VICTORIA COMMERCIAL BANK

EXPERIENCE THE ULTIMATE

ANNUAL REPORT

AND FINANCIAL STATEMENTS

ANNUAL REPORT

AND FINANCIAL STATEMENTS

TWENTY TWENTY

ANNUAL
REPORT
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STATEMENTS
2020

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ANNUAL REPORT

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SECTION I

ANNUAL REPORT

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BANK INFORMATION

BOARD OF DIRECTORS

Ketaki Sheth*
Chair of the Board

Yogesh K Pattni, Ph.D
Chief Executive Officer

Sylvano O Kola
Mahesh P Acharya
Mihir Chalishazar

Raminder Bir Singh
Appointed on 2 March 2020

Kanji D Pattni
Demise, 24 February 2020

* BRITISH

PRINCIPAL OFFICERS

Yogesh K Pattni Ph.D
Chief Executive Officer

Manish L Parmar
Director, Business Development

Dharmesh M Vaya
General Manager

Azmina Pattni
Head of Liabilities Relationships

Hezron Kamau
Head of Finance

Mitesh Chouhan
Head of Credit Administration

Alpesh C Parmar
Senior Manager, Treasury

Fiddelice Otwani
Human Resources Manager

Daniel Kabuku
Internal Auditor

Nasibo Abdullahi
Head of Risk and Compliance

COMPANY SECRETARY

Kaplan & Stratton
Williamson House, 4th Ngong Avenue
P O Box 40111-00100
Nairobi, Kenya

REGISTERED OFFICE

Victoria Commercial Bank Ltd
Mezzanine Floor
Victoria Towers
Kilimanjaro Avenue, Upper Hill
P O Box 41114-00100
Nairobi, Kenya

AUDITOR

PricewaterhouseCoopers LLP
Certified Public Accountants (Kenya)
PwC Tower, Waiyaki Way/Chiromo Road, Westlands
P O Box 43963 - 00100
Nairobi, Kenya

PRINCIPAL CORRESPONDENTS

Standard Chartered Bank
New York

Standard Chartered Bank
London

Standard Chartered Bank
Frankfurt

Standard Chartered Bank
Tokyo

Axis Bank Limited
India

Crown Agents Bank
London

MAIN LAWYERS

Taibjee and Bhalla Advocates LLP
Ashitiva and Company Advocates LLP
Iseme Kamau and Maema Advocates
Njoroge Regeru & Company Advocates

STATEMENT ON CORPORATE GOVERNANCE

Corporate Governance involves the way the business and affairs of an institution are governed by its board and senior management and provides the structure through which the objectives of the institution are set, and the means of attaining those objectives and monitoring performance are determined.

These structures are aimed at maintaining and increasing shareholder value simultaneously with the satisfaction of other stakeholders in the context of the institution's corporate mission.

Victoria Commercial Bank Limited is keen on ensuring the adoption of good corporate governance.

_BOARD OF DIRECTORS

The Board of Directors is composed of the Chairperson of the Board, non-executive directors, Independent non-executive directors, and executive director who is the Chief Executive Officer. The directors have extensive business and professional experience applied in the management of the Bank.

The Board meets regularly to review the Bank's performance against business plans in addition to formulating and implementing strategy as well as discharge its duties relating to the corporate accountability and associated risks in terms of management, assurance, and reporting.

The Central Bank of Kenya Prudential Guidelines require that appointment of all directors must be approved by Central Bank, a requirement that the Bank has complied with since inception.

The Board has delegated authority for the conduct of the day-to-day business to the Management. However, the Board retains ultimate responsibility for establishing and maintaining the Bank's overall internal control of financial, operational and compliance issues.

The Board has four main functional committees (Audit, Credit, Nomination and Remuneration, and Risk Management) which meet at least on quarterly basis with the main functions outlined below. These are supported by Management committees charged with implementing various decisions of the Board.

All the Directors are committed to act honestly and in the best interests of the Bank. The Board also ensures that the Directors' personal interests do not conflict with their duty to the Bank and to all the stakeholders.

The following are the board and management committees of Victoria Commercial Bank Limited with brief description of their key role, composition, and membership as well as the frequency of the meetings.

_BOARD AUDIT COMMITTEE (BAC)

This Committee provides independent oversight of the Bank's financial reporting and internal control system, ensure checks and balances within the Bank are in place and recommends remedial actions regularly.

The committee comprises of three non- executive directors. In addition, the Chairperson of the Committee can invite members to attend meetings as may be deemed necessary.

The external and internal auditors of the Bank shall have free access to the Audit Committee. The Auditors can request the Chairperson of the Committee to convene a meeting to consider any matter that the auditors believe should be brought to the attention of directors or shareholders.

The BAC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference.

_BOARD RISK MANAGEMENT COMMITTEE (BRMC)

This Committee assists the board of directors in the discharge of its duties relating to the corporate accountability and associated risks in terms of management, assurance, and reporting. The responsibility to ensure quality, integrity and reliability of the Bank's risk management is delegated to the BRMC.

The committee comprises of three non- executive directors. In addition, the Chairperson of the Committee can invite members to attend meetings as may be deemed necessary.

The Risk and Compliance function of the Bank has free access to the BRMC.

The BRMC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference.

_BOARD CREDIT COMMITTEE (BCC)

This Committee assists the board of directors in reviewing and overseeing the overall lending of the Bank. The committee also monitors and reviews the quality of the Banks' portfolio and ensures adequate levels of loan loss provisions are maintained. The BCC deliberates and considers loan applications beyond the discretionary limits of the Credit Risk Management Committee.

The Committee comprises of two non-executive directors and the Chief Executive Officer, who is an executive director.

The BCC is chaired by an independent non-executive director and meets once every quarter as per its terms of reference. In addition, the Chairperson of the Committee can invite members to attend meetings as may be deemed necessary.

_BOARD NOMINATION AND REMUNERATION COMMITTEE (BNRC)

The objective of this Committee is to assist the Board undertake structured assessment of candidates for membership of the Board and senior executives as well as regular review of structure, size and composition of the Board and make recommendations on any adjustments deemed necessary.

The Committee also oversees the compensation system's design and operation in line with clearly defined remuneration principles. The Committee comprises of three non-executive directors and the Chief Executive Officer, who is an executive director.

The BNRC is chaired by an independent non-executive director and meets at least twice every year as per its terms of reference.

_EXECUTIVE COMMITTEE (EXCO)

This committee is the link between the Board and the management of the Bank. It assists the Chief Executive Officer in implementing operational plans, the annual budget and periodic review of the Bank's overall strategies.

The Committee comprises of the senior management of the Bank. The Committee is chaired by the Chief Executive Officer of the Bank and meets at a minimum of twice per month unless otherwise notified by the Chairperson to the committee.

_RISK MANAGEMENT AND COMPLIANCE COMMITTEE

This Committee assists the board risk management Committee in the discharge of its duties relating to the corporate accountability and associated risks in terms of management, assurance, and reporting.

The Committee is chaired by the Head of Risk and Compliance and members include all the line managers and a representative of the senior management team. In addition, the Chairperson can invite other members of the Bank as may be necessary.

The Committee meets once every quarter as per its terms of reference.

_ASSETS AND LIABILITIES COMMITTEE (ALCO)

ALCO is responsible for monitoring and managing the assets and liabilities of the Bank. This includes managing interest rate movements, liquidity, treasury risk management, cost of funds/margins, reviewing and monitoring Bank deposit base, foreign exchange exposure and capital adequacy. The Committee also recommends appropriate steps with regards the areas above in line with the CBK/Risk Management guidelines.

The Committee comprises mainly of the executive team and is chaired by the Head of Treasury.

The Committee meets at a minimum once a month as per its terms of reference.

_CREDIT RISK MANAGEMENT COMMITTEE

The objectives of the Credit Risk Management Committee are to review, oversee, decline or approve the credit facilities in line with the lending policy set by the Board Credit Committee.

The committee also deals with the day-to-day management of loans and advances as well as off - balance sheet facilities in accordance with the credit policies of the Bank.

The committee is chaired by the General Manager in charge of credit. Other members are the senior management team, relationship managers, credit Manager, legal officer, and the committee secretary. The committee reports to the Board Credit Committee.

The Committee meets on monthly basis as per its terms of reference.

_ICT STEERING COMMITTEE

The responsibilities of the ICT steering committee include directing the investigation and development of ICT requirements; developing long-term strategies and plans for ICT services; recommending and implementing approved systems, policies and strategies; recommending and approving hardware and software changes; ensuring accurate management information is available on a timely and reliable manner and that appropriate security arrangements are in place including information security.

The Committee is chaired by the Chief Executive Officer and membership consists of representatives from senior management, the IT function, Credit Manager, Operations Officer as well as the Project Manager.

The Committee meets once every three months as per its terms of reference.

_ALTERNATIVE DISPUTE RESOLUTION COMMITTEE (ADRC)

The committee has a general responsibility for establishing and maintaining systems of alternative dispute resolution, including provisions for both dispute mediation and dispute arbitration. It also provides efficient and effective mechanisms for handling complaints relating to our provision of financial products and services. The mandate extends to ensuring there is prudent management of customer complaints by the Bank on timely basis.

_INSIDER LENDING

The Bank complies with the requirements of Prudential guidelines and the Banking Act with regards to insider lending.

_CODE OF CONDUCT

The Bank adheres to the banking code of ethics which requires all employees to conduct business with high integrity. The code of conduct ensures that all actions are in the overall best interests of the Bank and reflects commitment to maintaining the highest standards of integrity, ethical behaviour and compliance with all applicable internal and external laws and regulations.

All the Bank's Directors and employees adhere to the principles of the Code of Conduct in all their dealings on behalf of the Bank.

_CONFLICT OF INTEREST

Persons empowered with decision-making authority such as the directors and management are required to exercise care to avoid situations that may give rise to a conflict of interest. The Bank has adopted a code of conduct and ethics to ensure potential conflicts can be identified and managed appropriately.

_RELATIONSHIP WITH SHAREHOLDERS

The shareholders' role is to appoint the Board of Directors and independent auditors. This role is extended to holding the Board accountable and responsible for efficient and effective governance of the Bank for mutual good of the various stakeholders.

_ANTI-BRIBERY AND CORRUPTION POSITION

The Bank has a zero-tolerance attitude to bribery and corruption and is fully committed to maintaining ethical behavior in its relationships with its various stakeholders.

_BOARD OF DIRECTORS EVALUATION

The Board, on an annual basis, carries out a self-assessment of its members. Each Board member evaluates fellow Board members as well as the Chairperson of the Board. An evaluation of the performance of the Chief Executive Officer during the period under review is also carried out.

The assessment is broad based and encompasses all aspects of management of the business and particularly the contribution of each Board member. Effectiveness, participation, attendance, and co-operation amongst directors also form part of the basis of the assessment. Mix of skills and experiences of each director are taken into consideration. All directors and the Chairperson of the Board will continue making these assessments on an annual basis.

_ATTENDANCE AT BOARD MEETINGS

NAME	JAN 23.2020	MAR 3.2020	MAR 31.2020	APR 29.2020	MAY 28.2020	JUN 30.2020	JUL 30. 2020	AUG 27.2020	SEP 24.2020	OCT 29.2020	NOV 30.2020
Ketaki Sheth *Chair of the Board*	P	P	P	P	P	P	P	P	P	P	P
Yogesh K Pattni *CEO*	P	P	P	P	P	P	P	P	P	P	P
K D Pattni *Demise, 24 February 2020*	P										
S O Kola	P	A	AP	AP	P	P	P	P	P	P	P
Mihir Chalishazar	P	P	P	P	P	P	P	P	P	P	P
Mahesh P Acharya	P	P	P	P	P	P	P	P	P	P	P
R B Singh *Appointed on 2 March 2020*			P	P	P	P	P	P	P	P	P

P - Present **A** - Absent **AP** - Apology

_INTERNAL CONTROLS

The Board is committed to managing risk and to controlling the business and financial activities of the Bank in a manner which enables it to maximize profitable business opportunities, avoid or reduce risks which can cause loss or reputational damage and ensure compliance with applicable laws and regulations.

_GOING CONCERN

The Board is satisfied that the Bank has adequate resources to continue in business for the foreseeable future. For this reason, it continues to adopt the going concern basis when preparing the financial statements and carrying out its business objectives in pursuit of the Bank's vision and strategic goals.


63.772
48.991
31.012
.417
31.012
12.002
06.381

_Five-Year Financial Review

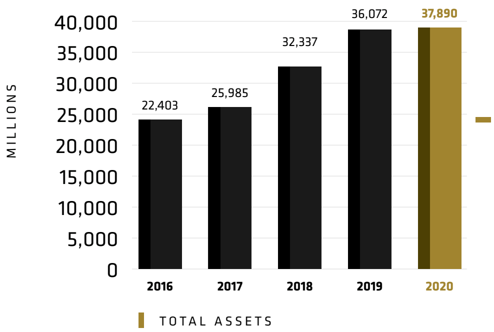
BALANCE SHEET	2016 Shs'000	2017 Shs'000	2018 Shs'000	2019 Shs'000	2020 Shs'000
Assets					
Government securities	2,993,604	2,586,695	3,814,317	5,657,692	7,822,250
Loans and advances to customers	15,292,829	18,870,101	22,586,671	23,789,164	23,815,461
Property and equipment	192,350	174,508	213,341	170,786	374,075
Other assets	3,924,698	4,353,856	5,722,626	6,454,768	5,878,357
Total assets	**22,403,481**	**25,985,160**	**32,336,955**	**36,072,410**	**37,890,143**
Liabilities					
Customer deposits	15,695,947	18,677,388	23,764,638	26,395,094	28,286,342
Borrowings	1,519,870	1,382,370	1,940,093	2,062,303	2,097,604
Other liabilities	127,627	313,509	669,326	1,258,528	761,601
Total liabilities	**17,343,444**	**20,373,267**	**26,374,057**	**29,715,925**	**31,145,547**
Shareholder's funds	**5,060,037**	**5,611,893**	**5,962,898**	**6,356,485**	**6,744,596**
Total equity and liabilities	**22,403,481**	**25,985,160**	**32,336,955**	**36,072,410**	**37,890,143**

INCOME STATEMENT	2016	2017	2018	2019	2020
Interest income	2,541,003	2,711,691	3,198,776	3,709,846	3,722,937
Interest expense	(1,302,865)	(1,274,363)	(1,698,639)	(1,881,415)	(1,839,309)
Net interest income	**1,238,138**	**1,437,328**	**1,500,137**	**1,828,431**	**1,883,628**
Non- funded income	177,878	205,697	221,181	256,628	272,331
Operating income	**1,416,016**	**1,643,025**	**1,721,318**	**2,085,059**	**2,155,959**
Credit impairment charge	(12,032)	(35,321)	(371,204)	(509,705)	(760,494)
Other operating expenses	(607,571)	(758,505)	(785,019)	(906,795)	(915,248)
Profit before income tax and exceptional items	**796,413**	**849,199**	**565,095**	**668,559**	**480,217**
Exceptional items	-	-	-	-	-
Profit before tax after exceptional items	**796,413**	**849,199**	**565,095**	**668,559**	**480,217**
Income tax expense	(204,018)	(232,022)	(128,091)	(141,414)	31,698
Profit for the year	**592,395**	**617,177**	**437,004**	**527,145**	**511,915**

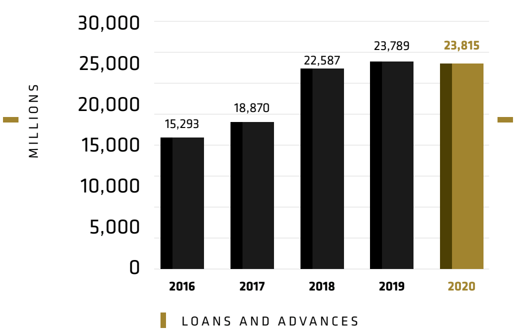
PERFORMANCE RATIOS	2016	2017	2018	2019	2020
Earnings per share (Shs)	18.6	14.72	10.42	12.57	12.21
Dividend per share (Shs)	3.00	3.50	2.53	2.70	-
Return on average shareholder's funds	20.84%	15.91%	9.76%	10.85%	7.81%
Return on average assets	3.75%	3.51%	1.94%	1.95%	1.40%
Non-performing loans to total loans and advances	0%	0.09%	3.08%	4.85%	6.60%
Net advances to customer deposits (%)	97.43%	101.03%	95.04%	90.13%	84.19%

_Five-Year Financial Review

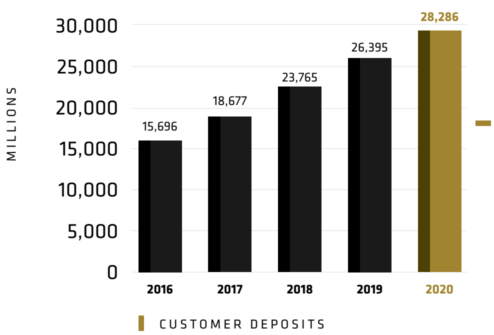
TOTAL ASSETS



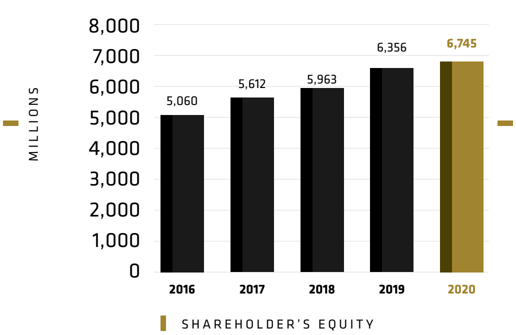
LOANS AND ADVANCES



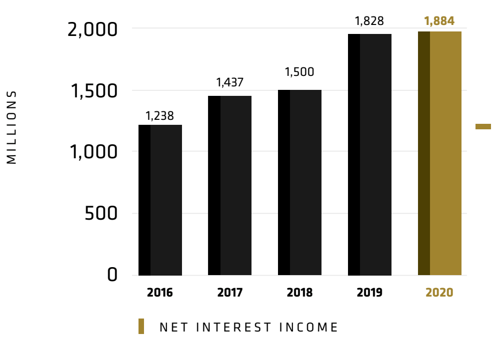
CUSTOMER DEPOSITS



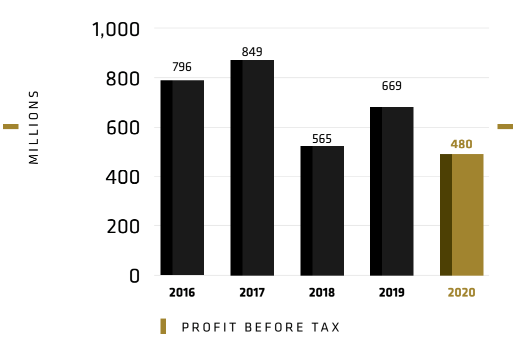
SHAREHOLDER'S EQUITY



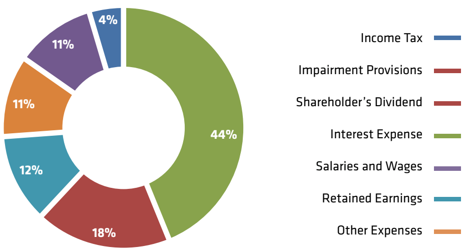
NET INTEREST INCOME



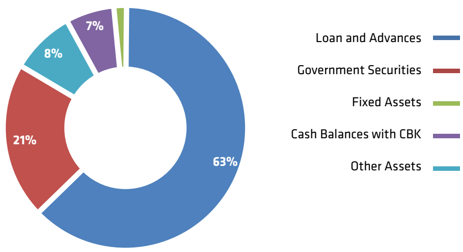
PROFIT BEFORE TAX



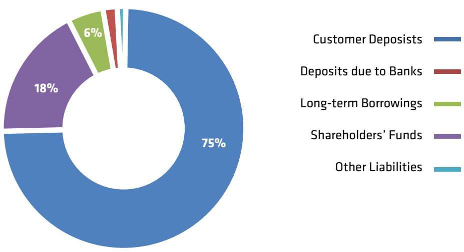
UTILISATION OF INCOME 2020



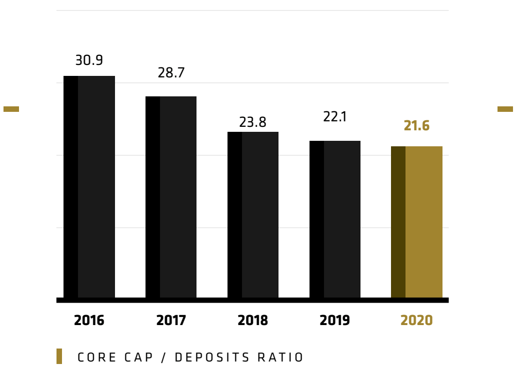
COMPOSITION OF ASSETS 2020



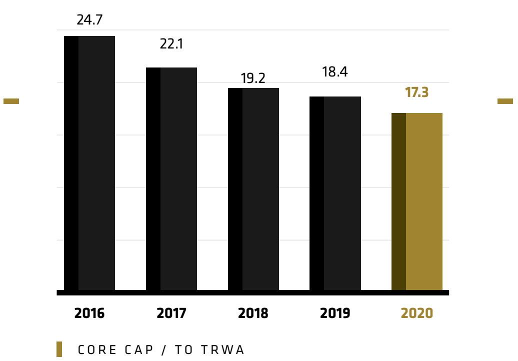
COMPOSITION OF LIABILITIES 2020



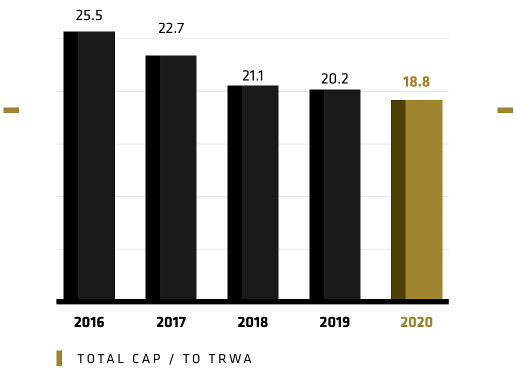
CORE CAPITAL TO DEPOSITS RATIO (%)



CORE CAPITAL TO TOTAL RISK WEIGHTED ASSETS (%)



TOTAL CAPITAL TO TOTAL RISK WEIGHTED ASSETS (%)



_Directors' Report

The directors submit their report together with the audited financial statements of Victoria Commercial Bank Limited (the "Bank") for the year ended 31 December 2020.

_PRINCIPAL ACTIVITIES

The principal activities of the Bank is provision of retail and corporate banking services.

_DIVIDEND

The net profit for the year of Shs 511,915,000 (2019: Shs 527,145,000) has been added to retained earnings. The Bank did not pay any dividend during the year (2019: Shs 113,197,000). The directors do not recommend payment of a dividend.

_BUSINESS REVIEW

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

A detailed performance review is set out on pages 19 to 21.

_DIRECTORS

The directors who held office during the year and to the date of this report were:

Ketaki Sheth	Chair of the Board
Yogesh K Pattni PhD	Chief Executive Officer
Kanji D. Pattni	Non-Executive Director (Demise, 24 February 2020)
Sylvano O. Kola	Non- Executive Director
Mihir Chalishazar	Non- Executive Director
Mahesh Acharya	Non- Executive Director
Raminder Bir Singh	Non-Executive Director (Appointed on 2 March 2020)

_STATEMENT AS TO DISCLOSURES TO THE BANK'S AUDITOR

The directors confirm that with respect to each director at the time this report was approved:

(a) there is, so far as the director is aware, no relevant audit information of which the Bank's auditor is unaware; and

(b) the director has taken all the steps that the director ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

_TERMS OF APPOINTMENT OF THE AUDITOR

PricewaterhouseCoopers LLP continue in office in accordance with the Bank'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.

By order of the Board

KAPLAN & STRATTON
P. O. Box 40111
00100 - GPO
NAIROBI

Company Secretary, 19 March 2021

_Statement of Directors' Responsibilities

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

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

(i) Designing, implementing and maintaining internal control as they determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;

(ii) Selecting suitable accounting policies and then apply them consistently; and

(iii) Making judgements and accounting estimates that are reasonable in the circumstances.

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

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

Approved by the board of directors on 19 March 2021 and signed on its behalf by:

Ketaki Sheth
Chair of the Board

Mihir Chalishazar
Director

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Victoria Commercial Bank Limited (the "Bank") set out on pages 28 to 81 which comprise the statement of financial position at 31 December 2020, the statements of profit or loss, other comprehensive income, changes in equity and cash flows for the year then ended and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of Victoria Commercial Bank Limited at 31 December 2020 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies Act, 2015.

Basis for opinion

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

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

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

Other information

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

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

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T: +254 (20)285 5000 F: +254 (20)285 5001 www.pwc.com/ke

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED (CONTINUED)

Responsibilities of the directors for the financial statements

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

In preparing the financial statements, the directors are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF VICTORIA COMMERCIAL BANK LIMITED (CONTINUED)

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

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Report on other matters prescribed by the Companies Act, 2015

In our opinion, the information given in the report of the directors on page 22 is consistent with the financial statements.

Certified Public Accountants **22 March 2021**
Nairobi

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

TWENTY TWENTY

SECTION II

ANNUAL REPORT

AND FINANCIAL STATEMENTS

Financial Statements

STATEMENT OF PROFIT OR LOSS

	Notes	2020 Shs'000	2019 Shs'000
Interest income	5 (a)	3,722,937	3,709,846
Interest expense	6	(1,839,309)	(1,881,415)
Net interest income		1,883,628	1,828,431
Credit impairment charge	14	(760,494)	(509,705)
Net interest income after credit impairment charge		1,123,134	1,318,726
Fee and commission income		133,534	133,544
Fee and commission expense		(29,334)	(23,018)
Net fee and commission income		104,200	110,526
Foreign exchange income		77,512	35,269
Other income	5 (b)	78,445	74,814
Non funded income		260,157	220,609
Net operating income		1,383,291	1,539,335
Operating expenses	7	(915,248)	(906,795)
Profit from operations		468,043	632,540
Share of profit from associates	9	12,174	36,019
Profit before income tax		480,217	668,559
Income tax credit/(expense)	10	31,698	(141,414)
Profit for the year		511,915	527,145
Earnings per share (Shs per share)			
Basic	11	12.21	12.57
Diluted	11	11.76	12.12

STATEMENT OF OTHER COMPREHENSIVE INCOME

	Notes	2020 Shs'000	2019 Shs'000
Profit for the year		511,915	527,145
Other comprehensive income:			
Items that may be subsequently reclassified to profit or loss			
Change in fair value of debt instruments at fair value through other comprehensive income	15	(156,185)	(105,962)
Deferred income tax thereon	18	46,856	31,789
Other comprehensive income for the year, net of tax		(109,329)	(74,173)
Fair value loss derecognised during the year	15	(20,678)	-
Deferred tax thereon	18	6,203	-
Fair value derecognised net of deferred income tax		(14,475)	-
Realised gain on disposal of debt instruments at fair value through other comprehensive income		-	53,812
Other comprehensive income net of realised gain on disposal of fixed income securities		(123,804)	(20,361)
Total comprehensive income for the year		388,111	506,784

STATEMENT OF FINANCIAL POSITION

	Notes	2020 Shs'000	2019 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	13	2,662,502	2,812,337
Investment securities:			
- Fair value through other comprehensive income	15	6,081,891	4,277,471
- At amortized cost	15	1,892,911	1,826,658
Deposits and balances due from banking institutions	22	1,079,572	1,921,286
Loans and advances to customers	14	23,815,461	23,789,164
Investment in associate	9	358,813	346,639
Property and equipment	16	374,075	170,786
Intangible assets	17	69,336	92,135
Current income tax		49,305	-
Deferred income tax	18	706,730	435,278
Right of use assets	26	20,214	22,997
Other assets	19	779,333	377,659
TOTAL ASSETS		37,890,143	36,072,410
LIABILITIES			
Customer deposits	20	28,286,342	26,395,094
Deposits and balances due to banking institutions	21	519,821	955,113
Borrowings	23	2,097,604	2,062,303
Lease liabilities	27	22,635	25,194
Other liabilities	24	219,145	142,857
Current income tax		-	135,364
Total liabilities		31,145,547	29,715,925
EQUITY			
Share capital	25	838,494	838,494
Share premium	25	1,321,289	1,321,289
Fair value reserve		(167,162)	(43,358)
Revaluation reserve		137,000	137,000
Retained earnings		4,614,975	4,103,060
Shareholders' equity		6,744,596	6,356,485
TOTAL EQUITY AND LIABILITIES		37,890,143	36,072,410

The financial statements on pages 28 to 81 were approved for issue by the Board of Directors 19 March 2021 and signed on its behalf by:

Ketaki Sheth
Chair of the Board

Mihir Chalishazar
Director

STATEMENT OF CHANGES IN EQUITY

	Notes	Share Capital Shs'000	Share Premium Shs'000	Faire Value Reserve Shs'000	Revaluation Reserve Shs'000	Regulatory Reserve Shs'000	Retained Earnings Shs'000	Total Shs'000
Year ended 31 December 2019								
At start of year		838,494	1,321,289	30,815	137,000	-	3,635,300	5,962,898
Profit for the year		-	-	-	-	-	527,145	527,145
Other comprehensive loss, net of tax		-	-	(20,361)	-	-	-	(20,361)
Total comprehensive income for the year		-	-	(20,361)	-	-	527,145	506,784
Realised gains on disposal of fixed income securities		-	-	(53,812)	-	-	53,812	-
Transactions with owners								
Interim dividend paid	12	-	-	-	-	-	(113,197)	(113,197)
At end of year		838,494	1,321,289	(43,358)	137,000	-	4,103,060	6,356,485
Year ended 31 December 2020								
At start of year		838,494	1,321,289	(43,358)	137,000	-	4,103,060	6,356,485
Profit for the year		-	-	-	-	-	511,915	511,915
Other comprehensive income, net of tax		-	-	(123,804)	-	-	-	(123,804)
Total comprehensive income for the year		-	-	(123,804)	-	-	511,915	388,111
At end of year		838,494	1,321,289	(167,162)	137,000	-	4,614,975	6,744,596

STATEMENT OF CASH FLOWS

	Notes	2020 Shs'000	2019 Shs'000
Cash flows from operating activities			
Interest receipts		3,471,553	3,720,018
Interest payments		(1,798,504)	(1,752,015)
Finance charge on leases	27	(3,005)	(3,939)
Net fee and commission receipts		104,200	110,526
Foreign exchange income receipts		77,512	35,269
Other income received		72,108	68,834
Payments to employees and suppliers		(813,924)	(836,716)
Income tax paid		(371,364)	(263,075)
Cashflows from operating activities before changes in operating assets and liabilities		738,576	1,078,902
Changes in operating assets and liabilities			
- (Increase)/decrease in loans and advances		(552,787)	(1,647,734)
- (Increase)/decrease in cash reserve ratio	29	198,116	(194,543)
- (Increase)/decrease in other assets		(407,919)	39,082
- Increase/(decrease) in customer deposits		1,853,448	2,504,995
- Increase/(decrease) in other liabilities	24	76,288	47,518
Net cash flow generated from operating activities		1,905,722	1,828,220
Cash flows from investing activities			
Purchase of property and equipment	16	(255,269)	(6,167)
Purchase of intangible assets	17	(1,149)	(70,647)
Net purchases of investment securities		(2,032,858)	(1,942,118)
Proceeds from sale of property and equipment		82	6
Dividend income received		6,254	5,974
Net cashflows utilised in investing activities		(2,282,940)	(2,012,952)
Cash flows from financing activities			
Borrowings during the year		(399,991)	503,338
Principal portion of lease liability payments	27	(16,224)	(11,321)
Dividends paid		-	(113,197)
Net cash flows (used in) from financing activities		(416,215)	378,820
Net (decrease) / increase in cash and cash equivalents		(793,433)	194,088
Cash and cash equivalents at the beginning of the year		3,367,631	3,173,543
Cash and cash equivalents at end of year	29	2,574,198	3,367,631

Notes to the Financial Statements

1. General Information

Victoria Commercial Bank Limited (the "Bank") is a Company domiciled in Kenya. The registered address of the Bank is:

Mezzanine Floor, Victoria Towers
Kilimanjaro Avenue, Upper Hill
P O Box 41114 - 00100
Nairobi, Kenya

2. Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of Preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC) applicable to Companies reporting under IFRS. The financial statements comply with IFRS as issued by the International Accounting Standards Board (IASB).

(a) Basis of measurement

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

For those assets and liabilities measured at fair value, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When measuring the fair value of an asset or a liability, the Bank uses market observable data as far as possible. If the fair value of an asset or a liability is not directly observable, it is estimated by the Bank using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs (e.g. by use of the market comparable approach that reflects recent transaction prices for similar items or discounted cash flow analysis). Inputs used are consistent with the characteristics of the asset / liability that market participants would take into account.

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

- Level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (I.e as prices) or indirectly (i.e derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

(b) Use of estimates

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

(c) Changes in accounting policies and disclosures

i) New and amended standards adopted by the Bank.

The following standards have been issued but do not have a material impact on the Bank.

2. Summary of Significant Accounting Policies (continued)

(c) Changes in accounting policies and disclosures (continued)

i) New and amended standards adopted by the Bank (continued)

Number	Effective Date	Executive Summary
Amendment to IAS 1, 'Presentation of financial statements' and IAS 8, 'Accounting policies, changes in accounting estimates and errors' on the definition of material.	Annual periods beginning on or after 1 January 2020. (Published October 2018)	These amendments to IAS 1 and IAS 8 and consequential amendments to other IFRSs: • use a consistent definition of materiality through IFRSs and the Conceptual Framework for Financial Reporting. • clarify the explanation of the definition of material; and • incorporate some of the guidance in IAS 1 about immaterial information. The amended definition is: *"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."*
Amendments to IFRS 9, 'Financial Instruments', IAS 39, 'Financial Instruments: Recognition and Measurement' and IFRS 7, 'Financial Instruments: Disclosure' – Interest rate benchmark reform (Phase 1).	Annual periods beginning on or after 1 January 2020 (early adoption is permitted). (Published September 2019)	These amendments provide certain reliefs in connection with interest rate benchmark reform (IBOR). The reliefs relate to hedge accounting and have the effect that IBOR should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness should continue to be recorded in the income statement.

2. Summary of Significant Accounting Policies (continued)

2.1 Basis of Preparation (continued)

(c) Changes in accounting policies and disclosures (continued)

ii) New standards, amendments and interpretations not yet adopted by the Bank.

Number	Effective Date	Executive Summary
IFRS 16, 'Leases' COVID-19-Related Rent Concessions Amendment.	Annual periods beginning on or after 1 June 2020 (early adoption is permitted). (Published June 2020)	The IASB has provided lessees (but not lessors) with relief in the form of an optional exemption from assessing whether a rent concession related to COVID-19 is a lease modification, provided that the concession meets certain conditions. Lessees can elect to account for qualifying rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concession as a variable lease payment.
Amendments to IFRS 9 'Financial Instruments', IAS 39 'Financial Instruments: Recognition and Measurement', IFRS 7 'Financial Instruments: Disclosures', IFRS 4 'Insurance Contracts' and IFRS 16 'Leases' – interest rate benchmark (IBOR) reform (Phase 2).	Annual periods beginning on or after 1 January 2021. (Published August 2020)	The Phase 2 amendments address issues that arise from the implementation of the reform of an interest rate benchmark, including the replacement of one benchmark with an alternative one.
Amendment to IAS 1 'Presentation of Financial Statements' on Classification of Liabilities as Current or Non-current.	Annual periods beginning on or after 1 January 2022. (Published January 2020)	The amendment clarifies that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Classification is unaffected by expectations of the entity or events after the reporting date (for example, the receipt of a waiver or a breach of covenant).
Amendments to IAS 16 'Property, Plant and Equipment' on Proceeds before Intended Use.	Annual periods beginning on or after 1 January 2022. (Published May 2020)	The amendment to IAS 16 prohibits an entity from deducting from the cost of an item of PPE any proceeds received from selling items produced while the entity is preparing the asset for its intended use (for example, the proceeds from selling samples produced when testing a machine to see if it is functioning properly). The proceeds from selling such items, together with the costs of producing them, are recognised in profit or loss.

2. Summary of Significant Accounting Policies (continued)

2.1 Basis of Preparation (continued)

(c) Changes in accounting policies and disclosures (continued)

ii) New standards, amendments and interpretations not yet adopted by the Bank (continued)

Number	Effective Date	Executive Summary
Amendments to IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' on Onerous Contracts–Cost of Fulfilling a Contract.	Annual periods beginning on or after 1 January 2022. (Published May 2020)	The amendment clarifies which costs an entity includes in assessing whether a contract will be loss-making. This assessment is made by considering unavoidable costs, which are the lower of the net cost of exiting the contract and the costs to fulfil the contract. The amendment clarifies the meaning of 'costs to fulfil a contract'. Under the amendment, costs to fulfil a contract include incremental costs and the allocation of other costs that relate directly to fulfilling the contract.
Annual improvements cycle 2018 -2020.	Annual periods beginning on or after 1 January 2022. (Published May 2020)	These amendments include minor changes to: • IFRS 1, 'First time adoption of IFRS' has been amended for a subsidiary that becomes a first-time adopter after its parent. The subsidiary may elect to measure cumulative translation differences for foreign operations using the amounts reported by the parent at the date of the parent's transition to IFRS. • IFRS 9, 'Financial Instruments' has been amended to include only those costs or fees paid between the borrower and the lender in the calculation of "the 10% test" for derecognition of a financial liability. Fees paid to third parties are excluded from this calculation. • IFRS 16, 'Leases', amendment to the Illustrative Example 13 that accompanies IFRS 16 to remove the illustration of payments from the lessor relating to leasehold improvements. The amendment intends to remove any potential confusion about the treatment of lease incentives. IAS 41, 'Agriculture' has been amended to align the requirements for measuring fair value with those of IFRS 13. The amendment removes the requirement for entities to exclude cash flows for taxation when measuring fair value.

The Directors do not plan to apply the above standards, until they become effective.

2. Summary of Significant Accounting Policies (continued)

2.2 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the bank operates ('the Functional Currency'). The financial statements are presented in Kenya shillings, which is the Bank's presentation currency.

(b) Translations and balances

Foreign currency transactions are translated into the Functional Currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except for differences arising on translation of non-monetary financial assets carried at fair value through other comprehensive income, which are recognised in other comprehensive income.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within "interest expense". All other foreign exchange gains and losses are presented in the statement of profit or loss for the year within "operating expenses".

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available for sale, are included in other comprehensive income.

2.3 Financial instruments

2.3.1 Financial assets and liabilities

Measurement methods

Amortised cost and effective interest rate

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

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired financial assets – assets that are credit-impaired at initial recognition, the Bank calculates the credit adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

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

Interest income

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

a) Purchased or originated credit impaired (POCI) financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset; and

b) Financial assets that are not "POCI" but have subsequently become credit-impaired, for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e.net of the expected credit loss provision) in subsequent reporting periods.

Initial recognition and measurement

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

At initial recognition, the Bank measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through the profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees

2. Summary of Significant Accounting Policies (continued)

2.3.1 Financial assets and liabilities (continued)

Measurement methods (continued)

and commissions. Transaction costs of financial assets and financial liabilities are carried at fair value through profit or loss and are expensed in profit or loss. Immediately after the initial recognition, an expected credit loss allowance (ECL) is recognised for the financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

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

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

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

i) Classification and subsequent measurement

From January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

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

Debt instruments

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

i) The Bank's business model for managing the asset and the cash flow characteristics of the asset.
Based on these factors, the Bank classifies its debt instruments into one of the following three measurement categories:

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

- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in "Net investment income" using the effective interest rate method; and

- Fair value through the profit or loss: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented within "Net trading income" in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in "Net investment income".

Business model: The business model reflects how the Bank manages the assets in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of "other" business model and measured at FVPL. Factors considered by the Bank in determining the business model for a Bank of assets include past experience on how cash flows for these assets

2. Summary of Significant Accounting Policies (continued)

2.3.1 Financial assets and liabilities (continued)

i) Classification and subsequent measurement (continued)

were collected, how the asset's performance is evaluated and reported by key management personnel, how risks are assessed and managed and how managers are compensated. For example, the liquidity portfolio of assets is held by the Bank as part of liquidity management and is generally classified with the hold to collect and sell business model. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the "other" business model and measured at FVPL.

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

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

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

ii) Impairment

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

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

iii) Modification of loans

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

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

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

However, the Bank also assesses whether the new financial asset recognised is deemed to be credit impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in

2. Summary of Significant Accounting Policies (continued)

2.3.1 Financial assets and liabilities (continued)

derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate of credit-adjusted effective interest rate for POCI financial assets.

iv) Derecognition other than a modification

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

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

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

Collateral (shares and bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowings transactions are not derecognised because the Bank retains substantially all the risks and rewards on the basis of predetermined repurchase price, and the criteria for derecognition are therefore not met.

Financial liabilities

i) Classification and subsequent measurement
In both the current period and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

ii) Derecognition

- Financial liabilities at fair value through profit or loss such as derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair values of the financial liability that is attributable to changes in the credit risk of that liability) and partially profit or loss (the remaining amount of change in the fair value of the liability);

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Bank recognises any expense incurred on the financial liability; and

- Financial guarantee contracts and loan commitments.

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

The exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modification of the terms of the existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration.

If the exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange of modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset, and the net amount reported in the statement of financial position

2. Summary of Significant Accounting Policies (continued)

Offsetting financial assets and financial liabilities (continued)

when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

2.4 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less. Funds restricted for a period of more than three months on origination and cash reserve deposits with the Central Bank of Kenya are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

2.5 Intangible assets - Software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of 5 years.

Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

2.6 Property and equipment

Property and equipment are stated at historical cost less depreciation.

Depreciation is calculated on the straight-line basis to allocate their cost less their residual values over their estimated useful lives, as follows:

Office premises	50 years
Office improvements	8 years
Furniture, fittings, and equipment	8 years
Motor vehicles	4 years
Computer equipment	3-4 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. The Bank assesses at each reporting date whether there is any indication that any item of property and equipment is impaired. If any such indication exists, the Bank estimates the recoverable amount of the relevant assets. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

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

2.7 Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Employee Benefits

(a) Retirement benefit obligations

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

The Bank also contributes to the statutory National Social Security Fund. This is a defined contribution pension scheme registered under the National Social Security Act. The Bank's obligations under the scheme are limited to specific obligations legislated from time to time and are currently limited to a maximum of Shs 200 per month per employee. The Bank contributions in respect of retirement benefit schemes are charged to profit or loss in the year to which they relate.

2. Summary of Significant Accounting Policies (continued)

2.9 Income tax expense

The tax expense for the period comprises current and deferred income tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity respectively.

(a) Current income tax

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

(b) Deferred income tax

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised, or the deferred income tax liability is settled.

2.10 Leases

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

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

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

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

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

To determine the incremental borrowing rate, the Bank:

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

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

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

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

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

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

2. Summary of Significant Accounting Policies (continued)

months or less.

Extension and termination options

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

Leases under which the Company is the lessor

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

2.11 Dividend payable

Dividends on ordinary shares are charged to equity in the period in which they are declared.

2.12 Share capital

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

2.13 Interest income and expense

Interest income and expense for all interest-bearing financial instruments, except for those classified as held for trading or designated at fair value through profit or loss, are recognised within 'interest income' or 'interest expense' in the income statement account using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest that was used to discount the future cash flows for the purpose of measuring the impairment loss.

2.14 Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for advances are credited to income upon first utilisation of the facility and are charged on an annual basis.

2.15 Dividend income

Dividends are recognised in profit or loss when the Bank's right to receive payment is established.

2.16 Acceptances and letters of credit

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

2.17 Investment in associates

The investment in the associates is accounted for using the equity method. It is initially recorded at cost and the carrying amount is increased or decreased to recognise the Bank's share of the profits or losses of the investee after the acquisition date. Distributions received from the investee reduce the carrying amount of the investment.

On disposal of the investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to the profit or loss.

2.18 Derivative financial instruments

Derivatives, which comprise solely forward foreign exchange contracts, are initially recognised at fair value on the date the derivative contract is entered into and are subsequently measured at fair value. The fair value is determined using forward exchange market rates at the balance sheet date or appropriate pricing models. The derivatives do not qualify for hedge accounting. Changes in the fair value of derivatives are recognised immediately in the statement of profit or loss.

3. Critical accounting estimates and judgments in applying accounting policies

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. The directors also need to exercise judgment in applying the Bank's accounting policies.

All estimates and assumptions required in conformity with IFRS are best estimates undertaken in accordance with the applicable standard. Estimates and judgements are evaluated on a continuous basis, and are based on past experience and other factors, including expectations with regard to future events.

This note provides an overview of the areas that involve a higher degree of judgment or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgements is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

Measurement of expected credit losses

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

A number of significant judgements are also required in applying the accounting requirement
for measuring ECL, such as:

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

Further details on ECL measurement are on note 4.

4. Financial risk management

The Bank's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. Those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the Bank's business, and the financial risks are an inevitable consequence of being in business. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on its financial performance.

Risk management is carried out by the Risk and Compliance unit under policies approved by the Board Risk Management Committee (BRMC). Assets and Liability Committee (ALCO) identifies, evaluates, and hedges financial risks in close cooperation with the operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, use of derivative and non-derivative financial instruments.

4.1 Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will cause a financial loss to the Bank by failing to pay amounts in full when due. Credit risk is the most important risk for the Bank's business: management therefore carefully manages the exposure to credit risk. Credit exposures arise principally in lending and investment activities. There is also credit risk in off-balance sheet financial instruments, such as loan commitments. Credit risk management and control is centralised in the Credit Risk Management Committee, which reports regularly to the Board Credit Committee (BCC).

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 are subject to annual or more frequent review. Limits on the level of credit risk by industry sector are approved regularly by the BCC.

The exposure to any one borrower including banks is further restricted by sub-limits covering on- and off-balance sheet exposures and daily delivery risk limits in relation to trading

4.1 Credit risk (continued)

items such as forward foreign exchange contracts. Actual exposures against limits are monitored daily.

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

4.1.1 Credit risk measurement

Loans and advances (including loan commitments and guarantees)

The estimation of credit exposure is complex and requires the use of models, as the value of a product varies with changes in market variables, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties.

The Bank has developed models to support the quantification of the credit risk. These rating and scoring models are in use for all key credit portfolios and form the basis for measuring default risks. In measuring credit risk of loans and advances at a counterparty level, the Bank considers three components: (i) the 'Probability of Default' (PD) by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and its likely future development, from which the Bank derive the 'Exposure at Default' (EAD); and (iii) the likely recovery ratio on the defaulted obligations (the 'Loss Given Default') (LGD). The models are reviewed regularly to monitor their robustness relative to actual performance and amended as necessary to optimise their effectiveness.

Credit risk grading

The Bank has developed an internal credit risk grading system that reflect its assessment of the probability of defaults of individual counterparties. The Bank uses internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, the level of collateral for retail exposures, and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgment from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for the considerations which may not be captured as part of the other data input into the model.

The following are additional considerations for each type of portfolio held by the Bank:

Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on a periodic basis to develop a behavioural score. Any other known information about the borrower, which impacts their creditworthiness – such as unemployment and previous delinquency history – is also incorporated into the behavioural score. This score is mapped to a PD.

Corporate

For wholesale business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and PD.

For debt securities in the treasury portfolio, external rating agency credit grades are used. These published grades are continuously monitored and updated. The PDs associated with each grade are determined based on realised default rates over the prior 12 months, as published by the rating agency.

Treasury

For debt securities in the treasury portfolio, external rating agency credit grades are used. These published grades are continuously monitored and updated. The PDs associated with each grade are determined based on realised default rates over the prior 12 months, as published by the rating agency.

4.1.2 Expected credit loss measurement

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

- A financial instrument that is not credit impaired at initial recognition is classified in "Stage 1" and has its

4.1.2 Expected credit loss measurement (continued)

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

The key judgements and assumptions adopted by the Bank in addressing the requirements of the Standard are as follows:

4.1.2.1 Significant increase in credit risk

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

Quantitative criteria

The standard also sets out a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. The Bank has adopted the default standard definition of 30 days past due to determine the significant increase in credit risk.

Qualitative criteria

The Bank considers a significant increase in credit risk in their portfolio if the borrower is on the watch list and/or the instrument meets one or more of the following criteria:

- Significant increase in credit spread;
- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates;
- Actual or expected forbearance or restructuring; and
- Actual or expected significant adverse change in operating results of the borrower.
- Significant change in collateral value (secured facilities only) which is expected to increase risk of default; and
- Early signs of cash flows/liquidity problems such as delay in servicing of trade creditors/loans.

The assessment of SICR incorporates forward-looking information and is performed at the counterparty level and on a periodic basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent credit team.

4.1.2.2 Definition of default and credit-impaired assets

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance;
- The borrower is deceased;
- The borrower is insolvent or becoming probable that the borrower will enter bankruptcy;
- The borrower is in breach of financial covenants;
- An active market for that financial asset has disappeared because of financial difficulties;
- Concessions have been made by the lender relating to the borrower's financial difficulty; and
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

The above criteria have been applied to all financial instruments held by the Bank and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Bank's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different

4.1.2.2 Definition of default and credit-impaired assets (continued)

possible cure definitions.

The expected credit loss (ECL) is measured on either a 12-month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD).

LGD represents the Bank's expectations of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type of seniority of claim and availability of collateral or other credit support. LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs over the next 12 months and lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

4.1.2.3 Measuring expected credit loss – inputs, assumptions, and estimation techniques

Forward-looking economic information is also included in determining the 12-month and lifetime-PD, EAD and LGD. These assumptions vary by product type.

4.1.2.4 Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Bank has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio. These economic variables and their associated impact on PD, EAD and LGD vary by financial instrument.

4. Financial risk management (continued)

4.1.2.4 Forward-looking information incorporated in the ECL models (continued)

Building and Construction		**Base**	**Upside**	**Downside**
			Average weighting	
	Coefficients	95%	2.5%	2.5%
Reverse REPO	-1.359	6.17%	9.57%	2.76%
91 Day T-Bills	-8.982	6.69%	7.12	6.26
Inflation	-2.54	3.90%	4.63%	3%
Deposit	-5.997	6.93%	7.21%	7%
Housing price index	-2.344	-0.19%	0.17%	-0.54%
Constant	1.529	-	-	-

Energy and Water		**Base**	**Upside**	**Downside**
			Average weighting	
	Coefficients	95%	2.5%	2.5%
Interbank	0.4302	4.17%	3.18%	5.16%
Deposit	1.6541	6.93%	6.64%	7.21%
Constant	-0.1317	-	-	-

Real Estate		**Base**	**Upside**	**Downside**
			Average weighting	
	Coefficients	95%	2.5%	2.5%
Reverse REPO	-0.1763	6.72%	10.13%	3.32%
Central Bank Rate	-2.2284	6.83%	7.29%	6.37%
Deposit	-2.1285	6.93%	6.64%	7%
Constant	0.3948	-	-	-

Personal and Household		**Base**	**Upside**	**Downside**
			Average weighting	
	Coefficients	95%	2.5%	2.5%
91 Day T-Bills	0.9753	6.69%	6.26%	7.12%
Central Bank Rate	-2.8373	6.83%	7.29%	6.37%
Deposit	-1.3227	6.93%	7.21%	6.64%
Lending	0.3628	12.09%	10.72%	13%
Constant	0.2508	-	-	-

Trade		**Base**	**Upside**	**Downside**
			Average weighting	
	Coefficients	66%	33%	1%
91 Day T-Bills	1.152	6.69%	6.26%	7.12%
Central Bank Rate	-0.9119	6.83%	7.29%	6.37%
Deposit	-1.1587	6.93%	7.21%	6.64%
Public debt to GDP	0.5706	63.00%	60.45%	65.55%
Constant	-0.2361	-	-	-

4. Financial risk management (continued)

4.1.2.4 Forward-looking information incorporated in the ECL models (continued)

Some sectors did not have correlations with macro-economic factors. These include: Agriculture, Manufacturing, Mining & Quarrying, Energy & Water, Tourism, Restaurant & Hotels, Transport & Communication and Financial Services. This was due to no historical default rates for these sectors and historical PDs were noted as 0%. In view of this, management judgements were applied by taking a minimum PD of 0.01% for purposes of ECL calculation.

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have been considered, but are not deemed to have a material impact on therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

Sensitivity analysis

Set out below are the changes to the ECL at 31 December 2020 that would result from reasonably possible changes in the Bank's macro-economic overlays and the probability weightings from actual assumptions used in the Bank's economic variable assumptions.

The impact of a 5% increase/decrease in macro-economic overlays will lead to the following change in expected credit loss;

	Base Shs '000	Upside Shs '000	Downside Shs '000
5% Change	46,910	39,064	(32,063)

4.1.3 Credit risk exposure

	2020 Shs '000	2019 Shs '000
Maximum exposure to credit risk before collateral held		
On-balance sheet items		
Balances with Central Bank of Kenya (Note 13)	2,558,881	2,714,573
Deposits and balances due from banking institutions (Note 22)	1,079,572	1,921,286
Loans and advances to customers (Note 14)	23,815,461	23,789,164
Government and other securities held to maturity (Note 15)	1,892,911	1,826,658
Available for sale investment securities (Note 15)	6,081,891	4,277,471
Other assets	606,823	188,535
Off-balance sheet items:		
- Acceptances and letters of credit	2,371,898	1,762,668
- Guarantee and performance bonds	1,834,224	543,916
- Commitments to lend	4,041,148	3,904,690
	44,282,809	40,928,961

4. Financial risk management (continued)

4.1 Credit risk (continued)

4.1.3 Credit risk exposure (continued)

The above table represents a worst-case scenario of credit risk exposure to the Bank at 31 December 2020 and 2019, without taking account of collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on carrying amounts as reported in the balance sheet.

Loans and advances to customers and off-balance sheet items are secured by collateral in form of charges over land and buildings and/or plant and machinery or corporate guarantees and other collateral acceptable by the Kenyan law. However, there are loans and advances to corporate customers and individuals that are unsecured. Before disbursing any unsecured loan, the Bank undertakes stringent credit risk assessment.

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

- The Bank exercises stringent controls over the granting of new loans;
- 93% of the loans and advances portfolio are neither past due nor impaired; and
- 100% of investment securities at amortised cost are government securities.

Financial assets that are past due or impaired

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

Accounts are classified into five categories as follows:

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

Loans and advances less than 30 days past due date are not considered to be impaired unless other information is available to indicate otherwise.

Loans and advances are summarised as follows:

	2020 Shs '000	2019 Shs '000
Stage 1: Neither past due nor impaired	21,017,823	22,316,717
Stage 2: Past due but not impaired	2,631,556	1,279,455
Stage 3: Impaired	1,678,769	1,204,434
Gross loans and advances (Note 14)	25,328,148	24,800,606
Staff loan adjustment (Note 14)	(19,240)	(25,485)
Less: allowance for impairment (Note 14)	(1,493,447)	(985,957)
Net loans and advances (Note 14)	23,815,461	23,789,164

No other financial assets are either past due or impaired.

4. Financial risk management (continued)

4.1 Credit risk (continued)

4.1.3 Credit risk exposure (continued)

Write-off policy

The Bank writes off a loan balance when the credit department determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation or that proceeds from collateral have failed to cover the entire facility outstanding. For smaller balance standardised loans, write-off decisions are generally based on a product specific past due default history.

Collateral on loans and advances

The Bank routinely obtains collateral and security to mitigate credit risk. The Bank ensures that any collateral held is sufficiently liquid, legally effective, enforceable and regularly reassessed.

Before attaching value to collateral, business holding approved collateral must ensure that they are legally perfected devoid of any encumbrances. Security structures and legal covenants are subject to regular review, to ensure that they remain fit for purpose and remain consistent with accepted local market practice.

The principal collateral types held by the Bank for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory, and accounts receivable; and
- Charges over financial instruments such as debt securities and equities.

Valuation of collateral taken will be within agreed parameters and will be conservative in value. The valuation is performed only on origination or in the course of enforcement actions. Collateral for impaired loans is reviewed regularly to ensure that it is still enforceable, and that the impairment allowance remains appropriate given the current valuation.

The Bank will consider all relevant factors, including local market conditions and practices, before any collateral is realized. See below summary of impairment of collateral on loans and advances. The current values of collateral held by the Bank as at year end is summarized as follows;

		2020 Shs '000	2019 Shs '000
Stage 1:	Against collectively impaired:		
	Property	12,780,614	915,000
	Other*	21,467,468	6,000
Stage 2:	Against past due but not impaired		
	Property	1,653,500	14,242,526
	Other*	557,465	16,407,759
Stage 3:	Against individually impaired:		
	Property	532,800	1,094,851
	Other*	151,297	18,585

**Other collaterals include logbooks, cash cover, machinery, debentures and directors' guarantees.*

4. Financial risk management (continued)

4.2 Concentrations of risk

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

	Loans and advances %	Credit commitments %
31 December 2020		
CORPORATE		
Manufacturing	24%	25%
Wholesale and retail trade	25%	41%
Transport and communication	1%	1%
Business services	4%	7%
Agriculture	8%	5%
Building & construction	7%	9%
Real estate	18%	2%
Others	9%	1%
RETAIL		
Personal & households	4%	9%
	100%	100%
31 December 2019		
CORPORATE		
Manufacturing	25%	22%
Wholesale and retail trade	21%	34%
Transport and communication	1%	1%
Business services	3%	7%
Agriculture	8%	2%
Building & construction	9%	3%
Real estate	17%	16%
Others	11%	7%
RETAIL		
Personal & households	5%	8%
	100%	100%

4. Financial risk management (continued)

4.2 Concentrations of risk (continued)

Customer deposits

	2020 %	2019 %
Insurance companies	1%	1%
Private enterprises	33%	29%
Commercial banks	0%	0%
Individuals	60%	66%
Non – residents	1%	1%
Non-profit organizations	1%	1%
Others	4%	2%
	100%	100%

4.3 Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations associated with its financial liabilities as they fall due and to replace funds when they are withdrawn.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, and calls on cash settled contingencies. The Bank does not maintain cash resources to meet all these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Central Bank of Kenya requires that the Bank maintain a cash reserve ratio computed as 4.25% of customer deposits of the preceding month. In addition, the Board and Assets and liabilities Committee (ALCO) closely monitors the limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The Treasury department monitors liquidity ratios on a daily basis. The table below details the reported ratios of net liquidity assets to deposits from customer during the year:

	2020 %	2019 %
At close of the year	37.9%	34.4%
Average for the period	37.6%	32.33%
Maximum for the period	40.1%	34.90%
Minimum for the period	34.0%	28.40%

The Bank complies at all times with the regulatory minimum liquidity ratio of 20%.

The table below presents the undiscounted cash flows payable by the Bank under financial liabilities by remaining contractual maturities at the balance sheet date. All figures are in thousands of Kenya Shillings.

4. Financial risk management (continued)

4.3 Liquidity risk (continued)

At 31 December 2020	Up to 1 Month Shs'000	1-3 Months Shs'000	3-6 Months Shs'000	6-12 Months Shs'000	Over 1 Year Shs'000	Total Shs'000
Liabilities						
Customer deposits	8,447,766	10,279,465	6,233,025	3,515,018	-	28,475,274
Deposits and balances due to banking institutions	-	552,138	26,897	-	-	579,035
Borrowings	-	325,271	993,220	458,192	699,429	2,476,112
Other financial liabilities	91,596	-	-	-	-	91,596
Total financial liabilities (Contractual maturity dates)	8,539,362	11,156,874	7,253,142	3,973,210	699,429	31,622,017

At 31 December 2019	Up to 1 Month Shs'000	1-3 Months Shs'000	3-6 Months Shs'000	6-12 Months Shs'000	Over 1 Year Shs'000	Total Shs'000
Liabilities						
Customer deposits	7,384,911	11,828,611	4,608,145	3,151,741	7,621	26,981,029
Deposits and balances due to banking institutions	-	965,314	-	-	-	965,314
Borrowings	-	325,319	-	-	1,957,396	2,282,715
Other financial liabilities	168,051	-	-	-	-	168,051
Total financial liabilities (Contractual maturity dates)	7,552,962	13,119,244	4,608,145	3,151,741	1,965,017	30,397,109

4.4 Market risk

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

4. Financial risk management (continued)

4.4 Market risk (continued)

<u>Currency risk</u>

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank 's financial instruments, categorised by currency (all amounts expressed in thousands of Kenya Shillings):

31 December 2020

	USD	GBP	Euro	Other	Total
Assets					
Cash and balances with Central Bank of Kenya	483,238	34,828	29,919	39	548,024
Deposits and balances due from banking institutions	853,943	157,738	59,196	4,802	1,075,679
Loans and advances to customers	4,377,268	393,586	435,095		5,205,949
Investment securities	338,116	-	-	-	338,116
Total assets	6,052,565	586,152	524,210	4,841	7,167,768
Liabilities					
Customer deposits	3,929,951	578,742	113,768	-	4,622,461
Deposits and balances due to banking institutions	519,821	-	-	-	519,821
Borrowings	1,776,037	-	321,567	-	2,097,604
Other liabilities	957	2	4	-	963
Total liabilities	6,226,766	578,744	435,339	-	7,240,849
Net on-balance sheet position	(174,201)	7,408	88,871	4,841	(73,081)
Net off-balance sheet position	61,186	5,471	(79)	-	66,578
Overall open position	(113,015)	12,879	88,792	4,841	(6,503)
31 December 2019					
Total assets	6,148,311	684,511	593,873	1,589	7,428,284
Total liabilities	6,127,130	749,852	510,417	-	7,387,399
Net on-balance sheet position	21,181	(65,341)	83,456	1,589	40,885
Net off-balance sheet position	13,085	74,779	(56,684)	1,392	32,572
Overall open position	34,266	9,438	26,772	2,981	73,457

The net off-balance sheet position represents the off-balance sheet facilities that were held by the Bank

4. Financial risk management (continued)

4.4 Market risk (continued)

Currency risk (continued)

Currency risk sensitivity analysis

The table below shows the impact on post tax profit of 10% appreciation or depreciation of the shilling against other major currencies (all amounts expressed in thousands of Kenya Shillings)

31 December 2020

	Currency Carrying Amount Shs'000	Appreciation by 10% Shs'000	Depreciation by 10% Shs'000
Assets			
Cash and balances with Central Bank of Kenya	548,024	(54,802)	54,802
Deposits and balances due from banking institutions	1,075,679	(107,568)	107,568
Loans and advances to customers	5,205,949	(520,595)	520,595
Investment securities	338,116	(33,812)	33,812
Total assets	7,167,768	(716,777)	716,777
Liabilities			
Customer deposits	4,622,461	462,246	(462,246)
Deposits and balances due to banking institutions	519,821	51,982	(51,982)
Borrowings	2,097,604	209,760	(209,760)
Other liabilities	963	96	(96)
Total liabilities	7,240,849	724,084	(724,084)
Total (decrease) / increase	(73,081)	7,307	(7,307)
Tax charge 25%		(1,827)	1,827
Impact on profits		5,480	(5,480)

At 31 December 2020, if the Shilling had weakened/strengthened hypothetically by 10% against the foreign currencies in which the Bank had exposures, with all other variables held constant, post-tax profit for the year would have been higher/lower by Shs 5,480,000 (2019: Shs 2,862,000).

4. Financial risk management (continued)

4.4 Market risk (continued)

Interest rate risk

The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Management sets limits on the level of mismatch of interest rate re-pricing that may be undertaken, which is monitored daily.

At 31 December 2020	Up to 1 Month	1-3 Months	3-6 Months	6-12 Months	Over 1 Year	Non-interest Bearing	Total
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Assets							
Cash and balances with Central Bank of Kenya	150,057	-	-		-	2,512,445	2,662,502
Investment securities:							
- Fair Value through OCI	-	-	-	-	6,081,891		6,081,891
- At Amortised Cost	104,733	105,318	-		1,682,860	-	1,892,911
Deposits and balances due from banking institutions	1,079,572	-	-	-	-	-	1,079,572
Loans and advances to customers	3,319,415	2,128,160	1,983,744	3,366,358	13,017,784	-	23,815,461
Investments in associates	-	-	-	-	-	358,813	358,813
Property and equipment	-	-	-	-	-	374,075	374,075
Intangible assets	-	-	-	-	-	69,336	69,336
Tax recoverable	-	-	-	-	-	49,305	49,305
Deferred income tax asset	-	-	-	-	-	706,730	706,730
Right of use asset	-	-	-	-	-	20,214	20,214
Other assets	-	-	-	-	-	779,333	779,333
Total assets	4,653,777	2,233,478	1,983,744	3,366,358	20,782,535	4,870,251	37,890,143
Liabilities & Shareholders' Funds							
Customer deposits	11,512,651	7,315,752	6,109,350	3,348,589	-	-	28,286,342
Deposit and balances due to banking Institutions	53,600	466,221	-	-	-	-	519,821
Borrowings	-	321,567	782,504	447,673	545,860	-	2,097,604
Lease liability	-	-	-	-	-	22,635	22,635
Other liabilities	-	-	-	-	-	219,145	219,145
Shareholders' funds	-	-	-	-	-	6,744,596	6,744,596
Total liabilities & shareholders' funds	11,566,251	8,103,540	6,891,854	3,796,262	545,860	6,986,376	37,890,143
Interest sensitivity gap	(6,912,474)	(5,870,062)	(4,908,110)	(429,904)	20,236,675	(2,116,125)	-
At 31 December 2019							
Total assets	3,675,543	1,326,149	2,181,946	2,555,394	20,727,051	5,606,327	36,072,410
Total liabilities	9,154,003	8,188,474	4,742,599	2,956,092	1,748,737	9,282,505	36,072,410
Interest sensitivity gap	(5,478,460)	(6,862,325)	(2,560,653)	(400,698)	18,978,314	(3,676,178)	-

4. Financial risk management (continued)

4.4 Market risk (continued)

Interest rate risk (continued)

Interest rates risk sensitivity analysis

31 December 2020

	Carrying amount Shs'000	Increase by 1% Shs'000	Decrease by 1% Shs'000
Assets			
Cash and balances with Central Bank of Kenya	2,662,502	-	-
Investment securities:	-	-	-
- Fair Value through OCI	6,081,891	-	-
- At Amortized Cost	1,892,911	-	-
Deposits and balances due from banking institutions	1,079,572	-	-
Loans and advances to customers	23,815,461	238,155	(238,155)
Investment in associate	358,813	-	-
Property and equipment	374,075	-	-
Intangible assets	69,336	-	-
Tax recoverable	49,305	-	-
Deferred income tax	706,730	-	-
Right of use asset	20,214	-	-
Other assets	779,333	-	-
Liabilities and Equity			
Customer deposits	24,384,866	(243,849)	243,849
Customer deposits Zero rated	3,901,476	-	-
Deposits and balances due to banking institutions	519,821	(5,198)	5,198
Borrowings	2,097,604	-	-
Lease liability	22,635	-	-
Other liabilities	219,145	-	-
Shareholders' equity	6,744,596	-	-
Net interest income increase/(decrease)		(10,892)	10,892
Tax charge at 25%		2,723	(2,723)
Impact on post tax profit		(8,169)	8,169

At 31 December 2020 assuming all other variables remain constant an increase/decrease of 100 basis point on interest rates would have resulted in an increase/decrease in post-tax profit of Shs 8,169,000 (2019: Shs 12,075,000).

4. Financial risk management (continued)

4.4 Market risk (continued)

Interest rate risk (continued)

Interest rates risk sensitivity analysis (continued)

The effective interest rates by major currency for monetary financial instruments at 31 December 2020 and 2019 were in the following ranges:

	2020 CURRENCIES		2019 CURRENCIES	
	Shs	**Other**	**Shs**	**Other**
Assets				
Government securities	11.69%	-	11.98%	-
Deposits and balances due from banking institutions	-	-	6.75%	-
Loans and advances to customers	11.97%	7.23%	12.51%	8.39%
Other investment securities	-	-	-	5.00%
Liabilities				
Customer deposits	6.56%	2.24%	7.69%	2.55%
Deposits and balances due to banking institutions	-	2.78%	-	4.35%
Borrowings	-	5.22%	-	6.69%

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

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

4.5 Fair values of financial assets and liabilities

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

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

The following table presents the Bank's assets that are measured at fair value at 31 December. There were no liabilities measured at fair value through profit and loss for the same period (2019: Nil).

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

At 31 December 2020	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Total Balance Shs'000
Assets				
Fair value through OCI				
- Debt investments	5,929,339	-	-	5,929,339
- Equity investments	83,781	-	72,186	155,967
- Impairment charge	(2,300)	-	(1,115)	(3,415)
Total assets	6,010,820	-	71,071	6,081,891

At 31 December 2019	Level 1 Shs'000	Level 2 Shs'000	Level 3 Shs'000	Total Balance Shs'000
Assets				
Fair value through OCI				
- Debt investments	3,941,411	-	244,153	4,185,564
- Equity investments	95,322	-	-	95,322
- Impairment charge	(2,300)	-	(1,115)	(3,415)
Total assets	4,034,433	-	243,038	4,277,471

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry Bank, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Bank is the current bid price. These instruments are included in level 1. Instruments included in level 1 comprise primarily foreign corporate bonds and Nairobi Securities Exchange ("NSE") equity investments classified as available for sale.

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

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

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

The fair value of investment securities at amortised cost listed at NSE as at 31 December 2020 is estimated at Shs 1,874,658,000 (2019: Shs 1,648,374,000) compared to their carrying value of Shs 1,771,950,000 (2019: Shs1,571,950,000). The fair value through OCI investment securities are carried at fair value in the Bank's books. The fair values of the Bank's other financial assets and liabilities approximate the respective carrying amounts, due to the generally short periods to contractual repricing or

4. Financial risk management (continued)

4.5 Fair values of financial assets and liabilities (continued)

maturity dates as set out above. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the Bank at the balance sheet date.

4.6 Capital Management

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

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

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

The Central Bank of Kenya requires each bank to: (a) hold the minimum level of regulatory capital of Shs1 billion; (b) maintain a ratio of total regulatory capital to the risk-weighted assets plus risk-weighted off-balance sheet assets (the 'Basel ratio') at or above the required minimum of 10.50%; (c) maintain core capital of not less than 8% of total deposit liabilities; and (d) maintain total capital of not less than 14.50% of risk-weighted assets plus risk-weighted off-balance sheet items.

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

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

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

Introduction of Basel II principles in the measurement and assessment of Capital Adequacy Ratios (CARs)

Kenyan banks computed the CARs based on Basel I methodology i.e., restricted to credit risk measurement of assets only. In the revised guideline effective from 2015, some principles of Basel II measurement of capital adequacy have been introduced. This will require Kenyan banks to also take into account capital charges for:

a. Operational risk –using the Basic Indicator Approach; and
b. Market risk - both specific and general market risks to be calculated using the standardized management approach.

4. Financial risk management (continued)

Introduction of Basel II principles in the measurement and assessment of Capital Adequacy Ratios (CARs) (continued)

The table below summarises the composition of regulatory capital adequacy ratios as at 31 December 2020.

	2020 Shs'000	2019 Shs'000
Tier 1 capital	6,097,283	5,827,565
Tier 1 + Tier 2 capital	6,604,574	6,368,498
Risk-weighted assets		
Adjusted credit risk weighted assets	28,625,799	25,877,060
Total market risk weighted assets equivalent	3,119,276	2,321,637
Total risk weighted assets equivalent for operation risk	3,405,876	3,405,876
Total risk-weighted assets	35,150,951	31,604,573
Basel ratio		
Core capital to risk – weighted assets (CBK minimum –10.5%)	17.30%	18.40%
Total capital to risk– weighted assets (CBK minimum - 14.50%)	18.80%	20.20%
Core Capital to deposits (CBK minimum –8 %)	21.60%	22.10%

5 (a). Interest income

Loans and advances to customers	2,816,161	2,879,003
Government securities	754,888	561,675
Loan fee and commission income	100,554	210,898
Cash and short-term funds	45,100	52,484
Other investments	6,234	5,786
	3,722,937	3,709,846

5 (b). Other income

Profit on sale of government securities	77,324	71,856
Dividend income	6,254	5,974
Other income	(5,133)	(3,016)
	78,445	74,814

6. Interest expense

	2020 Shs'000	2019 Shs'000
Fixed deposit accounts	1,381,057	1,397,592
Current and demand deposits	274,368	278,755
Deposits and balances due to banking institutions	30,715	1,287
Borrowings	150,164	199,842
Finance charge on leases	3,005	3,939
	1,839,309	1,881,415

7. Expenses by nature

The following items are included within operating expenses

Employee benefits (Note 8):		
- Key management	146,938	164,947
- Other employees	306,646	299,983
Depreciation of property and equipment (Note 16)	51,980	48,722
Amortisation of intangible assets (Note 17)	23,948	11,546
Auditor's remuneration (inclusive of value added tax)	4,000	4,000

8. Employee benefits

The following items are included within employee benefits expense:

Retirement benefit costs:		
- National Social Security Fund	199	193
- Employer Pension Contribution	20,682	21,162

The average number of employees during the year was 83 (2019: 80)

9. Investment in associates	**2020 Shs'000**	**2019 Shs'000**
At start of year	346,639	310,620
Share of profit for the year, net of tax	12,174	36,019
At end of year	358,813	346,639

The Bank owns 24.52% share capital of Victoria Towers Limited. Victoria Tower Limited's profit after tax for 2020 attributable to the owners of the parent was Shs 49,624,347 (2019: Shs.146,895,578). The Bank accounts for its share of associate profit equivalent to its shareholding.

The summarized financial information in respect of the associate is set out below.

	2020 Shs'000	**2019 Shs'000**
Total assets	1,855,078	1,867,930
Total liabilities	(367,295)	(430,802)
Net assets	1,487,783	1,437,128
Less: Non-controlling interest	(24,434)	(23,428)
Net Assets – Equity holders of the parent	1,463,349	1,413,700
Bank's share of net assets of Victoria Towers Limited	358,813	346,639
Total revenue	205,877	872,264
Profit for the year attributable to equity holders of the parent	49,624	146,896
Bank's share of profit for the year	12,174	36,019
Total Bank's share of profit	12,174	36,019

10. Income tax expense

	2020 Shs'000	2019 Shs'000
Current income tax	186,695	413,401
Deferred income tax (Note 18)	(214,338)	(271,987)
Prior year over provision (Note 18)	(4,055)	-
	(31,698)	141,414

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

	2020 Shs'000	2019 Shs'000
Profit before income tax	480,217	668,559
Tax calculated at the statutory income tax rate of 25 % (2019: 30%)	120,054	200,568
Tax effect of:		
-Income not subject to tax	(139,778)	(83,313)
-Expenses not deductible for tax purposes	27,804	24,159
-Effect of change in tax rate	(35,723)	-
-Prior year over provision (Note 18)	(4,055)	-
Income tax (credit) / expense	(31,698)	141,414

11.Earnings per share

Basic earnings per share are calculated on the profit attributable to shareholders of Shs. 511,915,000 (2019: Shs. 527,145,000) and on the weighted average number of ordinary shares outstanding during the year.

	2020 Shs'000	2019 Shs'000
Net profit attributable to shareholders (Shs '000)	482,971	527,145
Weighted average number of ordinary shares in issue ('000)	41,925	41,925
Basic earnings per share (Shs)	12.21	12.57

The Bank issued a debt instrument that has an option to convert into equity (Note 23). The dilutive earnings per share is Shs. 11.76 (2019: 12.12).

12. Dividends per share

During the year, the Bank did not pay an interim dividend (2019: Shs 113,197,000). Payment of dividends is subject to withholding tax at a rate of 5% for residents and 10% for non-resident shareholders.

13. Cash and balances with Central Bank of Kenya	2020 Shs'000	2019 Shs'000
Cash in hand	103,621	97,764
Balances with Central Bank of Kenya	2,558,881	2,714,573
	2,662,502	2,812,337

None of the above balances is impaired. The balances have been assessed for impairment in line with IFRS 9 and the arising expected credit loss was not material to these financial statements. No provision has therefore been made on the above balances (2019: Nil).

14. Loans and advances to customers	2020 Shs'000	2019 Shs'000
Overdrafts	7,805,769	8,887,716
Term loans	15,789,955	14,012,915
Advances under finance lease agreements	1,668,521	1,807,395
Credit cards	63,903	92,580
Gross loans and advances	25,328,148	24,800,606
- Staff loan adjustment	(19,240)	(25,485)
Less: Provision for impairment of loans and advances		
-Stage 1	(181,824)	(105,130)
-Stage 2	(173,350)	(136,383)
-Stage 3	(1,138,273)	(744,444)
	(1,493,447)	(985,957)
Net loans and advances	23,815,461	23,789,164

14. Loans and advances to customers (continued)

i). Loans and advances to customers at amortised cost

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Year ended 31 December 2020				
At start of year	22,316,717	1,279,455	1,204,434	24,800,606
Changes in the gross carrying amount				
-Transfer from stage 1 to stage 2	(1,529,632)	1,529,632	-	-
-Transfer from stage 1 to stage 3	(302,647)	-	302,647	-
-Transfer from stage 2 to stage 3	-	(177,531)	177,531	-
-Transfer from stage 3 to stage 2	-	-	-	-
-Transfer from stage 2 to stage 1	-	-	-	-
-Write-offs	-	-	(5,843)	(5,843)
New financial assets originated	533,385	-	-	533,385
At end of year	21,017,823	2,631,556	1,678,769	25,328,148

ii). Provisions – Loans and advances to customers

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Year ended 31 December 2020				
At start of year	105,130	136,383	744,444	985,957
Charge to profit or loss				
-Transfer from stage 1 to stage 2	-	36,967	-	36,967
-Transfer from stage 1 to stage 3	-	-	151,324	151,324
-Transfer from stage 2 to stage 3	-	-	248,348	248,348
-Transfer from stage 3 to stage 2	-	-	-	-
-Transfer from stage 2 to stage 1	-	-	-	-
-Write-offs	-	-	(5,843)	(5,843)
New loans originated	76,694	-	-	76,694
Total charge to profit or loss	76,694	36,967	393,829	507,490
Total provisions	181,824	173,350	1,138,273	1,493,447

14. Loans and advances to customers (continued)

ii). Provisions – Loans and advances to customers (continued)

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

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Year ended 31 December 2020				
At start of year	105,130	136,383	744,444	985,957
Prior year increase/ (decrease) in impairment provision	76,694	36,967	393,829	507,490
At end of year	181,824	173,350	1,138,273	1,493,447
Charge/(credit) to profit or loss				
Increase in impairment provision	76,694	36,967	393,829	507,490

All impaired loans are written down to their estimated recoverable amount. The aggregate carrying amount of impaired loans at 31 December 2020 was Shs 1,678,769,000 (2019: Shs 1,204,434,000).

The loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2020 Shs'000	2019 Shs'000
Net investment in finance leases:		
Not later than 1 year	125,886	52,868
Later than 1 year and not later than 5 years	1,542,635	1,738,883
Later than 5 years	-	15,644
	1,668,521	1,807,395

There were no individually assessed provisions for finance leases as at 31 December 2020 (2019: Nil).

14b. Reconciliation of the impairment charges

	2020 Shs'000
Loan impairment charge (Note 14 (a))	507,490
Impairment charge on investments (Note 15)	123,712
Interest on stage 3 loans	123,449
Write off (Note 14)	5,843
Impairment charge for the year	760,494

15. Investment securities

	2020 Shs'000	2019 Shs'000
Fair value through other comprehensive income		
Government securities	5,929,339	3,941,411
Foreign investments	81,481	272,904
Other local investments	71,071	66,571
Impairment charge	-	(3,415)
	6,081,891	4,277,471
At amortised cost		
Government securities		
- Maturing after 91 days of the date of acquisition	1,892,911	1,718,915
Foreign investments	123,712	109,030
Impairment charge	(123,712)	(1,287)
	1,892,911	1,826,658
Total investment securities	7,974,802	6,104,129

The Bank invests in government securities, corporate infrastructure bonds, placements with other banks and other non-bank entities as well as various offshore funds. These investments have been classified as either held at fair value through other comprehensive income (FVOCI) or amortised cost.

15. Investment securities (continued)

The movement in investments is shown below:

	Value at 1/1/2020 Shs'000	Purchases at Cost Shs'000	Disposals/ Maturities Shs'000	Premium/ Discount Shs'000	Interest Receivable Shs'000	Impairment Charge Shs'000	Forex Gain/Loss Shs'000	Gain in Fair Value Shs'000	Value at 31/12/2020 Shs'000
Fair value through other comprehensive income									
Government securities									
- T Bonds	3,939,577	10,609,167	(8,652,087)	-	-	-	-	32,682	5,929,339
Foreign securities	271,524	-	-	-	-	-	19,502	(209,545)	81,481
Other local investments	66,370	-	-	-	-	-	4,701	-	71,071
	4,277,471	10,609,167	(8,652,087)	-	-	-	24,203	(176,863)	6,081,891
At amortised cost									
Government securities:									
- Maturing after 91 days of the date of acquisition	1,718,115	400,000	(261,335)	(4,933)	41,064	-	-	-	1,892,911
Foreign investments	108,543	-	-	-	5,954	(123,712)	9,215	-	-
	1,826,658	400,000	(261,335)	(4,933)	47,018	(123,712)	9,215	-	1,892,911
Total investment securities	6,104,129	11,009,167	(8,913,422)	(4,933)	47,018	(123,712)	33,418	(176,863)	7,974,802

	Value at 1/1/2019 Shs'000	Purchases at Cost Shs'000	Disposals/ Maturities Shs'000	Premium/ Discount Shs'000	Interest Receivable Shs'000	Impairment Charge Shs'000	Forex Gain/Loss Shs'000	Gain in Fair Value Shs'000	Value at 31/12/2019 Shs'000
Fair value through other comprehensive income									
Government securities									
- T Bonds	2,156,920	13,527,517	(11,642,971)	-	-	(827)	-	(101,062)	3,939,577
Foreign securities	278,041	-	-	-	-	(349)	(1,268)	(4,900)	271,524
Other local investments	66,737	-	-	-	-	(61)	(306)	-	66,370
	2,501,698	13,527,517	(11,642,971)	-	-	(1,237)	(1,574)	(105,962)	4,277,471
At amortised cost									
Government securities:									
- Maturing after 91 days of the date of acquisition	1,657,397	800,000	(798,736)	25,320	34,301	(167)	-	-	1,718,115
Local corporate bond investments	6,049	-	(6,049)	-	-	-			-
Foreign investments	103,829	5,150	(2,198)	-	2,296	(24)	(510)	-	108,543
	1,767,275	805,150	(806,983)	25,320	36,597	(191)	(510)	-	1,826,658
Total investment securities	4,268,973	14,332,667	(12,449,954)	25,320	36,597	(1,428)	(2,084)	(105,962)	6,104,129

16. Property and Equipment

	Office premise Shs'000	Office improvements Shs'000	Furniture, fittings, and equipment Shs'000	Motor vehicles Shs'000	Total Shs'000
At 1 January 2019					
Cost	77,246	104,166	183,416	82,498	447,326
Accumulated depreciation	(25,292)	(45,664)	(123,489)	(39,540)	(233,985)
Net book amount	51,954	58,502	59,927	42,958	213,341
Year ended 31 December 2019					
Opening net book amount	51,954	58,502	59,927	42,958	213,341
Additions	-	139	6,028	-	6,167
Depreciation charge	(1,545)	(10,431)	(17,854)	(18,892)	(48,722)
Closing net book amount	50,409	48,210	48,101	24,066	170,786
At 1 January 2020					
Cost	77,246	104,305	189,443	82,498	453,492
Accumulated depreciation	(26,837)	(56,095)	(141,342)	(58,432)	(282,706)
Net book amount	50,409	48,210	48,101	24,066	170,786
Year ended 31 December 2020					
Opening net book amount	50,409	48,210	48,101	24,066	170,786
Additions	117,795	51,460	86,014	-	255,269
Depreciation charge	(2,527)	(12,940)	(22,996)	(13,517)	(51,980)
Closing net book amount	165,677	86,730	111,119	10,549	374,075
At 31 December 2020					
Cost	195,041	155,765	275,457	82,498	708,761
Accumulated depreciation	(29,364)	(69,035)	(164,338)	(71,949)	(334,686)
Net book amount	165,677	86,730	111,119	10,549	374,075

Included in the office premises are costs related to the floor owned by the Bank at Victoria Towers and Victoria at Two Rivers and the parking bays at the premises. The remaining floors of Victoria Towers and Victoria at Two Rivers are owned by Victoria Towers Limited, an associate of the Bank (Note 9).

17. Intangible assets

	2020 Shs'000	2019 Shs'000
Opening net book amount	92,135	33,034
Additions	1,149	70,647
Amortisation charge	(23,948)	(11,546)
Closing net book amount	69,336	92,135
Cost	230,203	229,054
Cost derecognized during the year	(94,079)	-
Accumulated amortisation	(66,788)	(136,919)
Closing net book amount	69,336	92,135

18. Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2019: 30%).
The movement on the deferred income tax account is as follows:

	2020 Shs'000	2019 Shs'000
At start of year	435,278	131,502
Prior year over provision	4,055	
Charge to profit or loss (Note 10)	214,338	271,987
Charge to other comprehensive income	53,059	31,789
At end of year	706,730	435,278

18. Deferred income tax (continued)

The deferred income tax asset, deferred income tax charge/(credit) in the income statement is attributable to the following items:

	1.1.2020	Prior Year (under)/over Provision	Charge to P&L	Charge to OCI	31.12.2020
	Shs'000	Shs'000	Shs'000	Shs'000	Shs'000
Year ended 31 December 2020					
Provisions for impairment	433,901	-	212,893	-	646,794
Property and equipment	(2,225)	4,055	1,445	-	3,275
Financial assets at FVOCI	3,602	-	-	46,856	50,458
Prior year over provision	-	-	-	6,203	6,203
Deferred income tax asset	435,278	4,055	214,338	53,059	706,730
Year ended 31 December 2019					
Provisions for impairment	159,753	-	274,148	-	433,901
Property and equipment	(64)	-	(2,161)	-	(2,225)
Financial assets at FVOCI	(28,187)	-	-	31,789	3,602
Deferred income tax asset	131,502	-	271,987	31,789	435,278

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

The Bank has concluded that the deferred income tax assets will be recoverable using the estimated future taxable income based on the approved business plans and budgets. The Bank is expected to continue generating taxable income.

19. Other assets

	2020	2019
	Shs'000	Shs'000
Local and upcountry cheques for clearing or collection	141,702	135,697
Prepayments	153,270	163,638
Staff loan benefit	19,240	25,485
Other debtors	75,121	52,839
Other non-current asset	390,000	-
	779,333	377,659

20. Customer deposits

	2020 Shs'000	2019 Shs'000
Current and demand deposits	3,452,765	2,622,605
Savings accounts	4,995,007	4,762,306
Fixed deposit accounts	19,838,570	19,010,183
	28,286,342	26,395,094

21. Deposits and balances due to banking institutions

Balances due to local banks	80,400	-
Balances due to foreign banks	439,421	955,113
	519,821	955,113

22. Deposits and balances due from banking institutions

Overnight lending	-	200,037
Current account balances with other banks	1,079,572	1,588,276
Placements with other banks	-	132,973
	1,079,572	1,921,286

The Bank calculated the expected credit loss on deposits due from other Banks and the amount was not material and therefore no adjustment was made.

23. Borrowings

	2020 Shs'000	2019 Shs'000
At start of year	2,062,303	1,940,093
Additions	-	304,010
Payments during the year	(153,696)	(186,147)
Revaluation	175,733	(15,809)
Accrued interest	13,264	20,156
At end of year	2,097,604	2,062,303

31 December 2020

Lender	Type of Loan	Loan Balance Shs' 000	Currency	Interest Rate	Issue Date	Tenure
Swedfund	Subordinated debt	545,860	USD	Referenced to 3-months Libor	April 2018	7 Years
International AB World Business Capital	Senior debt	495,320	USD	Referenced to 3-months Libor	June 2018	10 Years
Sifem AG	Senior debt	287,184	USD	Referenced to 6-months Libor	April 2019	5 Years
GCL Green Company	Term loan	321,567	EUR	Fixed rate of interest	May 2012	12 Years
Other borrowings	Other borrowings	447,673	USD	Referenced to 6-months Libor	June 2016	5 Years
		2,097,604				

31 December 2019

Lender	Type of Loan	Loan Balance Shs' 000	Currency	Interest Rate	Issue Date	Tenure
Swedfund	Subordinated debt	506,794	USD	Referenced to 3-months Libor	April 2018	7 Years
International AB World Business Capital	Senior debt	507,663	USD	Referenced to 3-months Libor	June 2018	10 Years
Sifem AG	Senior debt	307,854	USD	Referenced to 6-months Libor	April 2019	5 Years
GCL Green Company	Term loan	320,569	EUR	Fixed rate of interest	May 2012	12 Years
Other borrowings	Other borrowings	419,423	USD	Referenced to 6-months Libor	June 2016	5 Years
		2,062,303				

*The amounts have been translated using the CBK prevailing exchange rates at year end.

23. Borrowings (continued)

The Bank's borrowings include:

I. Subordinated Debt

USD 5 million unsecured facility raised from Swedfund International AB in April 2018, with a tenure of 7years. This facility bears interest at rates referenced to the 3 months Libor. Outstanding principal Balance as at 31 December 2020 was USD 5,000,000 (2019: USD 5,000,000).

II. Senior Debt

USD 5 Million raised from World Business Capital Inc. (WBC) in June 2018, with a tenure of 10 years. This facility bears interest at rates referenced to 3 months Libor. Outstanding principal balance as at 31 December 2020 was USD 4,531,250 (2019: USD 5,000,000).

USD 10Million raised from Sifem AG acting by Obviam DFI AG in April 2019 with a tenor of 5 years. This facility bears interest at rates referenced to 6 months Libor. Outstanding principal balance as at 31 December 2020 was USD.2,625,000 (2019: USD 3,000,000).

III. Other Borrowings

USD 4 Million unsecured 5-year term loans acquired in June 2016. The facility attracts interest rate referenced to 6-month Libor. Outstanding Principal Balance as at 31 December 2020 was USD 4,000,000 (2019: USD 4,000,000). As per the loan agreement, the lender has an option to convert either part, or the whole balance into equity at an agreed price-to-book multiple of 1.7 of the Bank's core capital and noncurrent assets valued at the market value as per the last unaudited financial statements of the Bank preceding the date of conversion. As at 31 December 2020, the Bank fair valued this borrowing and there was no significant difference between the fair value and the Book Value.

USD 15 Million unsecured credit line from GCL Green Company Limited. The loan attracts a fixed rate of interest. Outstanding principal balance as at 31 December 2020 was USD 2,393,883 (2019: USD 3,152,124).

Compliance with debt covenants

During the year, the Bank met all its loan repayment obligations and was compliant with all financial covenants stipulated by the lenders except for the open credit exposure ratio with Sifem AG, and the non-performing loan ratio with Sifem AG and WBC. The bank obtained the applicable waivers from the respective lenders. The lenders have not varied the lending terms of the facilities.

24. Other liabilities

	2020 Shs'000	2019 Shs'000
Bankers cheques	10,144	10,554
Accrued expenses	46,643	64,772
Unamortized income	127,459	11,736
Others	34,899	55,795
	219,145	142,857

25. Share capital

	Number of Shares Shs '000	Share Capital Shs '000	Share Premium Shs '000
Balance at 1 January 2019, 31 December 2019 and, 31 December 2020	41,925	838,494	1,321,289

26. Right of use asset

	2020 Shs'000	2019 Shs'000
Cost		
At start of year	36,515	-
Additions	10,660	36,515
Disposals	(2,891)	-
At end of year	44,284	36,515
Accumulated depreciation		
At start of year	13,518	-
Charge for the period	13,443	13,518
Disposal	(2,891)	-
At end of year	24,070	13,518
Closing net book amount	20,214	22,997

27. Lease liability

	2020 Shs'000	2019 Shs'000
Lease liabilities	22,635	25,194

The total cash outflow for leases in the year was:

	2020 Shs'000	2019 Shs'000
Payment of principal portion of the lease liability	16,224	11,321
Interest paid on lease liabilities	3,005	3,939
	19,229	15,260
At start of year	25,194	-
Additions	10,660	36,515
Interest on lease liabilities	3,005	3,939
Lease payments	(16,224)	(15,260)
At end of year	22,635	25,194

28. Off balance sheet financial instruments, contingent liabilities, and commitments

In the ordinary course of business, the Bank conducts business involving guarantees, acceptances, and performance bonds. These facilities are offset by corresponding obligations of third parties. In addition, there are other off-balance sheet financial instruments including forward contracts for the purchase and sale of foreign currencies, whose nominal amounts are not reflected in the balance sheet. At the year end, the contingent items were as follows:

	2020 Shs'000	2019 Shs'000
Contingent liabilities		
Acceptances and letters of credit	2,371,898	1,762,668
Guarantees and performance bonds	1,834,224	543,916
	4,206,122	2,306,584

Nature of contingents

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

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

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

Forward foreign exchange contracts are commitments to either purchase or sell a designated financial instrument at a specified future date for a specified price and may be settled in cash or another financial asset. The fair values of the respective currency forwards are carried under other assets and other liabilities as appropriate.

	2020 Shs'000	2019 Shs'000
Other commitments		
Undrawn formal stand-by facilities, credit lines and other commitments to lend	4,041,148	3,904,690
Foreign exchange forward contracts	-	61,485
	4,041,148	3,966,175

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

Nature of commitments

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

The table below contains the maturity analysis of off balance sheet financial instruments, contingent liabilities, and commitments;

	0-3 months Shs' 000	3-6 months Shs' 000	6-12 months Shs' 000	1-5 Years Shs' 000	Total Shs' 000
31 December 2020					
Acceptances and letters of credit	1,240,490	975,858	155,550	-	2,371,898
Guarantees and performance bonds	140,084	391,551	423,919	878,670	1,834,224
Undrawn formal stand-by facilities, credit lines and other commitments to lend	1,353,048	667,284	1,984,527	36,289	4,041,148
31 December 2019					
Acceptances and letters of credit	653,388	897,191	212,089	-	1,762,668
Guarantees and performance bonds	209,494	111,956	197,181	25,285	543,916
Undrawn formal stand-by facilities, credit lines and other commitments to lend	1,813,030	321,550	641,609	1,128,501	3,904,690

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

	2020 Shs'000	2019 Shs'000
Cash and balances with Central Bank of Kenya (Note 13)	2,662,502	2,812,337
Less: Cash reserve requirement	(1,167,876)	(1,365,992)
Deposits and balances due from banking institutions (Note 22)	1,079,572	1,921,286
	2,574,198	3,367,631

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 91 days maturity from the date of acquisition including: cash and balances with central banks, treasury bills and other eligible bills, and amounts due from other banks. Cash and cash equivalents exclude the cash reserve requirement held with the Central Bank of Kenya.

Banks are required to maintain a prescribed minimum cash balance with the Central Bank of Kenya that is not available to finance the bank's day-to-day activities. The amount is determined as 4.25% (2019: 5.25%) of the average outstanding customer deposits over a cash reserve cycle period of one month.

30. Assets pledged as security

The Bank has pledged assets in form of treasury bonds to secure certain trade finance and money market lines. The total assets pledged as at 31 December 2020 was Shs 500,000,000 (2019: Shs 500,000,000).

31. Related party transactions

The Bank is owned by a diverse group of shareholders and none of them holds a controlling interest.

A number of transactions are entered into with related parties in the normal course of business. These include loans, deposits, and foreign currency transactions.

I) Loans and advances to related parties

Advances to customers at 31 December 2020 include an amount of Shs 300,330,000 (2019: Shs 339,158,000) relating to loans to companies controlled by directors or their families, and/ or shareholders of the Bank and Bank employees.

	2020 Shs'000	2019 Shs'000
At start of year	339,158	502,788
Loans advanced during the year	100,807	49,988
Loan repayments during the year	(192,605)	(256,791)
Interest charged	52,970	43,173
At end of year	300,330	339,158

I) Loans and advances to related parties

Out of Shs 300,330,000 that relates to lending to related parties, Shs 75,201,000 (2019: 77,039,000) relates to employee loans. Employees loans are advanced at rates lower than commercial rates but equal or higher than the ruling fringe benefit tax rates. Loans to all other related parties are advanced at commercial rates.

Loans and advances to related parties are 100% performing and fully secured. No identified impairment provision has been recognised on loans and advances to related parties during the year.

II) Related party deposits

At 31 December 2020, customer deposits include deposits due to staff, directors and shareholders or their associates amounting to Shs 686,671,000 (2019: Shs 571,600,000). These deposits attract rates of interest similar to all other deposits.

III) Purchase of goods and services

	2020 Shs'000	2019 Shs'000
Victoria Towers Limited - rent and service charge	8,233	8,241
Victoria Towers Limited – parking	552	557
Victoria at Two Rivers – service charge	1,618	-
At end of year	10,403	8,798

31. Related party transactions (continued)

IV) Key management compensation

Key management includes directors (executive and non-executive) and members of senior management. The compensation paid or payable to key management for employee services is shown below:

	2020 Shs'000	2019 Shs'000
Salaries and other short-term employee benefits	146,938	164,947

V) Directors' remuneration

Fees for services as a director	24,990	30,100
Salaries (included in key management compensation above)	80,818	78,663
	105,808	108,763

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