term deposits. These hedge relationships are assessed for prospective and retrospective hedge effectiveness on a monthly basis.

If the hedging instrument expires or is sold, terminated or exercised, or when the hedge no longer meets the criteria for hedge accounting, or the Bank decides to voluntarily discontinue the hedging relationship, the hedge relationship is discontinued prospectively. If the relationship does not meet the hedge effectiveness criteria, the Bank discontinues hedge accounting from the last date on which compliance with hedge effectiveness was demonstrated. If the hedge accounting relationship is terminated for an item recorded at amortised cost, the accumulated fair value hedge adjustment to the carrying amount of the hedged item is amortised over the remaining term of the original hedge by recalculating the EIR. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the income statement.

For fair value hedge relationships where the hedged item is not measured at amortised cost, such as debt instruments at FVOCI, changes in fair value that were recorded in the income statement whilst hedge accounting was in place are amortised in a similar way to amortised cost instruments using the EIR method. However, as these instruments are measured at their fair values in the statement of financial position, the fair value hedge adjustments are transferred from the income statement to OCI. There were no such instances in either the current year or in the comparative year.

3.13.2. Portfolio (macro) fair value hedges

The Bank applies macro fair value hedging to its fixed rate mortgages. The Bank determines hedged items by identifying portfolios of homogenous loans based on their contractual interest rates, maturity and other risk characteristics. Loans within the Identified portfolios are allocated to repricing time buckets based on expected, rather than contractual, repricing dates. The hedging instruments (pay fix/receive floating rate interest rate swaps) are designated appropriately to those repricing time buckets. Hedge effectiveness is measured on a monthly basis, by comparing fair value movements of the designated proportion of the bucketed loans due to the hedged risk, against the fair value movements of the derivatives, to ensure that they are within an 80% to 125% range.

For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognised directly in OCI within equity (Cash flow hedge reserve). The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in Net trading income in the Income statement.

The aggregated fair value changes in the hedged loans are recognised as an asset in the Fair value hedge accounting adjustment on the face of the Statement of financial position. Should hedge effectiveness testing highlight that movements for a particular bucket fall outside the 80-125% range (i.e., the hedge relationship was ineffective for the period), no fair value hedge accounting adjustment is recorded for that month for that particular bucket. Regardless of the results of the retrospective hedge effectiveness testing, at the end of every month, in order to minimise the ineffectiveness from early repayments and accommodate new exposures, the Bank voluntarily de-designates the hedge relationships and re-designates them as new hedges. At designation, the fair value hedge accounting adjustments are amortised on a straight-line basis over the original hedged life. The Bank has elected to commence amortisation at the date of de-designation.

3.14. Foreign currency transactions

The Group's consolidated financial statements are presented in Kenya Shillings, which is also the Group's functional currency. Transactions in foreign currencies are recognised at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates prevailing at that date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

3.14. Foreign currency transactions (continued)

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined. The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in OCI or profit or loss are also recognised in OCI or profit or loss, respectively).

3.15. Tax

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

3.15.1. Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the end of reporting period. Current tax relating to items recognised outside profit or loss is recognised outside profit or loss. Current tax items are recognised in correlation to the underlying transaction either in profit or loss, other comprehensive income or directly in equity. Detailed disclosures are provided in Note 14

3.15.2. Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences, except:

a) where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
b) in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

a) where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and,
b) in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

The Group offsets deferred tax assets and deferred tax liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

3.15.3. Deferred income tax (continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the end of reporting period. Deferred income tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in profit or loss, other comprehensive income or directly in equity.

3.15.4. Value Added Tax

Revenues, expenses and assets are recognised net of the amount of value added tax except where the value added tax incurred on a purchase of assets or services is not recoverable from the Kenya Revenue Authority (KRA), in which case the value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and receivables and payables are stated with the amount of value added tax included.

The net amount of value added tax recoverable from, or payable to, tax authorities is included as part of other assets or other payables in the statement of financial position.

3.15.5 Accounting for uncertain positions

The Group uses judgement to determine whether each tax treatment should be considered independently or whether some tax treatments should be considered together. The decision is based on which approach provides better predictions of the resolution of the uncertainty. The Group assumes that the taxation authority will examine amounts reported to it and will have full knowledge of all relevant information when doing so. Where the Group concludes that it is probable that a particular tax treatment will be accepted, it determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment included in its income tax filings. If the Group concludes that it is not probable that a particular tax treatment will be accepted, it uses the most likely amount or the expected value of the tax treatment when determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The method should be based on which method provides better predictions of the resolution of the uncertainty.

3.16. Property and Equipment

Property and equipment is measured at cost or at the revalued amount (as appropriate) net of accumulated depreciation and impairment losses, if any. Cost comprises expenditure initially incurred to bring the asset to its location and condition ready for its intended use and directly attributable to the acquisition of the asset.

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 Group and the cost can be reliably measured. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are recognised in profit or loss during the financial year in which they are incurred.

Depreciation is calculated on a straight-line basis to write down the cost of each asset to its residual value over its estimated useful life using the following annual rates:

Buildings	2.5%
Office renovation	12.5%
Computers & software	25.0%
Motor vehicles	25.0%
Furniture and fittings	12.5%
Office equipment	12.5%

Buildings are measured at fair value less accumulated depreciation and impairment losses recognised after the date of revaluation. Valuations are performed with sufficient frequency to ensure that the carrying amount of a revalued asset does not differ materially from its fair value. A revaluation surplus is recorded in OCI and credited to the asset revaluation surplus in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation surplus. The revaluation surplus included in equity is transferred directly to retained earnings when the asset is retired or derecognised.

3.16. Property and Equipment (continued)

Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation surplus relating to the particular asset being sold is transferred to retained earnings.

The Group reviews the estimated useful lives, the methods of depreciation and residual values of property and equipment at the end of each reporting period and adjusts them prospectively, if appropriate. During the financial year, no changes to the useful lives and residual values were identified by the directors.

An item of property and equipment and any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss when the asset is derecognized

The carrying amount, depreciation and gain on disposal is disclosed in note 21, 12 and 10 respectively.

3.17. Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is recognized in profit or loss in the year in which the expenditure is incurred.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Software is amortised on a straight line basis and the amortisation expenses are recognised in profit or loss over its estimated useful life, from the date it is available for use. The estimated useful life of software for the current and comparative period is 4 years.

The amortisation method, useful life and the residual value are reviewed at each financial year-end and adjusted, if appropriate. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation method or period, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognized in profit or loss in the expense category consistent with the function of the intangible asset.

The carrying amount and amortisation are disclosed in note 22 and 12 respectively.

Derecognition of intangible assets

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

3.18. Employee benefits

3.18.1. Defined contribution plans

The Group operates a defined contribution pension scheme for its employees, the assets of which are held in a separate trustee administered guaranteed scheme managed by an insurance company.

The pension plan is funded by contributions from the employees and the Group. The Group's contributions are charged to profit or loss in the year to which they relate. The Group has no further payment obligations once the contributions have been paid.

The Group and its employees contribute to the National Social Security Fund (NSSF), a statutory defined contribution scheme registered under the NSSF Act. The Group’s contributions to the defined contribution schemes are charged to profit or loss in the year to which they relate.

3.18.2. Leave accrual

The monetary value of the unutilised leave by staff as at year end is carried in accruals as a payable and the movement in the year debited/credited to the profit or loss.

3.18.3. Short-term benefits

Short -term benefits consist of salaries, bonuses and any non-monetary benefits such as medical aid contributions and free services. They exclude equity based benefits and termination benefits. Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided;

i) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.
ii) as an expense, unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset.

3.19. Cash and cash equivalents

Cash and cash equivalents as referred to in the cash flow statement comprises cash on hand, non–restricted current accounts with central banks and amounts due from banks on demand or with an original maturity of three months or less.

3.20. Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the consolidated statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability within cash collateral on securities lent and repurchase agreements, reflecting the transaction's economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the EIR. When the counterparty has the right to sell or re-pledge the securities, the Bank reclassifies those securities in its statement of financial position to financial assets held for trading pledged as collateral or to financial investments available-for-sale pledged as collateral, as appropriate.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within cash collateral on securities borrowed and reverse repurchase agreements, reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in net interest income and is accrued over the life of the agreement using the EIR.

If securities purchased under an agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within financial liabilities held for trading and measured at fair value with any gains or losses included in net trading income.

3.21. Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received as collateral is recorded as an asset or liability.

Securities borrowed are not recognised in the statement of financial position, unless they are then sold to third parties, in which case, the obligation to return the securities is recorded as a short sale within financial liabilities held for trading and measured at fair value with any gains or losses included in net trading income.

3.22. Leases

3.22.1. Leases (Policy applicable before 1 January 2019)

The determination of whether an arrangement is a lease, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or whether the arrangement conveys a right to use the asset

Group as a lessee

Leases that do not transfer to the Group substantially all of the risks and benefits incidental to ownership of the leased items are operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. Contingent rental payable is recognised as an expense in the period in which they it is incurred.

Group as a lessor

Leases where the Group does not transfer substantially all of the risk and benefits of ownership of the asset are classified as operating leases. Rental income is recorded as earned based on the contractual terms of the lease in Other operating income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

3.22.2. Leases (Policy applicable after 1 January 2019)

At inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group uses the definition of a lease in IFRS 16. The assumptions made in the determination of lease term for lease contracts with renewal and termination options and for estimating the incremental borrowing rate (IBR) have been highlighted in notes 6.7 and 6.8 respectively.

Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment may be necessary for an entity to obtain the future economic benefits from its other assets.

Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

a) Right-of-use assets

The Group recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, an estimate of costs to be incurred to restore the underlying asset back to its original state; and lease payments made at or before the commencement date less any lease incentives received. Subsequently, right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. Right-of-use assets are depreciated on a straight-line basis over the lease term.

The right-of-use assets are presented in Note 23 and are subject to impairment in line with the Bank's policy as described in Note 3.30 and Note 6.9

3.22.2. Leases (Policy applicable after 1 January 2019) (continued)

b) Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating the lease, if the lease term reflects the Group exercising the option to terminate. Variable lease payments that do not depend on an index or a rate are recognised as expenses (unless they are incurred to produce inventories) in the period in which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Group uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification that is not accounted for as a separate lease. The lease payments are remeasured when there is a change in the lease term, future lease payments resulting from a change in an index or rate used to determine such lease payments, the amounts expected to be payable under the residual value guarantees or a change in the assessment of an option to purchase the underlying asset.

The Group's lease liabilities are included in other liabilities in Note 29.

c) Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases of property and equipment (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered to be low value. Lease payments on short-term leases and leases of low value assets are recognised as expense on a straight-line basis over the lease term.

Group as a lessor

Leases in which the Bank does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight-line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

3.23. Contingent liabilities

Letters of credit, acceptances, guarantees and performance bonds are accounted for as off statement of financial position's 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 profit or loss.

3.24. Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is recognised in profit or loss net of any reimbursement.

3.25. Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instrument.

3.26. Fiduciary assets

When the Group acts in a fiduciary capacity such as nominee or agent, assets and income arising thereon with related undertakings to return such assets to customers are excluded from these financial statements. As at 31 December 2019, the Group did not earn any income from the fiduciary assets.

3.27. Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares outstanding during the year. Diluted earnings per share are computed using the weighted average number of equity shares and dilutive potential ordinary shares outstanding during the year. During the year there were no outstanding shares with dilutive potential.

3.28. Dividends

Dividends on ordinary shares are recognised as a liability in the period in which they are declared and proposed dividends are disclosed as a separate component of equity.

3.29. Impairment of non-financial assets

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions, conducted at arm’s length, for similar assets or observable market prices less incremental costs of disposing of the asset. The value in use calculation is based on a DCF model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that the Group is not yet committed to or significant future investments that will enhance the performance of the assets of the CGU being tested. The recoverable amount is sensitive to the discount rate used for the DCF model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes. These estimates are most relevant to goodwill and other intangibles with indefinite useful lives recognised by the Group.

4. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

4.1. New and amended standards and interpretations

The following new standards and amendments became effective as at 1 January 2019:

- IFRS 16 - Leases
- IFRIC Interpretation 23 - Uncertainty over Income Tax Treatments
- Amendments to IFRS 9 - Prepayment Features with Negative Compensation
- Amendments to IAS 28 - Long-term Interests in Associates and Joint Ventures
- Amendments to IAS 19 Plan Amendment, Curtailment or Settlement
- Annual IFRS Improvement Process
  - IFRS 3 Business Combinations - Previously held Interests in a joint operation
  - IFRS 11 Joint Arrangements - Previously held Interests in a joint operation
  - IAS 12 Income Taxes - Income tax consequences of payments on financial instruments classified as equity
  - IAS 23 Borrowing Costs - Borrowing costs eligible for capitalization

The standard that had an impact on the Group (IFRS 16) has been discussed below. The other new amended standards and interpretations did not have an impact on the Group.

IFRS 16 - Leases
The Bank applied IFRS 16 Leases for the first time, which is effective for annual periods beginning on or after 1 January 2019.

IFRS 16 supersedes IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the legal form of a Lease. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise most leases on the balance sheet.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 does not have an impact for leases where the Bank is the lessor.

The Bank adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 January 2019. Under this method, the standard is applied retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application.

The effect of adoption of IFRS 16 as at 1 January 2019 (increase/(decrease)) is as follows:

Assets	Kshs ‘000
Right-of-use assets	771,546
Prepayments	-
Total Assets	771,546
Liabilities	
Lease liabilities	771,546
Deferred tax liabilities	-
Total Liabilities	771,546
Total adjustment on equity:	
Retained earnings	-

The bank has lease contracts for all its office locations (head office and branches). Before the adoption of IFRS 16, the Bank classified its leases (as lessee) at the inception date as operating leases.

4. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

4.1. New and amended standards and interpretations (continued)

Upon adoption of IFRS 16, the Bank applied a single recognition and measurement approach for all leases except for short-term leases and leases of low-value assets. Refer to Note 3.23.2 Leases for the accounting policy beginning 1 January 2019. The standard provides specific transition requirements and practical expedients, which have been applied by the Bank. The Bank recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised. Lease liabilities were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application.

The Bank also applied the available practical expedients wherein it:

- Used a single discount rate to a portfolio of leases with reasonably similar characteristics
- Relied on its assessment of whether leases are onerous immediately before the date of initial application
- Applied the short-term leases exemptions to leases with lease term that ends within 12 months of the date of initial application
- Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application
- Used hindsight in determining the lease term where the contract contained options to extend or terminate the lease

Based on the above, as at 1 January 2019:
Right-of-use assets of KShs 771,546,000 were recognised and presented separately in the statement of financial position. Additional lease liabilities of KShs 771,546,000 (included in Other liabilities) were recognised. No prepayments and trade and other payables relating to previous operating leases were derecognised.

The lease liabilities as at 1 January 2019 can be reconciled to the operating lease commitments as of 31 December 2018, as follows:

	KShs '000
Operating lease commitments as at 31 December 2018 (note 23)	704,279
Understated lease components identified	112,936
Total operating lease commitments as at 31 December 2018	817,215
Weighted average incremental borrowing rate as at 1 January 2019	11.25%
Discounted operating lease commitments as at 1 January 2019	702,503
Add:	
Lease payments relating to renewal periods not included in operating lease commitments as at 31 December 2018	69,043
Lease liabilities as at 1 January 2019	771,546

There were no commitments relating to short term leases or low-value assets as at 01 January 2019.

4. CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (continued)

4.1. New and amended standards and interpretations (continued)

IFRIC Interpretation 23 *Uncertainty over Income Tax Treatment*

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12 *Income Taxes*. It does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances

The Group determines whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments and uses the approach that better predicts the resolution of the uncertainty. The Group applies significant judgement in identifying uncertainties over income tax treatments.

Upon adoption of the Interpretation, the Group considered whether it has any uncertain tax positions,

- Since the parent company of the Group is based in Mauritius, it assessed whether the Interpretation had an impact on its consolidated financial statements. The parent company and the Groups' tax filings in different jurisdictions include deductions related to transfer pricing and the taxation authorities may challenge those tax treatments.
- Further, there was a Kenya Revenue Authority (KRA) assessment relating to excise duty on gain on business combination (goodwill) that was recognised in the financial statements for the year ended 31 December 2018. Generally, goodwill is not exciseable. See additional disclosure in note 32 (d).

The Group determined, based on its tax compliance and transfer pricing study, and the underlying facts on the demand notice by KRA, that it is probable that its tax treatments (including those for the subsidiaries) will be accepted by the taxation authorities. The Interpretation did not have an impact on the consolidated financial statements of the Group.

4.2. Standards issued but not yet effective

The new and amended standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

- IFRS 17 Insurance contracts effective for reporting periods beginning on or after 1 January 2021
- Amendments to IFRS 3: Definition of a Business effective for annual periods beginning on or after 1 January 2020
- Amendments to IAS 1 and IAS 8: Definition of Material effective for annual periods beginning on or after 1 January 2020

5. FINANCIAL RISK MANAGEMENT

5.1. Introduction and risk profile

The Group's activities expose it to a variety of financial risks. Whilst risk is inherent in the Bank's activities, it is managed through an integrated risk management framework, including ongoing identification, measurement and monitoring, and subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities.

The Bank is exposed to credit risk, liquidity risk, operational risk and market risk, the latter being subdivided into trading and non–trading risks. It is also subject to country risk and various operating and business risks.

5.1.1. Risk management structure

The Board of Directors is responsible for the overall risk management approach and for approving the risk management strategies and principles.

Through the Board Risk committee, the Board is responsible for monitoring the overall risk process within the Bank. The Board Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks and policies and risk appetite. The Risk Committee is responsible for managing risk decisions and monitoring risk levels and reports to the Board.

The Risk Management Department provides the day-to-day oversight on management of risk and promotes the risk culture across the Bank. It is responsible for creating and maintaining the risk practices across the Bank and to ensure that controls are in place for all risk categories. The department ensures that exceptions are duly reported to both the management and board Risk Committee, and the relevant actions are taken to address exceptions and any areas of weakness.

The Bank's Treasury is responsible for managing its assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank. The Bank's policy is that risk management processes throughout the Bank are audited annually by the Internal Audit function, which examines both the adequacy of the procedures and the Bank's compliance with them. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Board.

5.1.2. Risk mitigation and risk culture

It is the Bank's policy to ensure that a robust risk awareness is embedded in its organizational risk culture. Employees are expected to take ownership and be accountable for the risks the Bank is exposed to that they decide to take on. The Bank's continuous training and development emphasizes that employees are made aware of the Bank's risk appetite and they are supported in their roles and responsibilities to monitor and keep their exposure to risk within the Bank's risk appetite limits. Compliance breaches and internal audit findings are important elements of employees' annual ratings and remuneration reviews.Policies related to specific types of risk or activities are used to manage risk exposures. Recommendations of risk management, internal audit, business units and senior executive management, industry best practices and regulatory requirements are factored into the policies.Risk appetite limits and tolerances are set as a prudent approach to manage risks. Limit setting establishes accountability for key activities within the risk-taking activities and establishes the conditions under which transactions may be approved or executed.The Board approves all the policies which have clear accountability and ownership and the management is responsible and accountable for the effective implementation and monitoring of risk appetite.

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The Bank actively uses collateral to reduce its credit risks (see below).

5.1.3. Risk measurement and reporting systems

The Bank's risks are measured using a method that reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worst-case scenarios that would arise in the event that extreme events which are unlikely to occur do, in fact, occur.

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank's policy is to measure and monitor the overall risk-bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all of the businesses is processed in order to analyse, control and identify risks on a timely basis. This information is presented and explained to the Board of Directors, the Risk Committee, and the Bank's senior management. The report includes aggregate credit exposure, credit forecasts, Value at Risk (VaR), liquidity ratios and risk profile changes.

5.1.4. Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

5.2. Credit risk

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

Credit risk is monitored by the credit risk and debt recovery sections of the Bank's independent Risk Controlling Unit. It is their responsibility to review and manage credit risk, including environmental and social risk for all types of counterparties and follow up on all delinquent accounts. Additionally, the Bank has a dedicated legal team tasked with dealing with all debt recovery issues for decision making and guidance. Monthly and quarterly progress reports are made to the Bank management and the Board.

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

5.2.1. Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded on the statement of financial position. In the case of credit derivatives, the Bank is also exposed to, or protected from, the risk of default of the underlying entity referenced by the derivative.

With gross–settled derivatives, the Bank is also exposed to a settlement risk, being the risk that the Bank honors its obligation, but the counterparty fails to deliver the counter value.

5.2.2. Credit–related commitments risks

The Bank makes available to its customers guarantees that may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to similar risks to loans and are mitigated by the same control processes and policies.

5.2.3. Impairment assessment

5.2.3.1. Definition of default, impaired and cure

The Bank considers a financial instrument defaulted for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

The Bank has aligned its definition of credit impaired assets under IFRS 9 to the Central Bank of Kenya definition of Non-Performing Loans (NPL).

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Bank
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection
- Debtor's listed debt or equity suspended at the primary exchange because of negative information or facts about financial difficulties

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The Bank applies the considerations of the Central Bank prudential guidelines to determine whether a financial asset should be upgraded from Stage 3 to Stage 2 and then Stage 1.

Where an account in Stage 3 is regularised (i.e. all past due principal and interest is repaid in full) it may be upgraded to Stage 2. A facility which meets the above condition and has been classified as Stage 2 may be reclassified to Stage 1 if a sustained record of performance is maintained for a period of six months.

5.2.3.2. The Bank's internal rating and PD estimation process

The Bank's Credit Department operates its internal credit rating models. The Bank runs separate models for its key portfolios in which its customers are rate from 1 to 5 using internal grades. The models incorporate both qualitative and quantitative information and, in addition to information specific to the borrower, utilize supplemental external information that could affect the borrower's behavior. Owing to limited historical data and insufficient default history on the Bank's loan portfolio, historical rating transition matrix for the bank was based on a 24-month period running from January 2018 to December 2019. This was used for the loans and advances. To ensure that the Probability of Defaults (PDs) were estimated accurately, a calibration was done with the central tendency of default for the bank's portfolios over a period of 2 years.

PDs are then adjusted for IFRS 9 ECL calculations to incorporate forward looking information and the IFRS 9 Stage classification of the exposure. This is repeated for each economic scenario as appropriate.

5.2.3.2. The Bank's internal rating and PD estimation process (continued)

Treasury, trading and interbank relationships
The Bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank's credit department analyses publicly available information such as financial information and other external data and assigns the internal rating.

Corporate and small business lending
For corporate and investment banking loans, the credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:
Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.

- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer.

Retail lending and mortgages
Retail lending comprises unsecured personal loans, credit cards and overdrafts. These products along with retail mortgages and some of the less complex small business lending ratings are primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing

The Bank's internal credit rating grades

Internal rating grade	Internal rating/risk description
Performing	
Grade 1	Normal risk
Grade 2	Watch risk
Non-performing	
Grade 3	Substandard risk
Grade 4	Doubtful risk
Grade 5	Loss

For purposes of matching the Bank's internal risk grading and IFRS 9, Grade 1 loans can be equated to Stage 1, Grade 2 to Stage 2 and Grades 3, 4 and 5 to Stage 3.

The Bank manages, limits and controls concentrations of credit risk wherever they are identified. The bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subjected to quarterly 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 management credit committee.

5.2.3.3. Exposure at default (EAD)

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too. EAD for credit cards and other revolving facilities is set out in Note 3.9.5.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

5.2.3.4. Loss given default (LGD)

LGDs for secured facilities were modelled at facility level. The collateral values used were based on the forced sale value. The FSV for both motor vehicles and property was based on the valuation report and is estimated to be between 70- 80% of the market value. A further haircut was applied on specific property based on current information on foreclosure of the specific property. In the event that a customer had multiple facilities, collateral value was apportioned proportionately based on the on the outstanding exposures.

The collaterals were discounted for the following period to consider the time value of money (i.e. time taken to realise the sale/foreclosure of collateral);

- Property Land & Buildings – 3 years
- Motor Vehicle – 1 year
- Machinery – 1 year
- Debentures- 1 year
- Cash – Not discounted

Where a customer had no identifiable collateral, collections history on NPLs that was modelled at portfolio level (see note 5.2.3.6) was used in the computation of the LGD.

5.2.3.5. Significant increase in credit risk

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

The Bank identifies a significant increase in credit risk where;

- exposures have a regulatory risk rating of 'watch';
- an exposure is greater than 30 days past due – this is in line with the IFRS 9 "30 Days past Due (DPD) rebuttable presumption";
- an exposure has been restructured in the past due to credit risk related factors or which was NPL and is now regular (subject to the regulatory cooling off period); or
- by comparing an exposure's:
    - credit risk quality at the date of reporting; with
    - the credit risk quality on initial recognition of the exposure.

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

5.2.3.6. Grouping financial assets measured on a collective basis

As explained in Note 3.9.1 dependent on the factors below, the Bank calculates the LGD and PD to be applied on either a collective or an individual basis.

Asset classes where the Bank calculates ECL on an individual basis include:

- All Stage 1 and 2 assets that are collateralized, regardless of the class of financial assets
- All stage 3 assets regardless of the class of financial assets The treasury, trading and interbank relationships (such as Due from Banks, Cash collateral on securities borrowed and reverse repurchase agreements and debt instruments at amortised cost/FVOCI
- Exposures that have been classified as POCI when the original loan was derecognised and a new loan was recognised as a result of a credit driven debt restructuring

LGD and PD is calculated on a collective basis upon classification and grouping of the Bank's financial assets into industry sectors based on the Central bank of Kenya's industry sector classifications as listed below;

- Trade
- Transport and Communication
- Personal/Household
- Manufacturing
- Financial Services
- Real Estate
- Tourism, Restaurants & Hotels
- Building & Construction
- Agriculture
- Energy and Water
- Mining and Quarrying

5.2.3.7. Inputs to the ECL model

An overview of the approach to estimating the allowance for ECL is set out in Note 3.9 and in Note 6.1. The macro sensitive PD model developed by the Bank for the ECL computation for credit exposures to the different industry segments was determined using a transition matrix, by modelling the movements of loans from one classification (Stage) to another classification as expounded on in note 5.2.3.2, note 5.2.3.4 and note 5.2.3.6 above. involves the use of the respective weighted average Default Rates published by S&P based on variations in global Gross Domestic Product (GDP) growth extracted from the International Monetary Fund (IMF). For each of the Bank's segments, a PD was computed based on the transition matrix modelled and a macroeconomic overlay done on the historical PDs to arrive at forecasted PDs. Local macroeconomic factors obtained from the Central Bank of Kenya and Kenya National Bureau of Statistics amongst others were used to determine the factors that best affected the quality of the Bank's books. As highlighted in note 3.9.6 were arrived at based on multiple regression modelling and backward elimination on the Bank's historical data.

5.2.3.8. Overview of modified and forborne loans

From a risk management point of view, once an asset is forborne or modified, the Bank's special department for distressed assets continues to monitor the exposure until it is completely and ultimately derecognised. Details of accounting policies for forbearance are disclosed in Note 3.12.

5.2.3.9. Analysis of risk concentration

The Bank's concentrations of risk are managed by client/counterparty industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2019 was KES 687 million (2018: KES 685 million), before taking into account collateral or other credit enhancements and KES 687 million (2018: KES 685 million) net of such protection.

Disclosure of credit quality and the maximum exposure for credit risk per categories based on the Bank's internal credit rating system and year-end stage classification are further disclosed in Note 17.

5.2.3.10. Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral. Assumptions used in the measuring of certain types of collateral has been highlighted in note 5.2.3.4.

The main types of collateral obtained are, as follows:

- For securities lending and reverse repurchase transactions, cash or securities
- For corporate and small business lending, charges over real estate properties, inventory and trade receivables.
- Motor vehicles, aeroplanes and machinery subject to discounting of the FSVs in assessing collectability.
- For retail lending, mortgages over residential properties

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral and will request additional collateral in accordance with the underlying agreement. In its normal course of business, the Bank engages external agents to recover funds from repossessed properties or other assets in its retail portfolio, generally at auction, to settle outstanding debt. Any surplus funds are returned to the customers/obligors. As a result of this practice, the residential properties under legal repossession processes are not recorded on the balance sheet and not treated as non–current assets held for sale.

For its derivative portfolio, the Bank also makes use of master netting agreements and other arrangements not eligible for netting under IAS 32 Financial Instruments: Presentation with its counterparties. Such arrangements provide for single net settlement of all financial instruments covered by the agreements in the event of default on any one contract.

Although master netting arrangements may significantly reduce credit risk, it should be noted that the credit risk is eliminated only to the extent of amounts due to the same counterparty.

It is the Bank's policy to maximise the use of the services of the Central Bank of Kenya Clearing House, in which case, balances are derecognised as explained in Note 3.8.

Disclosure of credit quality and the maximum exposure for credit risk per categories based on the Bank's internal credit rating system and year-end stage classification are further disclosed in Note 17.

The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is as follows:

5. FINANCIAL RISK MANAGEMENT (continued)

5.2. Credit Risk (continued)

GROUP

As at 31 December 2019	Up to 1 month KShs '000	1 - 3 months KShs '000	4 - 12 months KShs '000	1 – 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash balances with Central Bank of Kenya and other banking institutions	4,426,307	-	-	-	-	4,426,307
Government securities	-	-	4,979,379	15,517,964	22,323,699	42,821,042
Investment securities	-	227,066	65,071	3,002	-	295,139
Placements with other banking institutions	3,120,687	-	-	-	-	3,120,687
Other assets	611,262	-	-	-	-	611,262
Off statement of financial position*	767,645	111,088	746,557	86,273	11,734	1,723,297
Loans and advances to customers	1,760,520	281,856	1,274,246	6,907,939	5,239,021	15,463,582
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
	12,239,232	620,010	7,065,253	22,515,178	27,574,454	70,014,127

At 31 December 2018	Up to 1 month KShs '000	1 - 3 months KShs '000	4 - 12 months KShs '000	1 – 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash balances with Central Bank of Kenya and other banks	3,268,334	2,535,662	-	-	-	5,803,996
Government securities	3,186,550	4,935,230	19,030,592	8,083,901	8,103,098	43,339,371
Investment securities	-	-	299,513	-	-	299,513
Placements with other banking institutions	2,080,139	944,285	-	-	-	3,024,424
Other assets	437,599	-	-	-	-	437,599
Off statement of financial position*	838,856	1,893,760	1,177,967	500	19,640	3,930,723
Loans and advances to customers	2,063,448	125,191	723,984	4,216,040	5,077,570	12,206,233
Financial assets at fair value through profit and loss	926,112	-	-	-	-	926,112
	12,801,038	10,434,128	21,232,056	12,300,441	13,200,308	69,967,971

* These include letters of credit and guarantees.

5. FINANCIAL RISK MANAGEMENT (continued)

5.2. Credit Risk (continued)

BANK

At 31 December 2019	Up to 1 month KShs '000	1 - 3 months KShs '000	4 - 12 months KShs '000	1 – 5 years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash balances with Central Bank of Kenya and other banks	4,426,307	-	-	-	-	4,426,307
Government securities	-	-	4,979,379	15,517,964	22,323,699	42,821,042
Investment securities	-	227,066	65,071	3,003	-	295,140
Placements with other banking institutions	3,120,687	-	-	-	-	3,120,687
Other assets	611,262	-	-	-	-	611,262
Off statement of financial position*	767,645	111,088	746,557	86,273	11,734	1,723,297
Loans and advances to customers	1,760,582	281,856	1,274,246	6,907,939	5,239,022	15,463,645
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
	12,239,294	620,010	7,065,253	22,515,179	27,574,455	70,014,191

At 31 December 2018						
Assets						
Cash balances with Central Bank of Kenya and other banks	3,268,334	2,535,662	-	-	-	5,803,996
Government securities	3,186,550	4,935,230	19,030,592	8,083,901	8,103,098	43,339,371
Investment securities	-	-	299,513	-	-	299,513
Placements with other banking institutions	2,080,139	944,285	-			3,024,424
Other assets	436,428	-	-	-	-	436,428
Off statement of financial position*	838,856	1,893,760	1,177,967	500	19,640	3,930,723
Loans and advances to customers	2,066,751	125,191	723,984	4,216,040	5,077,570	12,209,536
Financial assets at fair value through profit and loss	926,112	-	-	-	-	926,112
	12,803,170	10,434,128	21,232,056	12,300,441	13,200,308	69,970,103

* These include letters of credit and guarantees,.

SBM BANK (KENYA) LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUE
FOR THE YEAR ENDED 31 DECEMBER 2019

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND AS

6.4. Effective Interest Rate (EIR) method

The Bank's EIR method, recognises interest income using a rate of r of return over the expected behavioral life of loans and deposits and charged at various stages and other characteristics of the product lif charges). This estimation, by nature, requires an element of judgeme instruments, as well expected changes to the Bank's base rate and instrument.

6.5. Deferred tax assets

Deferred tax assets are recognised for all deductible temporary differ is probable that taxable profit will be available against which the deduc can be utilized. Significant management judgement is required to d recognised, based upon the likely timing and the level of future taxab

5. FINANCIAL RISK MANAGEMENT (continued)

5.3. Liquidity risk and funding management

Liquidity risk is defined as the risk that the Bank does not have sufficient liquid financial resources to meet obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Bank might be unable to meet its payment obligations when they fall due as a result of mismatches in the timing of the cash flows under both normal and stress circumstances. Such scenarios could occur when funding needed for illiquid asset positions is not available to the Bank on acceptable terms. To limit this risk, management has arranged for diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and monitoring future cash flows and liquidity on a daily basis. The Bank has developed internal control processes and contingency plans for managing liquidity risk. The ALCO is responsible for managing the Bank's liquidity risk through comprehensive policies, governance and review procedures, stress testing, monitoring of limit sets to ensure these are in line with the overall liquidity risk appetite and strategy of the Bank. The treasury department of the bank is responsible for working with other departments within the Bank to ensure the liquidity risk strategy is executed. This incorporates an assessment of expected cash flows and the availability of high-grade collateral which could be used to secure additional funding, if required.

The Bank maintains a portfolio of highly marketable and diverse assets that are assumed to be easily liquidated in the event of an unforeseen interruption in cash flow. The Bank also has lines of credit that it can access to meet liquidity needs. Net liquid assets consist of cash, short–term bank deposits and liquid debt securities available for immediate sale, less deposit for banks and other issued securities and borrowings due to mature within the next month. The ratios during the year were as follows;

5.3.1. Liquidity ratios
Advances to deposits ratios (%)

	2019	2018
Year-end	30.5%	24.7%
Maximum	30.5%	24.7%
Minimum	25.0%	22.6%
Average	27.0%	23.7%

5.3.2. Stress Testing
In accordance with the Bank's policy, the liquidity position is assessed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. Additionally, stress testing is performed for a combination of both the market and specific stress factors relating to the Bank. Liquidity mismatch reporting and stress testing results are reported regularly and reviewed by the Risk Management Committee and periodically reviewed by the Asset and Liability Committee (ALCO), Executive Committee and Board Risk Committee.

5.3.3. Analysis of financial assets and liabilities by remaining contractual maturities

The Bank stresses the importance of current accounts and savings accounts as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers as a percentage of core customer current accounts and savings accounts, together with term funding with a remaining term to maturity in excess of one year. Loans to customers that are part of reverse repurchase arrangements, and where the Bank receives securities which are deemed to be liquid, are excluded from the advances to deposits ratio.

The table below summarizes the maturity profile of the Bank's financial assets and the undiscounted cash flows of its financial liabilities as at 31 December. Trading derivatives are shown at fair value in a separate column. All derivatives used for hedging purposes are shown by maturity, based on their contractual undiscounted payment obligations. Gross settled, non-trading derivatives are shown separately, by contractual maturity at the foot of the note.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date it could be required to pay and the table does not reflect the expected cash flows indicated by its deposit retention history.

IPTIONS (continued)

that represents the best estimate of a constant rate
nises the effect of potentially different interest rates
le (including prepayments and penalty interest and
garding the expected behavior and life-cycle of the
r fee income/expense that are integral parts of the

s and tax losses carried forward to the extent that it
emporary differences and tax losses carried forward
ine the amount of deferred tax assets that can be
fits together with future tax planning strategies.

5. FINANCIAL RISK MANAGEMENT (continued)

5.3.3. Analysis of financial assets and liabilities by remaining contractual maturities (continued)

GROUP

As at 31 December 2019

	Upto 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash in hand	1,278,352	-	-	-	-	1,278,352
Balances with Central Bank of Kenya	2,970,207	-	-	-	-	2,970,207
Government and other investment securities	354,499	854,226	4,438,189	35,365,028	32,710,268	73,722,210
Placements and balances with other banking institutions	4,578,939	-	-	-	-	4,578,939
Other assets	611,262	-	-	-	-	611,262
Loans and advances to customers	8,177,524	477,776	1,751,742	12,312,129	13,626,949	36,346,120
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
Total assets	19,523,594	1,332,002	6,189,931	47,677,157	46,337,217	121,059,901
Liabilities						
Deposits from banks	11,515	-	-	-	-	11,515
Customer deposits	18,971,871	8,119,510	15,469,361	8,987,530	-	51,548,272
Due to Central Bank of Kenya	6,184,000	-	-	6,392,626	-	12,576,626
Financial liabilities at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
Other liabilities	359,542	-	-	-	-	359,542
Lease liability	13,877	1,069	67,597	193,126	452,919	728,588
Total liabilities	27,093,616	8,120,579	15,536,958	15,573,282	452,919	66,777,354
Net liquidity gap	(7,570,022)	(6,788,577)	(9,347,027)	32,103,875	45,884,298	54,282,547

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

5. FINANCIAL RISK MANAGEMENT (continued)

5.3.3. Analysis of financial assets and liabilities by remaining contractual maturities (continued)

As at 31 December 2018

	Upto 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash in hand	2,333,823	-	-	-	-	2,333,823
Balances with Central Bank of Kenya	5,665,775	-	-	-	-	5,665,775
Government and other investment securities	4,536,366	5,339,944	20,891,826	14,699,634	12,206,278	57,674,048
Placements and balances with other banking institutions	2,364,589	944,462	-	-	-	3,309,051
Other assets	437,599	-	-	-	-	437,599
Loans and advances to customers	1,575,090	143,588	781,799	8,375,629	10,656,287	21,532,393
Financial assets at fair value through profit and loss	926,112	-	-	-	-	926,112
Total assets	17,839,354	6,427,994	21,673,625	23,075,263	22,862,565	91,878,801
Liabilities						
Customer deposits	13,668,886	8,594,685	11,364,998	18,370,236	4,788	52,003,593
Due to Central Bank of Kenya	-	-	-	9,104,981	-	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	-	-	-	926,112
Other liabilities	1,425,952	-	-	-	-	1,425,952
Total liabilities	16,020,950	8,594,685	11,364,998	27,475,217	4,788	63,460,638
Net liquidity gap	1,818,404	(2,166,691)	10,308,627	(4,399,954)	22,857,777	28,418,163

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

5. FINANCIAL RISK MANAGEMENT (continued)

5.3.3. Analysis of financial assets and liabilities by remaining contractual maturities (continued)

BANK as at 31 December 2019

	Up to 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash in hand	1,278,352	-	-	-	-	1,278,352
Balances with Central Bank of Kenya	2,970,207	-	-	-	-	2,970,207
Government and other investment securities	354,499	854,226	4,438,189	35,365,028	32,710,268	73,722,210
Placements and balances with other banking institutions	4,578,939	-	-	-	-	4,578,939
Other assets	611,262	-	-	-	-	611,262
Loans and advances to customers	8,177,586	477,776	1,751,742	12,312,129	13,626,949	36,346,182
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
Total assets	19,523,656	1,332,002	6,189,931	47,677,157	46,337,217	121,059,963
Liabilities						
Deposits from banks	11,515	-	-	-	-	11,515
Customer deposits	18,987,098	8,119,510	15,469,361	8,987,530	-	51,563,499
Due to Central Bank of Kenya	6,184,000	-	-	6,392,626	-	12,576,626
Financial liabilities at fair value through profit and loss	1,552,811	-	-	-	-	1,552,811
Other liabilities	359,542	-	-	-	-	359,542
Lease liability	13,877	1,069	67,597	193,126	452,919	728,588
Total liabilities	27,108,843	8,120,579	15,536,958	15,573,282	452,919	66,792,581
Net liquidity gap	(7,585,187)	(6,788,577)	(9,347,027)	32,103,875	45,884,298	54,267,382

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

5. FINANCIAL RISK MANAGEMENT (continued)

5.3.3. Analysis of financial assets and liabilities by remaining contractual maturities (continued)

As at 31 December 2018

	Up to 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Total KShs '000
Assets						
Cash in hand	2,333,823	-	-	-	-	2,333,823
Balances with Central Bank of Kenya	5,665,775	-	-	-	-	5,665,775
Government securities	4,536,366	5,339,944	20,891,826	14,699,634	12,206,278	57,674,048
Placements and balances with other banking institutions	2,364,589	944,462	-	-	-	3,309,051
Other assets	436,428	-	-	-	-	436,428
Loans and advances to customers	1,578,393	143,588	781,799	8,375,629	10,656,287	21,535,696
Financial assets at fair value through profit and loss	926,112	-	-	-	-	926,112
Total assets	17,841,486	6,427,994	21,673,625	23,075,263	22,862,565	91,880,933
Liabilities						
Customer deposits	13,684,355	8,594,685	11,364,998	18,370,236	4,788	52,019,062
Due to Central Bank of Kenya	-	-	-	9,104,981	-	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	-	-	-	926,112
Other liabilities	1,425,952	-	-	-	-	1,425,952
Total liabilities	16,036,419	8,594,685	11,364,998	27,475,217	4,788	63,476,107
Net liquidity gap	1,805,067	(2,166,691)	10,308,627	(4,399,954)	22,857,777	28,404,826

Experience indicates that customer deposits are maintained for longer periods than the contractual maturity dates. The deposit base is considered to be of a stable and long term nature.

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices.

The Bank classifies exposures to market risk into either trading (the Trading book) or non–trading (the Banking book) portfolios and manages each of those portfolios separately.

The market risk for the trading book is managed and monitored using value at risk (VaR), that reflects the interdependency between risk variables as set out in note 5.4.1 below.

The Bank's risk management strategy for its Banking book is different for each of the following categories of market risk and is set out in the subsequent subsections of these financial statements, as follows:

- Interest rate risk
- Currency risk

Market risk limits are set and continuously reviewed by the market risk department of the Bank's independent Risk Controlling Unit. As a part of their established market risk management process, the market risk department also monitors early signs of possible changes in market conditions such as: anticipated and actual changes to interest rates; socio-economic factors driving mortgage prepayment behaviors; and economic and geopolitical factors driving currency and equity price movements. Market risk limits are ultimately approved by the Board.

The Bank's Asset and Liability Committee (ALCO) is tasked with the overall management of market risk. At an operational level, market risk is primarily managed by the Bank's treasury department, which is responsible for ensuring that the Bank's exposures are in compliance with market risk limits approved by the Board and to take adequate actions subject to review and approval by ALCO.

The Bank's risk management strategies in relation to market risks are explained under the corresponding subheadings on the following pages.

5.4.1. Market risk — trading (trading book) (including financial assets and financial liabilities designated at fair value through profit or loss)

Objectives and limitations of the VaR (Value at Risk) methodology
The Bank uses simulation models to assess possible changes in the market value of the trading portfolio based on historical data. The VaR models are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The distribution is calculated by using exponentially weighted historical data. Due to the fact that VaR relies heavily on historical data to provide information and does not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be underestimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under– or over–estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99% confidence level.

In practice, the actual trading results will differ from the VaR calculation. In particular, the calculation does not provide a meaningful indication of profits and losses in stressed market conditions. To determine the reliability of the VaR models, actual outcomes are monitored regularly to test the validity of the assumptions and the parameters used in the VaR calculation.

5. FINANCIAL RISK MANAGEMENT (continued)

5.4.1. Market risk — trading (trading book) (including financial assets and financial liabilities designated at fair value through profit or loss) (continued)

VaR assumptions
The VaR that the Bank measures is an estimate, using a confidence level of 99%, of the potential loss that is not expected to be exceeded if the current market risk positions were to be held unchanged for one day. The use of a 99% confidence level means that, within a one-day horizon, losses exceeding the VaR figure should occur, on average under normal market conditions, not more than once every hundred days.

Since VaR is an integral part of the Bank's market risk management, VaR limits have been established for all trading operations and exposures are required to be reviewed daily against the limits by management.

Back testing
It is the Bank's policy to perform regular back–testing to validate the Bank's VaR calculations. When back–testing, the Bank compares daily profits and losses with the estimates derived from the Bank's VaR model.

5.4.2. Market risk – Banking book

The Bank's primary business model is to collect deposits, and use these funds to provide loans and other funding products and debt instruments to its customers. Interest rate risk is the impact that changes in interest rates could have on the Bank's margins, profit or loss, and equity. Interest risk arises from the mismatch of interest payable on the Bank's liabilities and the interest earned on its assets.

The Bank's asset-liability profile of its banking book is such that:

- Interest on deposits is primarily either floating or their maturities are so short term that their behavior is similar to floating rate instruments
- Interest rates payable on issued debt are primarily fixed
- The Bank's loan portfolio is a mixture of fixed and floating rates instruments

As a part of the Bank's risk management strategy, the Board has established limits on the non–trading interest rate gaps for the interest rate sensitivities. These limits are consistent with the Bank's enterprise risk appetite and the Bank aligns its hedge accounting objectives to keep exposures within those limits.

5.4.2.1. Interest rate risk
The Bank is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on its financial position and cash flows. Management closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes.

The following table provides an analysis of the Bank's interest rate risk exposure on non–trading financial assets and liabilities. The Bank's assets and liabilities are included at carrying amount and categorized by the earlier of contractual repricing or maturity dates.

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.1. Interest rate risk (continued)

GROUP

As at 31 December 2019

	Upto 1 month KShs '000	1 – 3 Months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Non-interest bearing KShs '000	Total KShs '000
Assets							
Cash in hand	-	-	-	-	-	1,278,352	1,278,352
Balances with Central Bank of Kenya	540,000	-	-	-	-	2,429,996	2,969,996
Government and investment securities	-	227,066	5,044,450	15,520,966	22,323,700	-	43,116,182
Placements and balances with other banking institutions	4,576,998	-	-	-	-	-	4,576,998
Other assets	-	-	-	-	-	611,262	611,262
Loans and advances to customers	1,760,520	281,856	1,274,246	6,907,939	9,077,606	-	19,302,167
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	-	1,552,811
Total assets	8,430,329	508,922	6,318,696	22,428,905	31,401,306	4,319,610	73,407,768
Liabilities							
Deposits from banks	11,515	-	-	-	-	-	11,515
Customer deposits	18,344,151	8,007,564	14,861,335	8,665,932	-	667,126	50,546,108
Due to Central Bank of Kenya	6,184,000	-	-	3,559,979	-	-	9,743,979
Financial liabilities at fair value through profit and loss	1,552,811	-	-	-	-	-	1,552,811
Other liabilities *	13,877	1,069	67,597	193,126	452,920	359,542	1,088,131
Total liabilities	26,106,354	8,008,633	14,928,932	12,419,037	452,920	1,026,668	62,942,544
On statement of financial position interest sensitivity gap	(17,676,025)	(7,499,711)	(8,610,236)	10,009,868	30,948,386	3,292,942	10,465,224

*Other liabilities include lease liabilities

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.1. Interest rate risk (continued)

As at 31 December 2018

	Upto 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Non-interest bearing KShs '000	Total KShs '000
Assets							
Cash in hand	-	-	-	-	-	2,333,823	2,333,823
Balances with Central Bank of Kenya	2,500,000	-	-	-	-	3,020,420	5,520,420
Government and investment securities	3,184,386	4,935,230	19,330,105	8,083,901	8,105,262	2,164	43,641,048
Placements and balances with other banking institutions	2,242,771	944,285	-	-	-	120,944	3,308,000
Other assets	-	-	-	-	-	437,599	437,599
Loans and advances to customers	1,996,017	125,191	723,984	4,216,040	5,145,001	-	12,206,233
Financial assets at fair value through profit and loss	926,112	-	-	-	-	-	926,112
Total assets	10,849,286	6,004,706	20,054,089	12,299,941	13,250,263	5,914,950	68,373,235
Liabilities							
Customer deposits	9,138,563	4,286,010	11,364,998	17,295,854	4,788	8,938,238	51,028,451
Due to Central Bank of Kenya	-	-	-	9,104,981	-	-	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	-	-	-	-	926,112
Other liabilities	-	-	-	-	-	1,425,952	1,425,952
Total liabilities	10,064,675	4,286,010	11,364,998	26,400,835	4,788	10,364,190	62,485,496
On statement of financial position interest sensitivity gap	784,611	1,718,696	8,689,091	(14,100,894)	13,245,475	(4,449,240)	5,887,739

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.1. Interest rate risk (continued)

BANK

As at 31 December 2019

	Upto 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Non-interest bearing KShs '000	Total KShs '000
Assets							
Cash in hand	-	-	-	-	-	1,278,352	1,278,352
Balances with Central Bank of Kenya	540,000	-	-	-	-	2,429,996	2,969,996
Government and investment securities	-	227,066	5,044,450	15,520,966	22,323,700	-	43,116,182
Placements with other banking institutions	4,576,998	-	-	-	-	-	4,576,998
Other assets	-	-	-	-	-	611,262	611,262
Loans and advances to customers	1,760,582	281,856	1,274,246	6,907,939	9,077,606	-	19,302,229
Financial assets at fair value through profit and loss	1,552,811	-	-	-	-	-	1,552,811
Total assets	8,430,391	508,922	6,318,696	22,428,905	31,401,306	4,319,610	73,407,830
Liabilities							
Deposits from other banking institutions	11,515	-	-	-	-	-	11,515
Customer deposits	18,358,711	8,008,231	14,861,335	8,665,932	-	667,126	50,561,335
Due to Central Bank of Kenya	6,184,000	-	-	3,559,979	-	-	9,743,979
Financial liabilities at fair value through profit and loss	1,552,811	-	-	-	-	-	1,552,811
Other liabilities*	13,877	1,069	67,597	193,126	452,920	359,542	1,088,131
Total liabilities	26,120,914	8,009,300	14,928,932	12,419,037	452,920	1,026,668	62,957,771
On statement of financial position interest sensitivity gap	(17,690,523)	(7,500,378)	(8,610,236)	10,009,868	30,948,386	3,292,942	10,450,059

*Other liabilities include lease liabilities

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.1. Interest rate risk (continued)

As at 31 December 2018

	Upto 1 month KShs '000	1 - 3 months KShs '000	4 - 12 Months KShs '000	1 - 5 Years KShs '000	Over 5 years KShs '000	Non-interest bearing KShs '000	Total KShs '000
Assets							
Cash in hand	-	-	-	-	-	2,333,823	2,333,823
Balances with Central Bank of Kenya	2,500,000	-	-	-	-	3,020,420	5,520,420
Government and investment securities	3,184,386	4,935,230	19,330,105	8,083,901	8,105,262	2,113	43,640,997
Placements with other banking institutions	2,242,771	944,285	-	-	-	120,944	3,308,000
Other assets	-	-	-	-	-	436,428	436,428
Loans and advances to customers	1,999,321	125,191	723,983	4,216,040	5,145,001	-	12,209,536
Financial assets at fair value through profit and loss	926,112	-	-	-	-	-	926,112
Total assets	10,852,590	6,004,706	20,054,088	12,299,941	13,250,263	5,913,728	68,375,316
Liabilities							
Customer deposits	9,138,563	4,286,010	11,364,998	17,295,854	4,788	8,953,707	51,043,920
Due to Central Bank of Kenya	-	-	-	9,104,981	-	-	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	-	-	-	-	926,112
Other liabilities	-	-	-	-	-	1,425,952	1,425,952
Total liabilities	10,064,675	4,286,010	11,364,998	26,400,835	4,788	10,379,659	62,500,965
On statement of financial position interest sensitivity gap	787,915	1,718,696	8,689,090	(14,100,894)	13,245,475	(4,465,931)	5,874,351

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.1. Interest rate risk (continued)

The table below summarises the effective interest rates calculated on a weighted average basis, by major currencies for monetary financial assets and liabilities:

Group and Bank	2019				2018			
	KShs	US $	GB £	Euro	KShs	US $	GB £	Euro
	%	%	%	%	%	%	%	%
Government securities	11.71	-	-	-	10.25	-	-	-
Balances due from banking institutions	6.99	2.65	-	-	6.00	2.88	1.22	1.17
Loans and advances to customers	12.52	7.70	8.31	8.21	11.39	3.95	1.17	0.39
Customer deposits	7.69	2.94	2.68	2.57	5.16	1.29	1.74	0.28

Interest rate risk sensitivity

At 31 December 2019, if the weighted average interest rate for loans and advances at that date had been 1 percent higher with all other variables held constant, post-tax profit for the year would have been KShs 165 million (2018: KShs 123 million) higher, arising mainly as a result of higher interest income.

At 31 December 2019, if the weighted average interest rate for customer deposits and deposits from other banking institutions, at that date had been 1 percent higher with all other variables held constant, post-tax profit for the year would have been KShs 57 million (2018: KShs 145 million) lower, arising mainly as a result of higher interest expense.

A similar decrease in interest rate would have yielded the same impact in the opposite direction in both cases.

5.4.2.2. Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Board has set limits on the net positions the Bank can hold in each currency, including foreign exchange positions of subsidiaries and both accounting and economic hedges.

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. The significant currency positions are as detailed out below:

5. FINANCIAL RISK MANAGEMENT (continued)
5.4. Market risk (continued)
5.4.2.2. Currency risk (continued)

GROUP AND BANK

As at 31 December 2019	US $	GB £	Euros	Others	Total
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Financial assets					
Cash in hand	183,198	75,593	308,683	25,519	592,993
Balances with Central Bank of Kenya	240,566	66,746	58,882	3,564	369,758
Balances & placements with other banking institutions	2,013,525	294,483	651,814	127,629	3,087,451
Loans and advances to customers	4,623,047	31,221	65,712	911	4,720,891
Total financial assets	7,060,336	468,043	1,085,091	157,623	8,771,093
Financial liabilities					
Customer deposits	6,147,989	481,712	1,082,949	127,267	7,839,917
Total financial liabilities	6,147,989	481,712	1,082,949	127,267	7,839,917
Net statement of financial position gap	912,347	(13,669)	2,142	30,356	931,176
As at 31 December 2018					
Financial assets					
Cash in hand	158,345	102,622	1,042,882	25,016	1,328,865
Balances with Central Bank of Kenya	225,885	59,145	55,249	545	340,824
Placements with other banking institutions	2,134,096	197,847	416,796	19,768	2,768,507
Loans and advances to customers	4,121,208	20,686	163,726	806	4,306,426
Total financial assets	6,639,534	380,300	1,678,653	46,135	8,744,622
Financial liabilities					
Customer deposits	5,624,749	437,580	704,083	11,401	6,777,813
Total financial liabilities	5,624,749	437,580	704,083	11,401	6,777,813
Net statement of financial position gap	1,014,785	(57,280)	974,570	34,734	1,966,809

5. FINANCIAL RISK MANAGEMENT (continued)

5.4. Market risk (continued)

5.4.2.2. Currency risk (continued)

Foreign exchange risk sensitivity
The table below summarizes the effect on profit and equity had the Kenya Shilling weakened by 10% against each currency, with all other variables held constant. If the Kenya Shilling strengthened against each currency, the effect would have been the opposite:

GROUP AND BANK

As at 31 December 2019

	US $ KShs '000	GB £ KShs '000	Euros KShs '000	Others KShs '000	Total KShs '000
Effect on profit or loss	91,235	(1,367)	214	3,036	93,118
Effect on equity	63,864	(957)	150	2,125	65,182
Closing exchange rates	101.35	132.97	113.63		

As at 31 December 2018

	US $ KShs '000	GB £ KShs '000	Euros KShs '000	Others KShs '000	Total KShs '000
Effect on profit or loss	101,479	(5,728)	97,457	3,473	196,681
Effect on equity	71,035	(4,010)	68,220	2,431	137,677
	KShs	KShs	KShs		
Closing exchange rates	101.85	129.79	116.51		

5. FINANCIAL RISK MANAGEMENT (continued)

5.4.3. Price risk sensitivity

The Bank is exposed to price risk on quoted investment securities

The table below summarizes the impact on increase in the market price on the Group's equity investments net of tax. The analysis is based on the assumption that the market prices had increased by 5% with all other variables held constant and all the Bank's equity instruments moved according to the historical correlation with the price:

	Impact on profit or loss and equity	
	2019	2018
	KShs '000	KShs '000
Effect of increase on profit	123	108

5.4.4. Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks such as those arising out of legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risk arises from the Group's operations and is faced by all other business entities.

The Group endeavors to manage the operational risk by creating a balance between avoidance of cost or financial losses and damage to the Group's reputation within overall cost effectiveness and to avoid control procedures that restrict creativity and initiative. The key responsibility for development policies and programs to implement the Group's operational risk management is with the senior management of the Group.

The above is achieved by development of overall standards for the Group to manage the risk in the following areas:

- Segregation of duties including independent authorization of transactions
- Monitoring and reconciliation of transactions
- Compliance to regulatory and legal requirements
- Documentation of controls and procedures
- Assessment of the operational risk on a periodic basis to address the deficiencies observed, if any
- Reporting of operational losses and initiation of remedial action
- Development of contingency plans
- Training staff to improve their professional competency
- Exercising good ethical and business standards.

5.4.5. Compliance and regulatory risk

Compliance and regulatory risk includes the risk of bearing the consequences of non-compliance with regulatory requirements. The Compliance function is responsible for establishing and maintaining an appropriate framework of Bank compliance policies and procedures. Compliance with such policies and procedures is the responsibility of all Managers.

5.4.6. Environmental and social risks

Environmental and social risks are the risks that the Bank could bear the consequences of socio-environmental fall-out of transactions. Such risks could arise from failure of the Bank to assess the impacts of activities (of both the Bank and its clients) which could hurt the environment or have negative social impact.

The Bank is aware that it has a responsibility to ensure that its internal practice and its lending activities do not have negative environmental and social impacts and is thus committed to ensure that such risks are sufficiently managed through its Environmental and Social Management policy and by adopting the country's Labor and environmental laws. The Bank also adheres to international best practice (IFC performance standards and ILO standards as ratified by the Kenya government). An Environmental and Social Management system is being put in place to ensure due diligence and monitoring of the Environmental and Social risk is done efficiently. Compliance with these laws is monitored by the compliance function.

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Bank's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods. In the process of applying the Bank's accounting policies, management has made the following judgements and assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Existing circumstances and assumptions about future developments may change due to circumstances beyond the Bank's control and are reflected in the assumptions if and when they occur. Items with the most significant effect on the amounts recognised in the consolidated financial statements with substantial management judgement and/or estimates are collated below with respect to judgements/estimates involved.

6.1. Impairment losses on financial assets

As disclosed in Note 3.9, the measurement of impairment losses both under IFRS 9 across all categories of financial assets in scope requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model
- The Bank's loan book segmentation based on industry sectors
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a LTECL basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models

It has been the Bank's policy to regularly review its models in the context of actual loss experience and adjust when necessary.

6.2. Going concern

The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt on the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

6.3. Fair value of financial instruments

The fair value of financial instruments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of valuation models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required in establishing fair values. Judgements and estimates include considerations of liquidity and model inputs related to items such as credit risk (both own and counterparty), funding value adjustments, correlation and volatility. The determination of fair value has been disclosed in Note 3.5. A comparison of the carrying amounts and fair value amounts by level of hierarchy for financial assets not measured at fair value has been disclosed in note 39.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

6.3. Fair value of financial instruments (continued)

GROUP

	Quoted prices in active markets Level 1	Significant observable inputs Level 2	Significant unobservable inputs Level 3	Total
	KShs '000	KShs '000	KShs '000	KShs '000
31 December 2019				
Derivative financial assets	-	-	-	-
Investment securities mandatorily measured at FVPL				
Debt securities [note 18(b)]	301,538	-	-	301,538
Investments at FVOCI (debt and equity instruments)				
Debt securities [note 18(c)]	27,133,666	-	-	27,133,666
Equity securities [note 19(b)]	2,467	-	-	2,467
Loans and advances at FVPL	-	-	1,552,811	1,552,811
Total assets	27,437,671	-	1,552,811	28,990,482
Derivative financial liabilities	-	-	-	-
Financial liabilities at fair value through profit and loss	-	-	1,552,811	1,552,811
Total liabilities	-	-	1,552,811	1,552,811

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

6.3. Fair value of financial instruments (continued)

GROUP

	Quoted prices in active markets Level 1	Significant observable inputs Level 2	Significant unobservable inputs Level 3	Total
	KShs '000	KShs '000	KShs '000	KShs '000
31 December 2018				
Derivative financial assets	-	-	-	-
Investment securities mandatorily measured at FVPL				
Debt securities [note 18(b)]	714,935	-	-	714,935
Investments at FVOCI (debt and equity instruments)				
Debt securities [note 18(c)]	5,755,259	-	-	5,755,259
Equity securities [note 19(b)]	2,164	-	-	2,164
Loans and advances at FVPL (note 7)	-	-	926,112	926,112
Total assets	6,472,358	-	926,112	7,398,470
Derivative financial liabilities	-	-	-	-
Financial liabilities at fair value through profit and loss	-	-	926,112	926,112
Total liabilities	-	-	926,112	926,112

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

6.3. Fair value of financial instruments (continued)

BANK

	Quoted prices in active markets Level 1 KShs '000	Significant observable inputs Level 2 KShs '000	Significant unobservable inputs Level 3 KShs '000	Total KShs '000
31 December 2019				
Derivative financial assets	-	-	-	-
Investment securities mandatorily measured at FVPL				
Debt securities [note 18(b)]	301,538	-	-	301,538
Investments at FVOCI (debt and equity instruments)				
Debt securities [note 18(c)]	27,133,666	-	-	27,133,666
Equity securities [note 19(b)]	2,416	-	-	2,416
Loans and advances at FVPL	-	-	1,552,811	1,552,811
Total assets	27,437,620	-	1,552,811	28,990,431
Derivative financial liabilities	-	-	-	-
Financial liabilities at fair value through profit and loss	-	-	1,552,811	1,552,811
Total liabilities	-	-	1,552,811	1,552,811

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

6.3. Fair value of financial instruments (continued)

BANK

	Quoted prices in active markets Level 1	Significant observable inputs Level 2	Significant unobservable inputs Level 3	Total
	KShs '000	KShs '000	KShs '000	KShs '000
31 December 2018				
Derivative financial assets	-	-	-	-
Investment securities mandatorily measured at FVPL				
Debt securities [note 18(b)]	714,935	-	-	714,935
Investments at FVOCI (debt and equity instruments)				
Debt securities [note 18(c)]	5,755,259	-	-	5,755,259
Equity securities [note 19(b)]	2,113	-	-	2,113
Loans and advances at FVPL (note 7)	-	-	926,112	926,112
Total assets	6,472,307	-	926,112	7,398,419
Derivative financial liabilities	-	-	-	-
Financial liabilities at fair value through profit and loss	-	-	926,112	926,112
Total liabilities	-	-	926,112	926,112

6. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS (continued)

6.4. Effective Interest Rate (EIR) method

The Bank's EIR method, recognises interest income using a rate of return that represents the best estimate of a constant rate of return over the expected behavioral life of loans and deposits and recognises the effect of potentially different interest rates charged at various stages and other characteristics of the product life cycle (including prepayments and penalty interest and charges). This estimation, by nature, requires an element of judgement regarding the expected behavior and life-cycle of the instruments, as well expected changes to the Bank's base rate and other fee income/expense that are integral parts of the instrument.

6.5. Deferred tax assets

Deferred tax assets are recognised for all deductible temporary differences and tax losses carried forward to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and tax losses carried forward can be utilized. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

6.6. Provisions and other contingent liabilities

The Bank operates in a regulatory and legal environment that, by nature, has a heightened element of litigation risk inherent to its operations. As a result, it is involved in various litigation, arbitration and regulatory investigations and proceedings both in Kenya, arising in the ordinary course of the Bank's business.

When the Bank can reliably measure the outflow of economic benefits in relation to a specific case and considers such outflows to be probable, the Bank records a provision against the case. Where the probability of outflow is considered to be remote, or probable, but a reliable estimate cannot be made, a contingent liability is disclosed. However, when the Bank is of the opinion that disclosing these estimates on a case-by-case basis would prejudice their outcome, then the Bank does not include detailed, case-specific disclosers in its financial statements.

Given the subjectivity and uncertainty of determining the probability and amount of losses, the Bank takes into account a number of factors including legal advice, the stage of the matter and historical evidence from similar incidents. Significant judgement is required to conclude on these estimates.

6.7. Determination of the lease term for lease contracts with renewal and termination options (Bank as a lessee)

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

6.8. Estimating the incremental borrowing rate

The Group cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate ('IBR') to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay', which requires estimation when no observable rates are available or when they need to be adjusted to reflect the terms and conditions of the lease.

In determining the IBR to apply, the Bank considered the yield on 6-year Government securities as the most readily observable rate after assessing the lease term on all its leases to be on average 6 years. The yield is a market determined rate by providers and users of funds the best estimates what a lender would be willing to avail funding and a market participant would access funding from the market.

6.9. Impairment of non-financial assets

Impairment exists when the carrying value of an asset or cash generating unit exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions, conducted at arm's length, for similar assets or observable market prices less incremental costs of disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for the next five years and do not include restructuring activities that the Group is not yet committed to or significant future investments that will enhance the performance of the assets of the cash generating unit being tested. The recoverable amount is sensitive to the discount rate used for the DCF model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes. These estimates are most relevant to goodwill and other intangibles with indefinite useful lives recognised by the Group.

7. BUSINESS COMBINATION

There have been no business combinations entered into in the 2019 financial year. On 18th August 2018, the Bank completed the acquisition of certain assets and assumption of specific liabilities of Chase Bank (Kenya) Limited-In Receivership (CBLIR). The fair values of the identifiable assets and liabilities of CBLIR as at the date of acquisition were:

	Fair value recognised on acquisition	
	2019	2018
	KShs '000	KShs '000
ASSETS		
Cash (both local and foreign)	-	472,417
Balances due from Central Bank of Kenya	-	3,083,726
Kenya Government Securities	-	8,813,480
Corporate Bonds	-	462,001
Deposits and balances due from local banking institutions	-	13,814,262
Loans and advances to customers (net)	-	8,103,524
Fully written off loans	-	-
Islamic Loans	-	926,112
Third party properties (Properties to be transferred to the Bank)	-	-
Property and equipment	-	1,263,951
Intangible assets	-	536,567
Other Assets	-	-
- Items in transit	-	234,964
- Prepayments	-	123,720
- Guarantee deposits	-	177,413
- Sundry debtors	-	677,228
- Due from Central Bank	-	31,057,566
Total assets	-	69,746,931
LIABILITIES		
Customer deposits	-	57,122,104
Balances due to Central Bank of Kenya	-	6,013,001
Other liabilities	-	1,858,289
Total liabilities	-	64,993,394
Fair value of identifiable net assets acquired	-	4,753,537

Gain from bargain purchase arising from the combination is determined as follows:

	2019	2018
	KShs '000	KShs '000
Fair value of consideration transferred:		
Contingent consideration		
- Fully written off loans	-	-
- Islamic Loans	-	926,112
- Third party properties (Properties to be transferred to the Bank)	-	-
Less: net fair value of the identifiable net assets acquired	-	(4,753,537)
Gain from bargain purchase arising on acquisition [note 10(a)]	-	(3,827,425)

7. BUSINESS COMBINATION (CONTINUED)

Contingent consideration related to Loan portfolio measured at fair value

	2019 KShs '000	2018 KShs '000
(Financial liabilities at fair value through profit or loss)		
At beginning of the year	926,112	-
Liability arising on business combination	-	926,112
Remittances of collections	(924,675)	-
Re-evaluation of Islamic loan portfolio	1,551,374	-
At end of the year	1,552,811	926,112

The descriptions of the contingent considerations are as follows;

(a) Fully written of loans
There was certain fully impaired loan portfolio with a carrying amount of KShs 21.453 billion at the acquisition date, which the Bank acquired as part of the business combination. These were non-performing, unsecured loans without repayment history and no proper credit documentation, a proportion of which was disputed by the customers. As required by IFRS 3, Business combinations, these loans were, therefore, recognised at nil fair value at the acquisition date.
As a result, a contingent consideration, representing future cash flows related to the proceeds that may be received from any recoveries of these loans, arose. This contingent consideration is fair valued at nil, which is the same as the fair value of the related loans.

(b) Properties to be transferred to the Bank
As at the acquisition date, there were certain properties with a market value of KShs 7.31 billion in which CBLIR had interest but could not be transferred to the Group at the acquisition date. As required by IFRS 3, Business combinations, the properties were recognised at fair value determined at nil. As a result, a contingent consideration, representing future cash flows related to the proceeds that may be received from the disposal of these properties, arose. This contingent consideration is fair valued at nil, which is the same as the fair value of the related properties.

(c) Islamic Loan Portfolio
As at the acquisition date, there was certain Islamic loan portfolio which the Bank acquired as part of the business combination on transitory basis.
As required by IFRS 3 on business combinations, these loans have been recognized at KShs 1,552,811,000 (2018: KShs 926,112,000). A contingent consideration, representing future cash flows related to the proceeds that may be received from the sell down of this portfolio, arose. This contingent consideration is fair valued at KES 1,552,811,000 (2018: KShs 926,112,000), which is the same as the fair value of the related loans.

The table below shows the movement in these loans during the year:

Balances as at 31 December	2019 KShs '000	2018 KShs '000
Financial assets at fair value through profit or loss		
At beginning of the year	926,112	-
Financial assets arising on business combination	-	926,112
Remittances of collections	(924,675)	-
Re-evaluation of Islamic loan portfolio	1,551,374	-
At end of the year	1,552,811	926,112

Net cash flow on acquisition of CBLIR

	2019	2018
Consideration paid in cash	-	-
Less: Cash (both local and foreign)	-	472,417
Balances due from Central Bank of Kenya	-	3,083,726
Deposits and balances due from local banking institutions	-	13,814,262
As at 31 December	-	17,370,405

8. NET INTEREST INCOME

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Interest income:				
Loans and advances	1,483,560	789,909	1,483,560	789,909
Government securities	4,508,664	1,518,844	4,508,664	1,518,844
Money market lending	215,363	182,400	215,363	182,400
Other investment securities	61,713	27,398	61,713	27,398
	6,269,300	2,518,551	6,269,300	2,518,551
Interest expense:				
Customer deposits	(2,807,291)	(1,215,852)	(2,807,291)	(1,215,852)
Money market borrowings	(4,266)	(31,217)	(4,266)	(31,217)
Interest expense on lease liability (note 23)	(60,064)	-	(60,064)	-
Other borrowings (note 28)	(622,851)	(215,501)	(622,851)	(215,501)
	(3,494,472)	(1,462,570)	(3,494,472)	(1,462,570)
Net interest income	2,774,828	1,055,981	2,774,828	1,055,981

9. NET FEE AND COMMISSION INCOME

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Fee and commission income				
Commitment charges on loans	121,582	9,720	121,582	9,720
Processing fees on loans	805	13,703	805	13,703
Ledger fees	29,140	21,767	29,140	21,767
Card income*	72,712	29,672	72,712	29,672
Commission fees and charges	120,511	80,384	120,511	68,715
	344,750	155,246	344,750	143,577
Fee and commission expense				
Correspondent and other bank charges	(7,863)	(3,485)	(7,818)	(2,970)
Brokerage fees and commissions	(7,102)	(2,102)	(7,102)	(2,102)
	(14,965)	(5,587)	(14,920)	(5,072)
Net fee and commission	329,785	149,659	329,830	138,505

*Card income was initially disclosed as part of other operating income, consequently in 2018, an amount of KShs 29,672,000 was recognised in note 10 (b). The amount is now disclosed as part of net fees and commission income due to the nature of income.

SBM BANK (KENYA) LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDED 31 DECEMBER 2019

22. INTANGIBLE ASSETS - SOFTWARE COSTS

Cost
At start of year
Additions
Acquired from CBLIR (note 7)
Impairment

10. OTHER INCOME

	Group 2019 KShs' 000	Group 2018 KShs' 000	Bank 2019 KShs' 000	Bank 2018 KShs' 000
(a) Bargain purchase gain				
Gain from bargain purchase arising on acquisition (note 7)	-	3,827,425	-	3,827,425
Deferred tax liability on recognition of gain from bargain purchase (note 14)	-	(1,036,649)	-	(1,036,649)
	-	2,790,776	-	2,790,776
(b) Other operating income				
Gain on sale of government securities	59,440	128	59,440	128
Gain on disposal of property and equipment	9,069	-	9,069	-
Gain on contract termination of right-of-use asset (note 23)	1,547	-	1,547	-
Other miscellaneous income	45,256	50,345	43,529	50,376
	115,312	50,473	113,585	50,504
(c) Dividend income				
Dividend from investment securities	-	174	-	174

In 2018, card income of KShs 29,672,000 was disclosed in note 10(b) Other operating income. The amount has been reclassified and is now disclosed in note 9 Net fees and commissions income due to the nature of income.

Further, in 2018, a write back of impairment losses on loans and advances of KShs 568,463,000 was disclosed in note 10 (b) Other operating income. The amount has been reclassified and is now disclosed in note 13 Net impairment charge on financial assets due to the nature of the amount.

11. PERSONNEL EXPENSES

	Group 2019 KShs' 000	Group 2018 KShs' 000	Bank 2019 KShs' 000	Bank 2018 KShs' 000
Salaries and wages	1,649,113	693,466	1,647,782	692,614
Staff leave accrual	1,690	25,396	1,690	25,396
Social security and pension contributions	66,290	24,949	66,290	24,949
Staff welfare cost	20,364	1,602	20,364	1,602
Staff insurances	128,548	62,375	128,548	62,375
Performance incentive	95,023	149,187	95,023	149,187
Other staff costs*	144,106	66,672	144,106	66,672
	2,105,134	1,023,647	2,103,803	1,022,795

*Other staff costs include expenses relating to staff trainings, staff relocation costs and miscellaneous staff allowances

The average number of persons in employment during the year were:

	Bank and Group 31 December 2019	Bank and Group 31 December 2018
Management and administration	799	796

Group and Bank 2019 Total KShs' 000	2018 Total KShs' 000
536,567	327,703
38,629	1,110
-	536,567
-	(328,813)

12. OPERATING EXPENSES

(a) Operating expenses

	Group 2019	Group 2018	Bank 2019	Bank 2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Contribution to Kenya Deposit Insurance Corporation	68,663	13,042	68,663	13,042
Software licensing and other information technology cost	541,310	281,147	541,310	281,147
Auditors' fees	9,500	9,500	9,500	9,500
Professional fees	71,519	19,781	71,519	19,781
Directors' fees	8,700	8,387	8,700	8,387
Utilities	40,088	15,378	40,088	15,378
Marketing costs	90,074	28,573	90,074	28,573
Operating lease rentals (note 23)	19,515	291,456	19,515	291,456
Licence and other registration fees	28,618	39,003	28,618	38,963
Other general and administrative expenses*	563,825	285,562	563,825	269,399
	1,441,812	991,829	1,441,812	975,626

*Other general and administrative expenses mainly consist of guarding expenses, insurances, office expenses, repair and maintenance expenses, travelling expenses and accommodation costs.

(b) Depreciation and amortisation charges

	Group 2019	Group 2018	Bank 2019	Bank 2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Depreciation on property and equipment (note 21)	312,732	124,230	312,707	124,199
Amortisation of intangible assets (note 22)	266,633	144,242	266,633	144,242
Depreciation on Right-Of-Use asset (note 23)	307,194	-	307,194	-
	886,559	268,472	886,534	268,441

(c) Other (gains)/losses

	Group 2019	Group 2018	Bank 2019	Bank 2018
Write back of general provisions	(100,094)	(465,160)	(100,094)	(470,165)
Write back of amounts due to Rover Investments Limited	-	-	-	(198,322)
Impairment of investment in subsidiaries (note 20)	-	-	-	336,394
Loss on revaluation of property (note 21)	-	174,778	-	179,783
Impairment of property and equipment (note 21)	-	44,112	-	47,221
Impairment of investment property	-	126,895	-	-
Impairment of intangible assets (note 22)	-	122,640	-	122,640
	(100,094)	3,265	(100,094)	17,551

13. NET IMPAIRMENT CHARGE ON FINANCIAL ASSETS

The following table below summarises the net impairment charges recorded in the statement of comprehensive income under IFRS 9:

	Group	Bank		
	2,019	2,018	2,019	2,018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
(a) Total portfolio and specific impairment				
On-balance sheet advances	(1,837,992)	973,701	(1,837,992)	973,701
Off-balance sheet exposure	(195,344)	-	(195,344)	-
Net (decrease)/increase in impairment	(2,033,336)	973,701	(2,033,336)	973,701
(b) Direct write-offs				
Bad debts written off for which no provisions were made	-	99	-	99
(c) Net increase/(decrease) in impairment loss on financial instruments				
Total portfolio and specific impairment	(2,033,336)	973,701	(2,033,336)	973,701
Direct write offs	-	99	-	99
	(2,033,336)	973,800	(2,033,336)	973,800
Net decrease/increase in ECL impairment loss on financial instruments is made up of:				
Net (write back)/charge on loans and advances (note17)	(1,855,055)	904,182	(1,855,055)	904,182
Net (write back)/charge on government securities at amortised cost (note 18(a))	(14,269)	69,618	(14,269)	69,618
Net charge on government securities at FVOCI (note 18(c))	22,950	-	22,950	-
Net charge on corporate bonds at amortised cost (note 19)	5,246	-	5,246	-
Net charge on cash and cash equivalents (note 16)	3,136	-	3,136	-
Net write back on off statement of financial position financial instruments [note 32(b)]	(195,344)	-	(195,344)	-
	(2,033,336)	973,800	(2,033,336)	973,800

In 2018, a write back of impairment losses on loans and advances of KShs 568,463,000 was disclosed in note 10 (b) Other operating income. The amount has been reclassified and is now disclosed in note 13 Net impairment charge on financial assets due to the nature of the income.

14. TAX

(a)

Profit / (loss) before tax is arrived at after:	Group 2019 KShs' 000	Group 2018 KShs' 000	Bank 2019 KShs' 000	Bank 2018 KShs' 000
Charging:				
Depreciation on property and equipment (Note 21)	312,732	124,230	312,707	124,199
Amortisation of intangible assets (Note 22)	266,633	144,242	266,633	144,242
Depreciation on right-of-use asset	307,194	-	307,194	-
Directors' emoluments;				
- Fees as non-executives	8,700	8,387	8,700	8,387
- Other	62,213	29,136	62,213	29,136
Auditors' remuneration	9,500	9,500	9,500	9,500
Other (gains)/losses	(100,094)	3,265	(100,094)	17,551
And after crediting:				
Gain on disposal of property and equipment	9,069	-	9,069	-
Gain on right-of-use asset discontinuation	1,547	-	1,547	-

(b)

Income tax (credit)/expense	Group 2019 KShs' 000	Group 2018 KShs' 000	Bank 2019 KShs' 000	Bank 2018 KShs' 000
Current tax	654,690	-	654,592	-
Deferred tax (Note 24)				
- originating and temporary difference	(376,632)	(367,001)	(376,632)	(367,001)
- (Under)/over provision in the prior year	(1,849)	6,850	(1,849)	6,850
Tax charge/(credit)	276,209	(360,151)	276,111	(360,151)
Deferred tax on business combination				
- Bargain purchase gain	-	1,036,649	-	1,036,649

14. TAX (CONTINUED)

(b) Income tax (credit)/expense (continued)

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

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Profit/ (loss) before tax	1,180,311	964,054	1,179,985	955,731
Tax calculated at a rate of 30% (2018: 30%)	354,094	289,216	353,996	286,719
Deferred tax on business combination	-	(1,036,649)	-	(1,036,649)
Expenses not deductible for tax purposes*	21,667	380,432	21,667	382,929
Incomes not allowable for tax purposes**	(97,703)	-	(97,703)	-
(Under)/over provision of deferred tax in prior year	(1,849)	6,850	(1,849)	6,850
Tax charge/(credit)	276,209	(360,151)	276,111	(360,151)

*The expenses include depreciation of non-qualifying assets, fringe benefit tax and pension
** The incomes include infrastructure bonds income and revaluation on bonds

(c) Tax (payable)/recoverable

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At 1 January	62,783	59,695	60,108	60,108
Paid during the year	-	3,088	-	-
Charge for the year	(654,690)	-	(654,592)	-
At 31 December	(591,907)	62,783	(594,484)	60,108

15. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit/(loss) attributable to the shareholders by the weighted average number of shares outstanding during the year.

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Profit for the year attributable to shareholders (KShs'000)	904,102	1,324,205	903,874	1,315,882
Weighted average number of ordinary shares in issue (thousands)	51,703,007	51,703,007	51,703,007	51,703,007
Earnings per share:				
- Basic and diluted (KShs)	0.02	0.03	0.02	0.03

There were no dilutive potential ordinary shares outstanding at 31 December 2019 (2018: nil).

16. CASH AND CASH EQUIVALENTS

(a) Cash and bank balances with Central Bank and other banking institutions:

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cash in hand	685,359	1,004,959	685,359	1,004,959
Foreign currency notes and coins	592,993	1,328,864	592,993	1,328,864
Balances with Central Bank of Kenya:				
Restricted balances (cash reserve ratio)	2,518,149	2,535,662	2,518,149	2,535,662
Unrestricted balances with central bank [1]	451,847	2,984,758	451,847	2,984,758
Balances with banks	1,456,311	283,576	1,456,311	283,576
	5,704,659	8,137,819	5,704,659	8,137,819

[1] Unrestricted balances with central banks represent amounts above the minimum cash reserve requirement. As at 31 December 2019, the cash reserve ratio requirement was 5.25% (2018 - 5.25%) of all customer deposits.

(b) Placements with other banking institutions:

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Loans to and placements with other banks [2]				
- in Kenya	2,765,962	2,080,139	2,765,962	2,080,139
- outside Kenya	354,725	944,285	354,725	944,285
	3,120,687	3,024,424	3,120,687	3,024,424

[2] The balances above relate to loans and placements with banks having an original maturity of up to three months.

16. CASH AND CASH EQUIVALENTS (continued)

(c) ECL impairment on cash and cash equivalents (continued)

GROUP AND BANK

	Stage 1 KShs' 000	Stage 2 KShs' 000	Stage 3 KShs' 000	Total KShs' 000
1 January 2019	-	-	-	-
New assets originated or purchased	-	-	-	-
Payments and assets derecognised	-	-	-	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Remeasurement of year end ECL	260	2,876		3,136
	260	2,876	-	3,136

17. LOANS AND ADVANCES TO CUSTOMERS

(a) Loans and advances - Pillars

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Corporate	10,342,977	9,580,623	10,343,040	9,583,926
SME	9,064,272	8,064,820	9,064,272	8,064,820
Retail	6,119,728	6,479,240	6,119,728	6,479,240
	25,526,977	24,124,683	25,527,040	24,127,986
Less: allowances for impairment losses	(10,063,395)	(11,918,450)	(10,063,395)	(11,918,450)
	15,463,582	12,206,233	15,463,645	12,209,536

In 2018, an amount of KShs 1,016,081,000 relating to interest in suspense as per CBK was included in the Gross loan balance and in the allowances for impairment losses. This amount has now been netted off so as to comply with the requirements of IFRS 9 Financial Instruments

17. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(b) Credit quality and exposure

The table below shows the credit quality and the maximum exposure to credit risk based on the Bank's internal credit rating system and year-end stage classification. The amounts presented are gross of allowance for ECL. Details of the Bank's internal grading system are explained in Note 5.2. and the Bank's impairment assessment and measurement approach also set out in Note 5.2.

GROUP

31December 2019	KShs '000	KShs '000	KShs '000	KShs '000
Internal rating grade:	Stage 1	Stage 2	Stage 3	Total
Performing				
Grade 1 - Normal risk	10,381,432	-	662,514	11,043,946
Grade 2 - Watch risk	-	666,202	-	666,202
Non-performing		-	-	
Grade 3 - Substandard risk	-	8,090	173,303	181,393
Grade 4 - Doubtful risk	-	95,049	533,259	628,308
Grade 5 - Loss	-	361,096	12,646,032	13,007,128
	10,381,432	1,130,437	14,015,108	25,526,977
31 December 2018				
Internal rating grade				
Performing				
Grade 1 - Normal risk	7,104,849	-	-	7,104,849
Grade 2 - Watch risk	-	1,728,327	-	1,728,327
Non-performing				
Grade 3 - Substandard risk	-	-	744,106	744,106
Grade 4 - Doubtful risk	-	-	544,207	544,207
Grade 5 - Loss	-	-	14,003,194	14,003,194
	7,104,849	1,728,327	15,291,507	24,124,683

BANK

31 December 2019				
	KShs '000	KShs '000	KShs '000	KShs '000
Internal rating grade	Stage 1	Stage 2	Stage 3	Total
Performing				
Grade 1 - Normal risk	10,381,495	-	662,514	11,044,009
Grade 2 - Watch risk	-	666,202	-	666,202
Non-performing				
Grade 3 - Substandard risk	-	8,090	173,303	181,393
Grade 4 - Doubtful risk	-	95,049	533,259	628,308
Grade 5 - Loss	-	361,096	12,646,032	13,007,128
	10,381,495	1,130,437	14,015,108	25,527,040
31 December 2018				
Internal rating grade				
Performing				
Grade 1 - Normal risk	7,104,849	-	-	7,104,849
Grade 2 - Watch risk	-	1,728,327	-	1,728,327
Non-performing				
Grade 3 - Substandard risk	-	-	744,106	744,106
Grade 4 - Doubtful risk	-	-	544,207	544,207
Grade 5 - Loss	-	-	14,006,497	14,006,497
	7,104,849	1,728,327	15,294,810	24,127,986

17. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

(c) Changes in gross carrying amount

A reconciliation for changes in the gross carrying amount of the loan book is as follows:

GROUP

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
As at 1 January 2019	7,104,849	1,728,327	15,291,507	24,124,683
New assets originated or purchased	5,384,849	127,458	1,285,450	6,797,757
Payments and assets derecognised	(2,017,242)	(899,001)	(2,437,290)	(5,353,533)
Transfers to Stage 1	1,260,544	(372,612)	(887,932)	-
Transfers to Stage 2	(828,916)	957,476	(128,560)	-
Transfers to Stage 3	(522,590)	(411,210)	933,800	-
Amounts written off	-	-	(41,930)	(41,930)
As at 31 December 2019	10,381,494	1,130,438	14,015,045	25,526,977

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
As at 1 January 2018	1,381,725	1,431,084	3,912,503	6,725,312
New assets originated or purchased	9,145,702	901,498	9,323,289	19,370,489
Payments and assets derecognised	-	-	-	-
Transfers to Stage 1	(3,545,453)	222,293	3,323,160	-
Transfers to Stage 2	122,875	(867,516)	744,641	-
Transfers to Stage 3	-	40,968	(40,968)	-
Effect of modifications	-	-	-	-
Amounts written off	-	-	(1,971,118)	(1,971,118)
As at 31 December 2018	7,104,849	1,728,327	15,291,507	24,124,683

17. LOANS AND ADVANCES TO CUSTOMERS (continued)

(c) Changes in gross carrying amount (continued)

BANK

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
1 January 2019	7,104,849	1,728,327	15,294,811	24,127,987
New assets originated or purchased	5,384,849	127,458	1,285,450	6,797,757
Payments and assets derecognised	(2,017,242)	(899,001)	(2,440,531)	(5,356,774)
Transfers to Stage 1	1,260,544	(372,612)	(887,932)	-
Transfers to Stage 2	(828,916)	957,476	(128,560)	-
Transfers to Stage 3	(522,590)	(411,210)	933,800	-
Amounts written off	-	-	(41,930)	(41,930)
As at 31 December 2019	10,381,494	1,130,438	14,015,108	25,527,040

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
1 January 2018	1,381,725	1,431,084	3,917,214	6,730,023
New assets originated or purchased	9,145,702	901,498	9,321,881	19,369,081
Payments and assets derecognised	-	-	-	-
Transfers to Stage 1	(3,545,453)	222,293	3,323,160	-
Transfers to Stage 2	122,875	(867,516)	744,641	-
Transfers to Stage 3	-	40,968	(40,968)	-
Effect of modifications	-	-	-	-
Amounts written off	-	-	(1,971,118)	(1,971,118)
As at 31 December 2018	7,104,849	1,728,327	15,294,810	24,127,986

17. LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Changes in ECL provisions

A reconciliation of changes in ECL provision for the loan book is as follows:

Group

Group

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
As at 1 January 2019	111,730	287,119	11,519,601	11,918,450
New assets originated or purchased	121,476	13,968	155,129	290,573
Payments and assets derecognised	(35,672)	(16,137)	(1,188,237)	(1,240,046)
Transfers to Stage 1	455,243	(37,887)	(417,356)	-
Transfers to Stage 2	(5,967)	174,002	(168,035)	-
Transfers to Stage 3	(28,650)	(7,428)	36,078	-
Impact on ECL of transfers	(1,044,296)	(329,892)	334,652	(1,039,536)
Remeasurement of year end ECL	(16,459)	(17,547)	(27,238)	(61,244)
Stage 3 interest	-	-	315,394	315,394
Changes to assumptions	664,680	144,500	(919,042)	(109,862)
Amounts written off	-	-	(10,334)	(10,334)
As at 31 December 2019	222,085	210,698	9,630,612	10,063,395
As at 1 January 2018	29,907	32,437	2,805,427	2,867,771
New assets originated or purchased	98,015	253,393	10,670,390	11,021,798
Assets derecognised or repaid (excluding write offs)	-	-	-	-
Transfers to Stage 1	(19,930)	9,386	10,544	-
Transfers to Stage 2	3,738	(20,373)	16,635	-
Transfers to Stage 3	-	12,276	(12,276)	-
Impact on year end ECL of exposures transferred between stages during the year	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Changes to models and inputs used for ECL calculations	-	-	-	-
Amounts written off	-	-	(1,971,119)	(1,971,119)
As at 31 December 2018	111,730	287,119	11,519,601	11,918,450

The net ECL on loans and advances written back to the income statement during the year is KShs 1,855,055,000 (2018: Net charge of KShs 973,800,000).

17. LOANS AND ADVANCES TO CUSTOMERS (continued)

(d) Changes in ECL provisions (continued)

A reconciliation of changes in ECL provision for the loan book is as follows:

Bank

	KShs '000 Stage 1	KShs '000 Stage 2	KShs '000 Stage 3	KShs '000 Total
As at 1 January 2019	111,730	287,119	11,519,601	11,918,450
New assets originated or purchased	121,476	13,968	155,129	290,573
Payments and assets derecognised	(35,672)	(16,137)	(1,188,237)	(1,240,046)
Transfers to Stage 1	455,243	(37,887)	(417,356)	-
Transfers to Stage 2	(5,967)	174,002	(168,035)	-
Transfers to Stage 3	(28,650)	(7,428)	36,078	-
Impact on ECL of transfers	(1,044,296)	(329,892)	334,652	(1,039,536)
Remeasurement of year end ECL	(16,459)	(17,547)	(27,238)	(61,244)
Stage 3 interest income	-	-	315,394	315,394
Changes to assumptions	664,680	144,500	(919,042)	(109,862)
Amounts written off	-	-	(10,334)	(10,334)
As at 31 December 2019	222,085	210,698	9,630,612	10,063,395
As at 1 January 2018	29,907	32,437	2,805,427	2,867,771
New assets originated or purchased	98,015	253,393	10,670,390	11,021,798
Assets derecognised or repaid (excluding write offs)	-	-	-	-
Transfers to Stage 1	(19,930)	9,386	10,544	-
Transfers to Stage 2	3,738	(20,373)	16,635	-
Transfers to Stage 3	-	12,276	(12,276)	-
Impact on year end ECL of exposures transferred between stages during the year	-	-	-	-
Changes to contractual cash flows due to modifications not resulting in derecognition	-	-	-	-
Changes to models and inputs used for ECL calculations	-	-	-	-
Amounts written off	-	-	(1,971,119)	(1,971,119)
As at 31 December 2018	111,730	287,119	11,519,601	11,918,450

18. GOVERNMENT SECURITIES

The Government securities held are classified as follows:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Government securities measured at amortised cost:	15,385,838	36,869,177	15,385,838	36,869,177
Government securities mandatorily measured at fair value through profit or loss (FVPL)	301,538	714,935	301,538	714,935
Government securities measured at fair value through other comprehensive income (FVOCI)	27,133,666	5,755,259	27,133,666	5,755,259
	42,821,042	43,339,371	42,821,042	43,339,371

Net ECL provisions charged to the income statement for all government securities was KShs 8,681,000 (2018: KShs 69,618,000) detailed as below;

- Write back of KShs 14,269,000 (2018: charge of KShs 69,618,000) on government securities held at amortised cost.
- Charge of KShs 22,950,000 (2018: NIL) on government securities held at FVOCI

The tables below show movements in both carrying amounts and ECL provisions under each category of government securities;

(a) Government securities measured at amortised cost:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Treasury bills	-	25,788,486	-	25,788,486
Treasury bonds	15,385,838	11,080,691	15,385,838	11,080,691
	15,385,838	36,869,177	15,385,838	36,869,177

The table below shows movement in government securities measured at amortised cost during the year.

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At start of the year	36,869,177	2,882,958	36,869,177	2,882,958
Acquired from CBLIR (note 7)	-	8,813,480	-	8,813,480
Purchases	6,047,691	25,184,741	6,047,691	25,184,741
Maturities	(27,344,984)	(608,480)	(27,344,984)	(608,480)
Movement in accrued interest	(186,735)	(51,933)	(186,735)	(51,933)
Amortisation of discounts and premiums	(13,580)	718,029	(13,580)	718,029
ECL impairment gain/(loss)	14,269	(69,618)	14,269	(69,618)
	15,385,838	36,869,177	15,385,838	36,869,177

18. GOVERNMENT SECURITIES (CONTINUED)

(a) Government securities measured at amortised cost (continued)

The table below shows movement in ECL provisions on government securities measured amortized cost during the year.

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At 1 January	106,959	-	106,959	-
New assets originated or purchased	1,401	37,341	1,401	37,341
Payments and assets derecognised	(2,115)	-	(2,115)	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Remeasurement of year end ECL	(13,555)	69,618	(13,555)	69,618
At 31 December	92,690	106,959	92,690	106,959

Total income statement write back of ECL on government securities measured at amortized cost was KShs 14,269,000 (2018: Net charge of KShs 69,618,000). All government securities held were classified under Stage 1.

(b) Government securities mandatorily measured at fair value through profit or loss (FVPL)

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Treasury bills	-	-	-	-
Treasury bonds	301,538	714,935	301,538	714,935
	301,538	714,935	301,538	714,935

The table below shows movement in government securities measured at FVPL during the year.

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At start of the year	714,935	-	714,935	-
Purchases	299,949	701,556	299,949	701,556
Maturities/Sales	(714,935)	-	(714,935)	-
Movement in accrued interest	1,515	13,417	1,515	13,417
Amortisation of discounts and premiums	74	(38)	74	(38)
	301,538	714,935	301,538	714,935

18. GOVERNMENT SECURITIES (CONTINUED)

(c) Government securities measured at fair value through other comprehensive income (FVOCI)

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Treasury bills	4,677,490	-	4,677,490	-
Treasury bonds	22,456,176	5,755,259	22,456,176	5,755,259
	27,133,666	5,755,259	27,133,666	5,755,259

The table below shows movement in government securities measured at FVOCI during the year.

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At start of the year	5,755,259	-	5,755,259	-
Purchases	21,008,991	6,157,849	21,008,991	6,157,849
Maturities	-	(518,987)	-	(518,987)
Movement in accrued interest	322,556	145,980	322,556	145,980
Amortisation of discounts and premiums	34,015	(14,880)	34,015	(14,880)
Fair valuation	35,795	(14,703)	35,795	(14,703)
Impairment loss	(22,950)	-	(22,950)	-
	27,133,666	5,755,259	27,133,666	5,755,259

The table below shows movement in the ECL provisions on government securities measured at FVOCI:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
1 January	-	-	-	-
New assets originated or purchased	-	-	-	-
Payments and assets derecognised	-	-	-	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Remeasurement of year end ECL	22,950		22,950	-
	22,950	-	22,950	-

Total income statement charge for ECL on government securities measured at FVOCI was KShs 22,950,000 (2018: NIL). There were no government securities measured at FVOCI classified under stages 2 and 3

Government securities amounting to KShs 7.730 billion were held under lien as at 31 December 2019 (2018: KShs 6.879 billion). Refer to note 33 for further details.

The fair value of the government securities measured at fair value through profit or loss are under the Level 1 class of fair value based on the information set out in accounting policy 3.5 on determination of fair value.

The fair value of the government securities measured at fair value through other comprehensive income are under the Level 1 class of fair value based on the information set out in accounting policy 3.5 on determination of fair value

The fair value of the treasury bonds in government securities measured at amortised cost of KShs 15,385,838,000 as at 31 December 2019 was KShs 15,455,225,000 (2018: KShs. 10,340,224,000). These are under the Level 1 class of fair value.

19. INVESTMENT SECURITIES

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Investment securities measured at amortized cost				
Corporate bonds (amortized cost)	295,140	299,513	295,140	299,513
Investment securities designated at FVPL				
Equity investments	2,467	2,164	2,416	2,113
Total investment in securities	297,607	301,677	297,556	301,626

a) Movement in corporate bonds classified as investment securities measured at amortised cost during the year is as follows:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At start of the year	299,513	-	299,513	-
Acquired from CBLIR (note 7)	-	462,001	-	462,001
Purchases	-	-	-	-
Maturities	-	(164,150)	-	(164,150)
Movement in accrued interest	873	(6,546)	873	(6,546)
Impairment loss/(gain)	(5,246)	8,208	(5,246)	8,208
At end of year	295,140	299,513	295,140	299,513

The table below summarizes movement in ECL provision on corporate bonds measured at amortised cost during the year:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
1 January 2019	181,942	-	181,942	-
New assets originated or purchased	-	190,150	-	190,150
Payments and assets derecognised	-	-	-	-
Transfers to Stage 1	-	-	-	-
Transfers to Stage 2	-	-	-	-
Transfers to Stage 3	-	-	-	-
Remeasurement of year end ECL	5,246	(8,208)	5,246	(8,208)
At 31 December 2019	187,188	181,942	187,188	181,942

Total income statement charge for ECL on investment securities measured at FVOCI was KShs 5,246,000 (2018: KShs 8,208,000 credit). All corporate bonds measured at amortised cost were classified under stage 1.

b) Movement in investment securities at FVPL during the year which are made up of quoted equity investments were as follows

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
At start of year	2,164	3,573	2,113	3,491
Additions	-	-	-	-
Fair value gain/(loss) recognized in profit or loss	303	(1,409)	303	(1,378)
At end of year	2,467	2,164	2,416	2,113

The fair values of the quoted equity instruments are under the Level 1 class of fair value based on the information set out in note 3.5 on determination of fair value and on note 6.3.

20. INVESTMENT IN SUBSIDIARIES

		31 December 2019	31 December 2018
		KShs' 000	KShs' 000
Company	% held		
Kentbury Investments Limited (Trading)	100%	-	17,587
Finsure Insurance Brokers Limited (Insurance brokerage)	100%	-	10,025
Richardson Properties Limited (Real estate investment)	100%	-	121,340
Rover Investments Limited (Real estate investment)	100%	-	187,442
		-	336,394
Less: impairment loss*		-	(336,394)
		-	-

*The investment in subsidiaries were impaired in 2018. In impairing the investment in subsidiaries, management considered the fact that the companies are currently dormant and are not expected to generate any revenues. Management is considering liquidating the companies.

21. PROPERTY AND EQUIPMENT

GROUP

Year ended 31 December 2019

	Buildings	Computers copiers and faxes	Motor vehicles	Furniture and Fittings	Office equipment	Work -in- process	Total
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cost or Valuation							
At start of the year	237,448	109,747	77,608	862,277	402,431	202,560	1,892,071
Additions	-	806	-	174,220	59,051	(172,943)	61,134
Disposals/write offs	-	-	(10,368)	-	-	-	(10,368)
Reclassification to ROU asset (note 23)	(35,000)	-	-	-	-	-	(35,000)
At end of the year	202,448	110,553	67,240	1,036,497	461,482	29,617	1,907,837
Depreciation							
At start of the year	2,448	103,319	22,127	196,493	101,352	-	425,739
Charge for the year	25,001	5,040	17,421	186,154	79,116	-	312,732
Elimination on Disposal/write off	-	-	(8,694)	-	-	-	(8,694)
Reclassification to ROU asset (note 23)	(365)	-	-	-	-	-	(365)
At end of the year	27,084	108,359	30,854	382,647	180,468	-	729,412
Net carrying amount	175,364	2,194	36,386	653,850	281,014	29,617	1,178,425

There were no commitments to acquire property, plant and equipment as at year end (2018: none)
Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

21. PROPERTY AND EQUIPMENT

GROUP

Year ended 31 Decmber 2018

	Leasehold land	Leasehold land and buildings	Office renovations	Computers copiers and faxes	Motor vehicles	Furniture and fittings	Office equipment	Work -in- process	Total
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cost or Valuation									
At start of the year	22,690	146,636	174,893	100,539	16,855	26,925	93,098	-	581,636
Additions	-	-	-	1,080	-	54,151	21,871	(23,659)	53,443
Acquired from CBLIR (note 7)	-	-	-	10,327	60,753	662,834	303,818	226,219	1,263,951
Reclassification from investment property*		313,148		-	-	-	-	-	313,148
Reclassification between assets' classes	(22,690)	22,690	(174,893)			174,893			-
Loss on revaluation**	-	(237,409)	-	-	-	-	-	-	(237,409)
Transfer**	-	(7,617)	-	-	-	-	-	-	(7,617)
Impairment***	-	-	-	(2,199)	-	(56,526)	(16,356)	-	(75,081)
At end of the year	-	237,448	-	109,747	77,608	862,277	402,431	202,560	1,892,071
Depreciation									
At start of the year	918	6,699	125,078	93,255	13,567	19,920	80,658	-	340,095
Charge for the year	-	2,448	-	10,064	8,560	71,415	31,743	-	124,230
Reclassification	(918)	918	(125,078)	-	-	125,078	-	-	-
Transfer**		(7,617)							(7,617)
Impairment****	-	-	-	-	-	(19,920)	(11,049)	-	(30,969)
At end of the year	-	2,448	-	103,319	22,127	196,493	101,352	-	425,739
Net carrying amount	-	235,000	-	6,428	55,481	665,784	301,079	202,560	1,466,332

21. PROPERTY AND EQUIPMENT

GROUP

Year ended 31 Decmber 2018

* Reclassifications in 2018 includes an amount of KShs 313,148,000 from investment property transferred to property and equipment, as there was a change in use evidenced by increase in owner-occupation of the building. As at 31 December 2019 the portion rented out is insignificant.

** In 2018, the leasehold land and building was revalued to KShs 235,000,000. This resulted in a loss on revaluation of KShs 174,778,000 (note 12) after offsetting an existing surplus of KShs 62,631,000 in the asset revaluation surplus. Valuation of the property was done by Ardhiworth (Real Estate) Limited on 16 November 2018.

*** This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

**** In 2018 an impairment loss of KShs 44,112,000 represented the write down of certain property and equipment as a result of closure of several branches. The cost of the written down assets was KShs 75,081,000 with an accumulated depreciation of KShs 30,969,000.

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

21. PROPERTY AND EQUIPMENT (continued)

BANK

Year ended 31 December 2019

	Buildings	Computers copiers and faxes	Motor vehicles	Furniture and fittings	Office equipment	Work -in- process	Total
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cost or Valuation							
At start of the year	235,000	109,390	77,608	861,670	402,431	202,560	1,888,659
Additions	-	806	-	174,220	59,051	(172,943)	61,134
Disposals/write offs		-	(10,368)	-	-	-	(10,368)
Reclassification to ROU asset (note 23)	(35,000)	-	-	-	-	-	(35,000)
At end of the year	200,000	110,196	67,240	1,035,890	461,482	29,617	1,904,425
Depreciation							
At start of the year	2,448	102,987	22,102	196,462	104,057	-	428,056
Charge for the year	25,001	5,040	17,421	186,135	79,110	-	312,707
Elimination on Disposal/write off		-	(8,694)	-	-	-	(8,694)
Reclassification to ROU asset (note 23)	(365)	-	-	-	-	-	(365)
At end of the year	27,084	108,027	30,829	382,597	183,167	-	731,704
Net carrying amount	172,916	2,169	36,411	653,293	278,315	29,617	1,172,721

There were no commitments to acquire property, plant and equipment as at year end (2018: none)

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

21. PROPERTY AND EQUIPMENT (continued)

BANK

Year ended 31 December 2018

	Leasehold land	Leasehold land and buildings	Office renovations	Computers copiers and faxes	Motor vehicles	Furniture and fittings	Office equipment	Work -in- process	Total
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cost or Valuation									
At start of the year	22,690	146,636	174,893	100,182	16,855	26,318	93,098	-	580,672
Additions	-	-	-	1,080	-	54,151	21,871	(23,659)	53,443
Acquired from CBLIR	-	-	-	10,327	60,753	662,834	303,818	226,219	1,263,951
Reclassification from investment property	-	313,148	-	-	-	-	-	-	313,148
Reclassification between assets' classes	(22,690)	22,690	(174,893)	-	-	174,893	-	-	-
Loss on revaluation*	-	(239,857)	-	-	-	-	-	-	(239,857)
Transfer**	-	(7,617)	-	-	-	-	-	-	(7,617)
Impairment***	-	-	-	(2,199)	-	(56,526)	(16,356)	-	(75,081)
At end of the year	-	235,000	-	109,390	77,608	861,670	402,431	202,560	1,888,659
Depreciation									
At start of the year	918	6,699	125,078	92,923	13,542	19,682	80,491	-	339,333
Charge for the year	-	2,448	-	10,064	8,560	71,384	31,743	-	124,199
Reclassification	(918)	918	(125,078)	-	-	125,078	-	-	-
Transfer**	-	(7,617)	-	-	-	-	-	-	(7,617)
Impairment***	-	-	-	-	-	(19,682)	(8,177)	-	(27,859)
At end of the year	-	2,448	-	102,987	22,102	196,462	104,057	-	428,056
Net carrying amount	-	232,552	-	6,403	55,506	665,208	298,374	202,560	1,460,603

There were no commitments to acquire property, plant and equipment as at year end (2018: none)

21. PROPERTY AND EQUIPMENT (continued)

BANK

Year ended 31 December 2018

* Reclassifications in 2018 includes an amount of KShs 313,148,000 from investment property transferred to property and equipment, as there was a change in use evidenced by increase in owner-occupation of the building. As at 31 December 2019 the portion rented out is insignificant.

** In 2018, the leasehold land and building was revalued to KShs 235,000,000. This resulted in a loss on revaluation of KShs 179,783,000 (note 12) after offsetting an existing surplus of KShs 60,074,000 in the asset revaluation surplus. Valuation of the property was done by Ardhiworth (Real Estate) Limited on 16 November 2018.

*** This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

**** In 2018 an impairment loss of KShs 47,221,000 represented the write down of certain property and equipment as a result of closure of several branches. The cost of the written down assets was KShs 75,081,000 with an accumulated depreciation of KShs 27,859,000.

Leasehold land and building LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way have been pledged as security to Central Bank of Kenya for amounts borrowed under the liquidity support framework as disclosed in Note 28.

Leasehold land and buildings are carried at cost. In 2018, following a change in use as evidenced by increase in owner-occupation, investment property of KShs 313,148 was reclassified to property and equipment.

329,785	149,659	329,830	138,505

Management and administration

other operating ... in 2018 ... KShs 29,672,000 ... disclosed as part of the fees and commission ... due to the nature of income.

22. INTANGIBLE ASSETS - SOFTWARE COSTS

	Group and Bank 2019 Total KShs' 000	2018 Total KShs' 000
Cost		
At start of year	536,567	327,703
Additions	38,629	1,110
90 Acquired from CBLIR (note 7)	-	536,567
Impairment	-	(328,813)
At end of year	575,196	536,567
Amortisation		
At start of year	105,178	167,109
Charge for the year	266,633	144,242
Impairment	-	(206,173)
At end of year	371,811	105,178
Net carrying amount	203,385	431,389

23. LEASES

Group as a lessee

The Group has lease contracts for various properties used as office space for its branches and head office. Leases of property generally have lease terms of between 4 and 6 years. The Group’s obligations under its leases are secured by the lessor’s title to the leased assets. Generally, the Group is restricted from assigning and subleasing the leased assets.

The group also has certain assets of low value. The group applies the low-value assets’ recognition exemptions for these leases.
As at 1 January 2019, right-of-use asset of KShs 771,546,000 was recognized equal to the present value of remaining lease payments discounted using the incremental borrowing rate as disclosed in Note 3.23.2 and Note 4.1.

Set out below are the carrying amounts of right-of-use assets recognised and the movements during the period:

GROUP AND BANK

	Buildings KShs '000
Carrying amount as at 1 January 2019	771,546
Reclassification from property and equipment (leasehold land)	34,635
Additions	244,548
Depreciation charge for the year	(307,194)
Discontinuations	(23,328)
Carrying amount as at 31 December 2019	720,207

23. LEASES (CONTINUED)

Set out below are the carrying amounts of lease liabilities (included under 'Other liabilities' in Note 29) and the movements during the period:

	KShs '000
As at 1 January – effect of adoption of IFRS 16	771,546
Additions	244,548
Disposals	(24,875)
Accretion of interest	60,064
Payments	(322,694)
At 31 December 2019	728,589
Current	80,188
Non-current	648,401
	728,589

The maturity analysis of lease liabilities is disclosed in note 5.3.3.

The following are the amounts recognised in profit or loss:

	KShs '000
Depreciation expense of right-of-use assets	307,194
Interest expense on lease liabilities	60,064
Expense relating to leases of low-value assets	19,515
Gain on contract termination of right-of-use asset [note 12(a)]	(1,547)
Total amount recognised in profit or loss	385,226

The Group had total cash outflows for leases of KShs 342,209,000 (total payments of KShs 322,694, 000 and KShs 19,515,000 relating to leases of low value) in 2019. The initial application of IFRS 16 resulted in noncash additions to right-of-use assets and lease liabilities of KShs 771,546,000 at 1 January 2019.

Prior to 1 January 2019, the group leased bank premises on which KShs 291,456,000 was charged to profit or loss in 2018. Commitments relating to future rent payable for the premises based in the contracts and projected renewals were as follows;

	31 December 2018*
	KShs' 000
Maturing within one year	36,878
Maturing over one to five years	450,499
Maturing in over 5 years	329,838
	817,215

*As at 31 December 2018, the total operating lease commitments was disclosed as KShs 704,279,000. This has now been restated to KShs 817,215,000. The difference of KShs 112,936,000 is an understatement due to escalation clauses that had been captured in the identified leases.

23. LEASES (CONTINUED)

Group as a lessor

The Group has entered into operating leases on its building. These leases have terms of between one and five years. All leases include a clause to enable upward revision of the rental charge on an annual basis according to prevailing market conditions.

Rental income recognised by the Group during the year is KShs 8,042,000 (2018: KShs 7,266,000).

Future minimum rentals receivable under non-cancellable operating leases as at 31 December are as follows:

	31 December 2019	31 December 2018
	KShs' 000	KShs' 000
Maturing within one year	5,269	5,278
Maturing over one to five years	13,568	21,110
	18,837	26,388

24. DEFERRED TAX

Deferred tax is calculated on all temporary differences under the liability method using a principal tax rate of 30% (2018: 30%). The deferred tax asset and deferred tax charge/(credit) in profit or loss are attributable to the following:

Group 2019:	1 January 2019	Prior year provisions (under) / over	Bargain purchase gain	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2019
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Arising from:		*(Note 14)*	*(Note 14)*	*(Note 14)*		
Fair value losses	(7,243)	-	-	-	-	(7,243)
Leave pay provision	(7,436)	-	-	(5,942)	-	(13,378)
Bonus provision	-	-	-	(40,746)	-	(40,746)
Other general provisions	(603,287)	-	-	(630,964)	-	(1,234,251)
Unrealised exchange loss	30,616	-	-	(41,160)	-	(10,544)
Deferred tax on bargain purchase	1,036,649	-	-	-	-	1,036,649
Tax losses carried forward	(445,795)	-	-	445,746	-	(49)
Excess capital allowance over depreciation	(3,083)	-	-	(103,566)	-	(106,649)
(Under)/over provision of deferred tax in prior year	-	(1,849)	-	-	-	(1,849)
Net deferred tax liability/(asset)	421	(1,849)	-	(376,632)	-	(378,060)

24. DEFERRED TAX ASSET (CONTINUED)

Group 2018:	1 January 2018	Prior year provisions (under) / over	Bargain purchase gain	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2018
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Arising from:		*(Note 14)*	*(Note 14)*	*(Note 14)*		
Fair value losses	(7,243)	-	-	-	-	(7,243)
Leave pay provision	(2,904)	-	-	(4,532)	-	(7,436)
Other general provisions	(435,682)	-	-	(167,577)	-	(603,287)
Unrealised exchange loss	(556)	6,850	-	24,322	-	30,616
Deferred tax on bargain purchase	-	-	1,036,649	-	-	1,036,649
Tax losses carried forward	(260,364)	-	-	(185,431)	-	(445,795)
Excess capital allowance over depreciation	30,700	-	-	(33,783)	-	(3,083)
Net deferred tax (asset)/liability	(676,049)	6,850	1,036,649	(367,001)	-	421

24. DEFERRED TAX ASSET (continued)

BANK 2019	1 January 2019	Prior year provisions (under) /over	Bargain purchase gain	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2019
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Arising from:		*(Note 14)*	*(Note 14)*	*(Note 14)*		
Fair value losses	(7,243)	-	-	-	-	(7,243)
Leave pay provision	(7,436)	-	-	(5,942)	-	(13,378)
Bonus provision	-	-	-	(40,746)	-	(40,746)
Other general provisions	(603,259)	-	-	(630,964)	-	(1,234,223)
Unrealised exchange loss	30,616	-	-	(41,160)	-	(10,544)
Deferred tax on bargain purchase	1,036,649	-	-	-	-	1,036,649
Tax losses carried forward	(444,767)	-	-	445,746	-	979
Excess capital allowance over depreciation	(3,161)	-	-	(103,566)	-	(106,727)
(Under)/over provision of deferred tax in prior year	-	(1,849)	-	-	-	(1,849)
Net deferred tax liability/(asset)	1,399	(1,849)	-	(376,632)	-	(377,082)

24. DEFERRED TAX ASSET (continued)

BANK 2018:	1 January 2018	Prior year provisions (under) / over	Bargain purchase gain	Recognised in profit or loss	Recognised in other comprehensive income	31 December 2018
	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Arising from:		*(Note 14)*	*(Note 14)*	*(Note 14)*		
Fair value losses	(7,243)	-	-	-	-	(7,243)
Leave pay provision	(2,904)	-	-	(4,532)	-	(7,436)
Other general provisions	(435,682)	-	-	(167,577)	-	(603,259)
Unrealised exchange loss	(556)	6,850	-	24,322	-	30,616
Deferred tax on bargain purchase	-	-	1,036,649	-	-	1,036,649
Tax losses carried forward	(259,336)	-	-	(185,431)	-	(444,767)
Excess capital allowance over depreciation	30,622	-	-	(33,783)	-	(3,161)
Net deferred tax (asset)/liability	(675,099)	6,850	1,036,649	(367,001)	-	1,399

25. OTHER ASSETS

Other assets and other receivables that have fixed or determinable payments and that are not quoted in an active market are measured at amortised cost less any impairment loss.

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Deposits and prepayments	475,470	320,323	474,299	320,323
Other receivables	611,262	437,599	611,262	436,428
	1,086,732	757,922	1,085,561	756,751

26. DEPOSITS FROM BANKS

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Bank current and demand accounts	11,515	-	11,515	-

27. CUSTOMER'S DEPOSITS

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Current and demand accounts	6,789,607	6,993,466	6,804,834	7,008,935
Savings accounts	2,285,242	3,625,995	2,285,242	3,625,995
Call deposits	1,175,911	197,733	1,175,911	197,733
Term deposits	32,455,432	33,433,444	32,455,432	33,433,444
Foreign currency deposits	7,839,916	6,777,813	7,839,916	6,777,813
	50,546,108	51,028,451	50,561,335	51,043,920

Analysis of the Group and Bank's customer deposits by maturity:

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Payable within 90 days	27,018,841	21,614,570	27,034,068	21,630,039
Payable after 90 days and within 1 year	14,861,335	11,364,998	14,861,335	11,364,998
Payable after 1 year	8,665,932	18,048,883	8,665,932	18,048,883
	50,546,108	51,028,451	50,561,335	51,043,920

27. CUSTOMER'S DEPOSITS (CONTINUED)

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

	2019 KShs' 000	%	2018 KShs' 000	%
Trade, wholesale, retail and hotel	3,317,588	7%	4,292,462	8%
Transport and communication	48,830	0%	1,041,099	2%
Agriculture	743,003	1%	1,178,710	2%
Hire purchases and insurance	988,519	2%	916,415	2%
Business services	12,996,800	26%	13,999,202	27%
Building, construction and real estate	588,132	1%	1,555,267	3%
Social community and personal Services	18,194,737	36%	17,586,584	34%
Manufacturing	94,825	0%	919,231	2%
Financial services	9,559,925	19%	8,918,976	17%
Petroleum and natural Gas	-	0%	18,293	0%
Electricity and water	19	0%	65,600	0%
Health services	591,870	1%	58,099	0%
Mining and quarrying	458	0%	37,974	0%
Public sector	3,436,629	7%	456,008	1%
	50,561,335	100%	51,043,920	100%

28. AMOUNTS DUE TO CENTRAL BANK OF KENYA

	GROUP 2019 KShs' 000	GROUP 2018 KShs' 000	BANK 2019 KShs' 000	BANK 2018 KShs' 000
Liquidity Support Framework	9,743,979	9,104,981	9,743,979	9,104,981

Movement in amounts due to Central Bank of Kenya:

	2019 KShs' 000	2018 KShs' 000
At 1 January	9,104,981	2,892,626
Acquired from CBLIR	-	9,683,999
Fair value gain on valuation of the acquired liquidity support from CBLIR	-	(3,670,998)
Fair value of liquidity support at acquisition date	-	6,013,001
Amortisation of fair value gain classified under interest expense (note 8)	622,851	215,501
Refund of interest paid in prior period	16,147	-
Accrued interest	-	27,266
Repaid during the year	-	(43,413)
At 31 December	9,743,979	9,104,981

28. AMOUNTS DUE TO CENTRAL BANK OF KENYA (CONTINUED)

'KShs 2.892 billion relates to an amount borrowed from Central Bank of Kenya under a liquidity support framework granted prior to 2017. The amount is partly secured by two properties belonging to the Group i.e. LR No. Mombasa/Block XXI/606 and LR No. 209/8873/2 Waiyaki Way, Nairobi, as disclosed in note 21.

The Bank assumed KShs 9,683,999,000 as part of the liabilities from the acquisition of CBLIR. At the acquisition date, the fair value of the liability was determined based on the new agreed terms and the change in fair value was factored into the determination of bargain purchase gain. Management assumed an interest rate of 10% and the liquidity support repayment term of 5 years.

Subsequently, the liquidity support is measured at amortized cost and the amortisation of the fair value gain is recorded as interest expense under note 8.

The amount is secured by government securities with a face value of KShs 7.730 billion (2018: KShs 6.879 billion).

29. OTHER LIABILITIES

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Outstanding bankers drafts and cheques	24,860	42,288	24,860	42,288
Sundry creditors	1,412,721	2,560,411	1,380,019	2,560,411
Leave pay provision	44,588	24,786	44,588	24,786
Lease liability (Note 23)	728,589	-	728,589	-
	2,210,758	2,627,485	2,178,056	2,627,485

With the exception of lease liability, all other liabilities are expected to be settled within 12 months from the reporting date. Sundry creditors include direct and indirect taxes payable as at year end, accrued expenses and general provisions held.

30. DUE TO GROUP COMPANIES

	GROUP		BANK	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Due to related entities	-	36,390	-	6,335

31. SHARE CAPITAL

(a) Ordinary Share capital

	GROUP AND BANK		GROUP AND BANK	
	Number of ordinary shares (thousands)		Issued and paid up capital	
	2019	2018	2019	2018
			KShs' 000	KShs' 000
At start of year	51,715,000	51,703,007	2,165,500	2,045,570
Transfer from share capital pending allotment	-	1,412	-	14,116
Additional capital injection	-	10,581	-	105,814
At end of year	51,715,000	51,715,000	2,165,500	2,165,500

The authorised share capital is divided into 165,000,000 ordinary shares of KShs 10 each amounting to a value of KShs 1,650,000,000, and 51,550,000,000 class B shares of KShs. 0.01 amounting to KShs 515,500,000.

No transfer was done to share capital during the year. In 2018 the Bank transferred KShs 14,116,133 to share capital from share capital pending allotment. These were made up of 1,411,613 number of shares at a par value of KShs 10. Additionally, 10,581,387 new shares were issued at a premium of KShs 427.80 per share.

(b) Share capital pending allotment

There was no share capital pending allotment as at 31 December 2019 (2018: Nil)

(c) Share premium

	GROUP AND BANK	
	2019	2018
	KShs' 000	KShs' 000
At start of the year	6,701,945	1,572,222
Transfer from share capital pending allotment	-	603,884
Share premium arising from capital injection	-	4,525,839
At end of the year	6,701,945	6,701,945

There was no movement in share premium during the year. 1,411,613 shares were allotted in 2018 at a par value of KShs 10 and premium of KShs 427.80 per share thus total premium of KShs 603,884,000. An additional 10,581,387 ordinary shares were also issued at a premium of KShs 427.80 per share.

(d) Preference share capital

	GROUP AND BANK		GROUP AND BANK	
	Number of preference shares (thousands)		Issued and fully paid	
	2019	2018	2019	2018
			KShs' 000	KShs' 000
Issued and fully paid	10,000	10,000	100,000	100,000

31. SHARE CAPITAL (CONTINUED)

(d) Preference share capital

The authorised preference shares are divided into 10,000,000 preference shares of KShs 10 each amounting to a value of KShs 100,000,000.

The non-cumulative preference shares confer the same voting rights as ordinary shares of the Bank. A non-cumulative annual preference dividend of 13% is payable by the Bank. These preference shares rank in priority to any dividend payable on the ordinary shares of the Bank.

In winding up the Bank, the non-cumulative preference shares will be paid off in priority to ordinary shares but rank behind creditors of the Bank.

(e) Fair value reserve of financial assets at fair value through comprehensive income

This represents the cumulative gains and losses arising from revaluation of financial assets at fair value through other comprehensive income (government securities measured at FVOCI) from cost to fair value based on the market values of the assets at the end of the reporting period. This is not distributable.

The disaggregation of changes of OCI by fair value reserve of financial assets at fair value through other comprehensive income in equity is shown below.

	GROUP AND BANK	
	2019	2018
	KShs' 000	KShs' 000
At start of the year	(14,703)	-
Reclassified to statement of profit and loss	-	-
Fair value loss/(gain) in the year	35,795	(14,703)
Fair value loss/(gain) on debt instruments at FVOCI [Note 18(c)]	21,092	(14,703)

(f) Statutory credit risk reserve

Where impairment losses required by legislation exceed those computed under International Financial Reporting Standards, the excess is recognized as a statutory reserve and accounted for as an appropriation of retained profits and the reverse for reduction. These reserves are not distributable.

Impairment provisions required by legislation and computed as per the Central Bank of Kenya's prudential guidelines was KShs 10,088,684,000 (2018: KShs 10,459,985,000) while ECL impairment provisions computed as per International Financial Reporting Standards was KShs 10,063,395,000 (2018: KShs 11,918,450,000).

For the year ended 31 December 2019, a statutory credit risk reserve of KShs 25,289,000 (2018: Nil) has thus been recognised.

32. OFF STATEMENT OF FINANCIAL POSITION FINANCIAL INSTRUMENTS, CONTINGENT LIABILITIES AND COMMITMENTS

(a) Legal proceedings – Bank

There were a number of legal proceedings outstanding against the Bank as at 31 December 2019. No provision has been made as professional advice indicates that it is unlikely that any significant loss will arise.

Land dispute over LR 209/8873/2

The property LR 209/8873/2, disclosed in note 21, is an investment property currently under legal dispute before the National Land Commission and the Environmental and Land court. In the dispute, the plaintiff, Muguga Greens Apartments Management Limited, alleged that the property had been illegally allocated to Emtol Properties. Emtol Properties were the previous owners before they sold it to the Bank.

(b) Contractual off-statement of financial position of financial liabilities

In the ordinary course of business, the Group conducts business involving guarantees, acceptances, letters of credit and bills for collection. These facilities are offset by corresponding obligations of third parties. At the year end, the contingencies were as follows:

	GROUP AND BANK	
	2019	2018
Contingencies related to:	KShs' 000	KShs' 000
Acceptances and letters of credit	1,173,547	708,621
Letters of guarantee	549,749	1,833,184
Forwards, swaps and options	24,529	1,388,918
At end of the year	1,747,825	3,930,723

The table below shows the movement in ECL provisions on off balance sheet assets during the year;

	GROUP AND BANK	
	2019	2018
	KShs' 000	KShs' 000
1 January	294,698	-
New assets originated or purchased	-	294,698
Payments and assets derecognised	(195,345)	-
Transfers to Stage 1	-	-
Transfers to Stage 2	-	-
Transfers to Stage 3	-	-
Remeasurement of year end ECL	-	-
At end of the year	99,353	294,698

ECL provisions of KShs 195,345,000 (2018: Nil) were written back in the year. All off balance sheet assets have been categorized under stage 1.

32. OFF STATEMENT OF FINANCIAL POSITION FINANCIAL INSTRUMENTS, CONTINGENT LIABILITIES AND COMMITMENTS

(c) Nature of contingent liabilities

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

Letters of credit commit the Bank to make payment to third parties, on production of documents, which are subsequently reimbursed by customers.

An acceptance is an undertaking by the Bank to pay a bill of exchange drawn on a customer. The Bank expects most acceptances to be presented and reimbursement by the customer is almost immediate.

Forward contracts are arrangements to buy or sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate. The fair values of the respective currency forwards are carried on the face of the statement of financial position.

(d) KRA Excise duty tax demand relating to income on goodwill

In 2018, Kenya Revenue Authority (KRA) demanded from the Bank, excise duty on gain on business combination that was recognized in the financial statements for the period ended 31 December 2018. This demand notice was disputed by the Bank and an appeal lodged at the Tax Tribunal through the services of a tax consultant. The ruling of the Tax Tribunal is being awaited. The directors, in consideration of the underlying facts about the demand notice, are confident that the Bank is not liable for payment of this tax. Consequently, no provision has been made in these financial statements for the principal tax, penalties and interest totalling KShs 400,318,269.

33. ASSETS PLEDGED AS SECURITY – BANK

As at 31 December 2019, Government securities with a face value of KShs 7.730 billion were held under lien in favor of the Central Bank of Kenya Limited (2018: KShs.6.879 billion). In addition, the property previously classified as investment property has been pledged as collateral to Central Bank of Kenya. These are disclosed in note 28.

34. DIVIDENDS

There were no dividends paid in the current year (2018: nil)

35. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Cash flows from operating activities

	Notes	GROUP 2019 KShs' 000	GROUP 2018 KShs' 000	BANK 2019 KShs' 000	BANK 2018 KShs' 000
Profit before tax		1,180,311	964,054	1,179,985	955,731
Adjustments for:					
Write back general provisions	12(c)	(100,094)	(465,160)	(100,094)	(470,165)
Leave accrual	11	19,802	25,936	19,802	25,936
Movement in accrued interest and ECL impairment loss on investment securities	19(a)	4,373	(253)	4,373	(253)
Fair value gain on investment securities	19(b)	(303)	-	(303)	-
Impairment of investment in subsidiaries	20	-	-	-	336,394
Loss on revaluation of property and equipment	21	-	174,778	-	179,783
Impairment of property and equipment	21	-	44,112	-	47,221
Impairment of intangible assets	22	-	122,640	-	122,640
Impairment of investment property	23	-	126,895	-	-
Accrued interest and amortisation of fair value gain on valuation of amounts due to Central Bank of Kenya	28	622,851	242,767	622,851	242,767
Depreciation on property and equipment	21	312,732	124,230	312,707	124,230
Amortisation on intangible assets	22	266,633	144,242	266,633	144,242
Depreciation on right-of-use asset	23	307,194	-	307,194	-
Net ECL charge on cash and bank balances	13(c)	3,136	-	3,136	-
Net increase/(decrease) in impairment loss on loans and advances		(1,855,055)	973,800	(1,855,055)	973,800
Interest on lease liability	23	60,064	-	60,064	-
ECL impairment loss on government securities	13(c)	8,681	69,618	8,681	69,618
Bargain purchase gain	10(a)	-	(2,790,776)	-	(2,790,776)
Amortisation of discounts/premiums and accrued interest on government securities	18	(157,845)	(810,575)	(157,845)	(810,575)
Profit on sale of property and equipment	21	(9,069)	-	(9,069)	-
Gain on ROU asset disposal	23	(1,547)	-	(1,547)	-
Dividend from investment securities	10(c)	-	(174)	-	(174)
Profit/(Loss) before changes in operating assets and liabilities		661,864	(1,053,866)	661,513	(849,581)

35. NOTES TO THE STATEMENT OF CASH FLOWS (continued)

(a) Cash flows from operating activities (continued)

	Notes	GROUP 2019 KShs' 000	GROUP 2018 KShs' 000	BANK 2019 KShs' 000	BANK 2018 KShs' 000
Profit/(Loss) before changes in operating assets and liabilities		661,864	(1,053,866)	661,513	(849,581)
(Increase)/decrease in operating assets:					
Movement in loans and advances to customers		(1,402,294)	(1,218,967)	(1,399,054)	(1,217,620)
Investment in securities		-	164,150	-	164,150
Investment in government securities		703,288	(30,916,679)	703,288	(30,916,679)
Cash and balances with Central Bank of Kenya		14,377	(2,227,740)	14,377	(2,227,740)
Other assets		(328,810)	31,537,743	(328,810)	31,537,357
Net decrease in operating assets and liabilities		(1,013,439)	(2,661,493)	(1,010,199)	(2,660,532)
(decrease)/increase in operating liabilities:					
Customer deposits		(482,343)	(12,508,779)	(482,585)	(12,507,224)
Due to group companies		(36,390)	36,390	(6,335)	(181,697)
Other liabilities		(1,065,024)	1,016,205	(1,097,726)	1,024,171
		(1,583,757)	(11,456,184)	(1,586,646)	(11,664,750)
Cash flows used in operations		(1,935,332)	(15,171,543)	(1,935,332)	(15,174,863)
Tax paid	14(c)	-	(3,088)	-	-
Net cash flows utilized in operating activities		(1,935,332)	(15,174,631)	(1,935,332)	(15,174,863)

(b) Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

GROUP

	2019 KShs' 000	2018 KShs' 000	Changes during the year
Cash and bank balances with Central Bank and other banking institutions [Note 16(a)]	5,704,659	8,137,819	(2,433,160)
Placements with other banking institutions [Note 16(b)]	3,120,687	3,024,424	96,263
Less: Restricted balances (Cash Reserve Ratio)	(2,518,149)	(2,535,662)	17,513
Less: Deposits due to other banking institutions (Note 26)	(11,515)	-	(11,515)
	6,295,682	8,626,581	(2,330,899)

BANK

	2018 KShs' 000	2018 KShs' 000	Changes during the year
Cash and bank balances with Central Bank and other banking institutions [Note 16(a)]	5,704,659	8,137,819	(2,433,160)
Placements with other banking institutions [Note 16(b)]	3,120,687	3,024,424	96,263
Less: Restricted balances (cash reserve ratio)	(2,518,149)	(2,535,662)	17,513
Less: Deposits due to other banking institutions (Note 26)	(11,515)	-	(11,515)
	6,295,682	8,626,581	(2,330,899)

36. RELATED PARTY TRANSACTIONS AND BALANCES

The parent company is SBM Africa Holdings Limited, and ultimate holding company is SBM Holdings Limited, both incorporated in Mauritius.

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).

Included in the letters of guarantee in Note 32(b) are guarantees to Finsure Insurance Brokers Limited, a subsidiary of the Bank amounting to KShs 3,000,000. There have been no other guarantees provided or received for any related party receivables or payables.

(a) Bank balances and placement with other banking institutions

	Group and Bank	
	2019	2018
	KShs' 000	KShs' 000
Current account balances		
SBM Bank (Mauritius) Limited	-	1,421
Placements with related banking institutions		
SBM Bank Mauritius (fellow subsidiary company)	-	944,285
	-	945,706

(b) Capital injection

	2019	2018
Capital injection from SBM Africa Holdings		
- share capital [Note 31(a)]	-	105,814
- share premium [Note 31(c)]	-	4,525,839
- shareholders' contributions pending allotment [Note 32(b)]	-	-
	-	4,631,653

(c) Other balances due to group companies (note 30)

	Group		Bank	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
SBM Holdings Limited	-	6,335	-	6,335
Richardson Properties Limited	-	7,630	-	-
Kentbury Investments Limited	-	14,836	-	-
Rover Investments Limited	-	1,905	-	-
Finsure Insurance Brokers Limited	-	5,684	-	-
	-	36,390	-	6,335

36. RELATED PARTY TRANSACTIONS AND BALANCES (CONTINUED)

(d) Loans and advances to related parties

	Non-Executive Directors		Related companies		Principal officers		Other employees	
	2019	2018	2019	2018	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Outstanding loans and advances								
At start of year	-	16,961	3,303	4,119	138,541	62,324	1,017,811	336
Net movement during the year		(16,961)	(3,240)	(816)	34,792	76,217	123,807	1,017,475
At end of the year	-	-	63	3,303	173,333	138,541	1,141,618	1,017,811
Guarantees	-	-	3,000	3,000	-	-	-	-
Interest income	-	-	-	-	14,776	4,933	90,480	33,504

All the loans and advances to related parties are performing.

Interest income earned from related parties in 2019 was KShs 105,256,000 (2018: KShs 38,437,0000). The effective interest rate was 4.7% (2018: 5%) with loan tenors stretching to a maximum of 20 years.

Credit facilities to key management personnel and executive directors are as per their contract of employment. All other transactions with key management personnel and directors, whether credit facilities, deposits or purchase of goods and services, are at market terms and conditions and will be settled in cash.

All credit facilities with entities considered as related parties disclosed above are at market terms and conditions and will be settled in cash. Credit facilities are secured except for credit card advances and some personal loans which are granted under an unsecured loan scheme in the normal course of business.

36. RELATED PARTY TRANSACTIONS AND BALANCES (CONTINUED)

(f) Deposits from related parties

	Non-Executive Directors		Related companies		Principal officers		Other employees	
	2019	2018	2019	2018	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Deposits								
At start of year	44,041	32,513	-	6	18,440	(4,119)	108,017	3,693
Deposits received during year	272,482	222,716	15,227	-	256,621	219,669	2,408,217	1,529,829
Interest paid	2,737	48	-	-	-	-	3,454	375
Withdrawals during year	(285,863)	(211,236)	-	(6)	(272,548)	(197,110)	(2,389,097)	(1,425,880)
At end of the year	33,397	44,041	15,227	-	2,513	18,440	130,591	108,017

The weighted average interest rate for deposits was 6.5% (2018: 6.5%).

36. RELATED PARTY TRANSACTIONS AND BALANCES (CONTINUED)

(g) Directors' benefits and other remuneration

	GROUP AND BANK	
	2019	2018
	KShs' 000	KShs' 000
Salaries	62,213	28,001
Post-employment benefits	2,735	1,135
Fees [note 12(a)]	8,700	8,387
	73,648	37,523

(h) Key personnel compensation

	GROUP AND BANK	
	2019 Total	2018 Total
	KShs' 000	KShs' 000
Salaries and other employment benefits	67,237	67,347
Post-employment benefits	2,010	4,378
	69,247	71,725

37. CAPITAL MANAGEMENT

The Central Bank of Kenya sets and monitors capital requirements for the Banking industry as a whole. The statutory minimum core capital is KShs 1 billion. In implementing current capital requirements, The Central Bank of Kenya requires the Bank to maintain a 14.5% prescribed ratio of total capital to total risk-weighted assets. The Bank has met this requirement.

The Bank's regulatory capital is analysed into two tiers:

(i) Tier 1 capital, which includes ordinary share capital, share premium, retained earnings, after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
(ii) Tier 2 capital, which includes 25% of asset revaluation reserves which have received prior Central Bank of Kenya approval, subordinated debt and other capital instruments approved by Central Bank of Kenya.

Various limits are applied to elements of the capital base; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 percent of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 Capital.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Bank has complied with all externally imposed capital requirements throughout the year.

37. CAPITAL MANAGEMENT (CONTINUED)

The Bank's regulatory capital position at 31 December was as follows:

	Statement of financial position nominal amount		Risk weighted amount	
	2019	2018	2019	2018
	KShs' 000	KShs' 000	KShs' 000	KShs' 000
Cash and bank balances with Central Bank and other banking institutions	4,248,348	8,137,819	-	-
Placements with other banking institutions	4,576,998	3,024,424	915,267	661,600
Loans and advances to customers	15,463,645	12,209,536	13,082,098	9,916,933
Financial assets at fair value through profit and loss	1,552,811	926,112	1,552,811	926,112
Government securities	42,821,042	43,339,371	-	-
Investment securities	297,556	301,626	297,556	301,626
Tax recoverable	-	60,108	-	60,108
Other assets	1,085,561	756,751	1,085,561	457,235
Investment in subsidiaries	-	-	-	-
Property and equipment	1,892,928	1,460,603	1,892,928	1,460,603
Intangible assets	203,385	431,389	203,385	431,389
Investment property	-	-	-	-
Deferred tax assets	377,082	-	377,082	-
Total assets (a)	72,519,356	70,647,739	19,406,688	14,215,606
Off statement of financial position:	-			
Credit related commitments and other off balance sheet items (b)	1,581,393	2,541,805	918,505	1,847,140
Total balance sheet and off balance sheet risk weighted assets (a+b)	74,100,749	73,189,544	20,325,193	16,062,746
Market risk qualifying assets (c)	(2,416)	(2,113)	(2,416)	(2,113)
Adjusted credit risk weighted assets (a+b+c)	74,098,333	73,187,431	20,322,777	16,060,633
Total market risk weighted assets (d)	10,029,340	11,379,597	10,029,340	11,379,597
Total risk weighted assets for operational risk (e)	3,631,092	1,224,337	3,631,092	1,224,337
Total (a+b+c+d+e)	87,758,765	85,791,365	33,983,209	28,664,567

*a,b,c,d and e computed as per Central Bank of Kenya prudential guidelines on risk weighted assets.

37. CAPITAL MANAGEMENT (CONTINUED)

Capital adequacy requirement calculation

	2019 Total	2018 Total
	KShs' 000	KShs' 000
Tier 1 - core capital		
Share capital	2,165,500	2,165,500
Share premium	6,701,945	6,701,945
Preference share capital	100,000	100,000
Accumulated losses	(1,136,650)	(2,015,235)
	7,830,795	6,952,210
Tier 2 capital - supplementary capital		
Statutory credit risk reserve	25,289	-
Revaluation reserve (25%)	-	-
	25,289	-
Total regulatory capital	7,856,084	6,952,210

Risk weighted amounts for loans and advances to customers are stated net of impairment losses. These balances have also been offset against fixed deposits and short term deposits placed by customers as securities. There is no borrower with either funded or non-funded facilities, exceeding 25% percent of core capital.

	Actual ratios		Minimum requirement	
	2019	2018	2019	2018
Core capital to risk weighted assets ratio	23.0%	24.3%	10.5%	10.5%
Core capital to deposits ratio	15.5%	13.6%	8.0%	8.0%
Total capital to risk weighted assets ratio	23.1%	24.3%	14.5%	14.5%

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, but in some cases the regulatory requirements do not reflect fully the varying degree of risk associated with different activities. In such cases the capital requirements may be flexed to reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes.

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Group Risk and Group Credit, and is subject to review by the Group Credit Committee or ALCO as appropriate. Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Group to particular operations or activities, it is not the sole basis used for decision-making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Group’s longer term strategic objectives. The Group’s policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

38. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The tables below show an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled. Trading assets and liabilities have been classified to mature and/or be repaid within 12 months, regardless of the actual contractual maturities of the products. With regard to loans and advances to customers, the Group uses the same basis of expected repayment behavior that was used for estimating the EIR. Issued debt reflect the contractual coupon amortisations.

GROUP

At 31 December 2019	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions	5,704,659	-	5,704,659
Placements with other banking institutions	3,120,687	-	3,120,687
Loans and advances to customers	3,316,622	12,146,960	15,463,582
Financial assets at fair value through profit and loss	1,552,811	-	1,552,811
Government securities	4,976,376	37,844,666	42,821,042
Investment securities	297,607	-	297,607
Other assets	1,086,732	-	1,086,732
Property and equipment	-	1,208,685	1,208,685
Intangible assets	-	203,385	203,385
Right-of-use assets	72,275	617,672	689,947
Deferred tax asset	378,060	-	378,060
	20,505,829	52,021,368	72,527,197
LIABILITIES			
Deposits from banks	11,515	-	11,515
Customers' deposits	41,880,176	8,665,932	50,546,108
Tax payable	591,907	-	591,907
Other liabilities	1,564,713	646,045	2,210,758
Amounts due to Central Bank of Kenya	6,184,000	3,559,979	9,743,979
Financial liabilities at fair value through profit and loss	1,552,811	-	1,552,811
TOTAL LIABILITIES	51,785,122	12,871,956	64,657,078
NET	(31,279,293)	39,149,412	7,870,119

38. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2018	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions	8,137,819	-	8,137,819
Placements with other banking institutions	3,024,424	-	3,024,424
Loans and advances to customers	2,912,623	9,293,610	12,206,233
Financial assets at fair value through profit and loss	926,112	-	926,112
Government securities	27,152,372	16,186,999	43,339,371
Investment securities	-	301,677	301,677
Tax recoverable	62,783	-	62,783
Other assets	757,922	-	757,922
Property and equipment	-	1,466,332	1,466,332
Intangible assets	-	431,389	431,389
	42,974,055	27,680,007	70,654,062
LIABILITIES			
Deposits from banks	-	-	-
Customers' deposits	32,979,568	18,048,883	51,028,451
Other liabilities	2,627,064	421	2,627,485
Due to group companies	36,390	-	36,390
Amounts due to Central Bank of Kenya	9,104,981	-	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	926,112
TOTAL LIABILITIES	45,674,115	18,049,304	63,723,419
NET	(2,700,060)	9,630,703	6,930,643

38. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

BANK

At 31 December 2019	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions	5,704,659	-	5,704,659
Placements with other banking institutions	3,120,687	-	3,120,687
Loans and advances to customers	3,316,685	12,146,960	15,463,645
Financial assets at fair value through profit and loss	1,552,811	-	1,552,811
Government securities	4,976,376	37,844,666	42,821,042
Investment securities	297,556	-	297,556
Other assets	1,085,561	-	1,085,561
Property and equipment	-	1,202,981	1,202,981
Intangible assets	-	203,385	203,385
Right-of-use assets	72,275	617,672	689,947
Deferred tax asset	377,082	-	377,082
	20,503,692	52,015,664	72,519,356
LIABILITIES			
Deposits from banks	11,515	-	11,515
Customers' deposits	41,895,403	8,665,932	50,561,335
Tax payable	594,484	-	594,484
Other liabilities	1,532,011	646,045	2,178,056
Amounts due to Central Bank of Kenya	6,184,000	3,559,979	9,743,979
Financial liabilities at fair value through profit and loss	1,552,811	-	1,552,811
TOTAL LIABILITIES	51,770,224	12,871,956	64,642,180
NET	(31,266,532)	39,143,708	7,877,176

38. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2018	Within 12 months KShs'000	After 12 months KShs'000	Total KShs'000
ASSETS			
Cash and bank balances with Central Bank and other banking institutions	8,137,819	-	8,137,819
Placements with other banking institutions	3,024,424	-	3,024,424
Loans and advances to customers	2,848,495	9,361,041	12,209,536
Financial assets at fair value through profit and loss	926,112	-	926,112
Government securities	27,152,372	16,186,999	43,339,371
Investment securities	-	301,626	301,626
Tax recoverable	60,108	-	60,108
Other assets	756,751	-	756,751
Property and equipment	-	1,460,603	1,460,603
Intangible assets	-	431,389	431,389
	42,906,081	27,741,658	70,647,739
LIABILITIES			
Customers' deposits	32,995,037	18,048,883	51,043,920
Other liabilities	2,627,485	1,399	2,628,884
Due to group companies	6,335	-	6,335
Amounts due to Central Bank of Kenya	-	9,104,981	9,104,981
Financial liabilities at fair value through profit and loss	926,112	-	926,112
TOTAL LIABILITIES	36,554,969	27,155,263	63,710,232
NET	6,351,112	586,395	6,937,507

39. FAIR VALUE MEASUREMENT

As explained in note 3.5, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price), regardless of whether that price is directly observable or estimated using a valuation technique. The hierarchy of valuations techniques has also been explained in note 3.5.

An analysis of financial instruments recorded at fair value by level of the fair value hierarchy has been tabled in note 6.3.

39.1. Valuation techniques

Valuation techniques applied for each of the financial instruments are as detailed below;

Government debt securities
Government debt securities are financial instruments issued by sovereign governments and include both long term bonds and short-term bills with fixed or floating rate interest payments. These instruments are generally highly liquid and traded in active markets resulting in a Level 1 classification.

39. FAIR VALUE MEASUREMENT (CONTINUED)

39.1. Valuation techniques (continued)

Debt securities issued by financial institutions and other debt securities
Whilst most of these instruments are standard fixed or floating rate securities, some may have more complex coupon or embedded derivative characteristics. The Bank uses active market prices when available, or other observable inputs in discounted cash flow models to estimate the corresponding fair value. The corporate bonds tend to be highly liquid and traded in active markets resulting in a level 1 classification.

Equity instruments
Equity instruments held are actively traded on public stock exchanges with readily available active prices on a regular basis. These instruments are classified as Level 1.

Loans and receivables at fair value through profit or loss
For loans and receivables designated at FVPL and mandatorily required to be measured at FVPL (those that did not meet the SPPI criteria), a discounted cash flow model is used based on various assumptions, including current and expected future credit losses, market rates of interest, prepayment rates and assumptions regarding market liquidity, where relevant. Classification between Level 2 and Level 3 is determined based on whether the assessment of credit quality is based on observable or unobservable data.

Foreign exchange contracts
Foreign exchange contracts include open spot contracts, foreign exchange forward and swap contracts and over the counter foreign exchange options. These instruments are valued by either observable foreign exchange rates, observable or calculated forward points and option valuation models. With the exception of contracts where a directly observable rate is available which are disclosed as Level 1, the Bank classifies foreign exchange contracts as Level 2 financial instruments when no unobservable inputs are used for their valuation or the unobservable inputs used are not significant to the measurement (as a whole).

39.2. Fair value of financial instruments not measured at fair value

Set out below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the financial statements. This table does not include the fair values of non–financial assets and non–financial liabilities.

39. FAIR VALUE MEASUREMENT (CONTINUED)

GROUP

As at 31 December 2019

		Fair value			
	Carrying amount KShs '000	Level 1 KShs '000	Level 2 KShs '000	Level 3 KShs '000	Total KShs '000
Financial Assets					
Cash and bank balances with Central Bank and other banking institutions	5,704,659	2,969,996	2,734,663	-	5,704,659
Placements with other banking institutions	3,120,687	-	3,120,687	-	3,120,687
Loans and advances to customers	15,463,582	-	-	15,463,582	15,463,582
Debt securities at amortised cost	15,385,838	15,455,225	-	-	15,455,225
Other assets	1,086,732	-	-	1,086,732	1,086,732
Total financial assets	40,761,498	18,425,221	5,855,350	16,550,314	40,830,885
Liabilities					
Deposits from banks	11,515	-	-	11,515	11,515
Customers' deposits	50,546,108	-	-	50,546,108	50,546,108
Other liabilities	359,542	-	-	359,542	359,542
Lease liabilites	728,589	-	-	728,589	728,589
Amounts due to Central Bank of Kenya	9,743,979	-	-	9,743,979	9,743,979
Total financial liabilities	61,389,733	-	-	61,389,733	61,389,733
Off Balance Sheet items					
Acceptances and letters of credit	1,173,547	-	-	1,173,547	1,173,547
Letters of guarantee	549,750	-	-	549,750	549,750
Forwards, swaps and options	24,529	-	-	24,529	24,529
Other commitments	3,838,585	-	-	3,838,585	3,838,585
Total off balance sheet items	5,586,411	-	-	5,586,411	5,586,411

39. FAIR VALUE MEASUREMENT (CONTINUED)

As at 31 December 2018

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial Assets	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Cash and bank balances with Central Bank and other banking institutions	8,137,819	5,520,420	2,617,399	-	8,137,819
Placements with other banking institutions	3,024,424	-	3,024,424	-	3,024,424
Loans and advances to customers	12,206,233	-	-	12,206,233	12,206,233
Debt securities at amortised cost	36,869,177	36,128,710	-	-	36,128,710
Other assets	757,922	-	-	757,922	757,922
Total financial assets	60,995,575	41,649,130	5,641,823	12,964,155	60,255,108
Liabilities					
Deposits from banks	-	-	-	-	-
Customers' deposits	51,028,451	-	-	51,028,451	51,028,451
Other liabilities	1,425,952	-	-	1,425,952	1,425,952
Amounts due to Central Bank of Kenya	9,104,981	-	-	9,104,981	9,104,981
Total financial liabilities	61,559,384	-	-	61,559,384	61,559,384
Off Balance Sheet items					
Acceptances and letters of credit	708,621	-	-	708,621	708,621
Letters of guarantee	1,833,184	-	-	1,833,184	1,833,184
Forwards, swaps and options	1,388,918	-	-	1,388,918	1,388,918
Other commitments	-	-	-	-	-
Total off balance sheet items	3,930,723	-	-	3,930,723	3,930,723

39. FAIR VALUE MEASUREMENT (CONTINUED)

BANK
As at 31 December 2019

	Carrying amount	Level 1	Level 2	Level 3	Fair value Total
Financial Assets	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Cash and bank balances with Central Bank and other banking institutions	5,704,659	2,969,996	2,734,663	-	5,704,659
Placements with other banking institutions	3,120,687	-	3,120,687	-	3,120,687
Loans and advances to customers	15,463,645	-	-	15,463,645	15,463,645
Debt securities at amortised cost	15,385,838	15,455,225	-	-	15,455,225
Other assets	1,085,561	-	-	1,086,732	1,086,732
Total financial assets	40,760,390	18,425,221	5,855,350	16,550,377	40,830,948
Liabilities					
Deposits from banks	11,515	-	-	11,515	11,515
Customers' deposits	50,561,335	-	-	50,546,108	50,546,108
Other liabilities	359,542	-	-	359,542	359,542
Lease liabilites	728,589	-	-	728,589	728,589
Amounts due to Central Bank of Kenya	9,743,979	-	-	9,743,979	9,743,979
Total financial liabilities	61,404,960	-	-	61,389,733	61,389,733
Off Balance Sheet items					
Acceptances and letters of credit	1,173,547	-	-	1,173,547	1,173,547
Letters of guarantee	549,750	-	-	549,750	549,750
Forwards, swaps and options	24,529	-	-	24,529	24,529
Other commitments	3,838,585	-	-	3,838,585	3,838,585
Total off balance sheet items	5,586,411	-	-	5,586,411	5,586,411

39. FAIR VALUE MEASUREMENT (CONTINUED)

As at 31 December 2018

		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Financial Assets	KShs '000	KShs '000	KShs '000	KShs '000	KShs '000
Cash and bank balances with Central Bank and other banking institutions	8,137,819	5,520,420	2,617,399	-	8,137,819
Placements with other banking institutions	3,024,424	-	3,024,424	-	3,024,424
Loans and advances to customers	12,209,536	-	-	12,209,536	12,209,536
Debt securities at amortised cost	36,869,177	36,128,710	-	-	36,128,710
Other assets	756,751	-	-	756,751	756,751
Total financial assets	60,997,707	41,649,130	5,641,823	12,966,287	60,257,240
Liabilities					
Deposits from banks	-	-	-	-	-
Customers' deposits	51,043,920	-	-	51,043,920	51,043,920
Other liabilities	1,425,952	-	-	1,425,952	1,425,952
Amounts due to Central Bank of Kenya	9,104,981	-	-	9,104,981	9,104,981
Total financial liabilities	61,574,853	-	-	61,574,853	61,574,853
Off Balance Sheet items					
Acceptances and letters of credit	708,621	-	-	708,621	708,621
Letters of guarantee	1,833,184	-	-	1,833,184	1,833,184
Forwards, swaps and options	1,388,918	-	-	1,388,918	1,388,918
Other commitments	-	-	-	-	-
Total off balance sheet items	3,930,723	-	-	3,930,723	3,930,723

40. EVENTS AFTER REPORTING PERIOD

Initial cases of the COVID-19 (Corona Virus) infection were reported in China towards the end of 2019. The infection has spread to many other countries in the world and on 12th March 2020 the World Health Organization (WHO) stated that the global COVID-19 outbreak can be described as a pandemic. The first case of this infection was reported in Kenya on 13th March 2020 and since then some other cases have been identified. As of date of approval of this report, the Bank operations were normal and uninterrupted. Whereas the pandemic outbreak will have some effect on future business performance, the directors, in consideration of the above facts asses the post year end outbreak as a non-adjusting event.