MIDDLE EAST BANK KENYA LIMITED

ANNUAL REPORT & FINANCIAL STATEMENTS

2022

Table of Contents

	Page No
Bank information	1 – 3
Chairman's statement	4 – 6
Directors' report	7 - 8
Statement of directors' responsibilities	9
Report of the independent auditor	10 – 12
Financial statements:	
Statement of comprehensive income	13
Statement of financial position	14
Statement of changes in equity	15
Statement of cash flows	16
Notes to the financial statements	17 – 77

Board of directors:	Akber A K Esmail - Chairman Isaac Mwige - Managing Director Nancy Kaminchia Thomas Mulwa Faith Kibowen Titus Ibui Dhiren Rana
Company secretary:	Zainash Registrars 1st Floor, Pacis Centre Off Waiyaki Way, Westlands P.O Box 349 – 00606 Nairobi, Kenya
Registered office and principal place of business:	MEBank Tower Milimani Road P.O Box 47387 – 00100 Nairobi, Kenya Tel: 0111183000 Email: ho@mebkenya.com Website: www.mebkenya.com
Auditors:	PricewaterhouseCoopers LLP PwC Tower Waiyaki Way/Chiromo Road, Westlands P.O Box 43963 – 00100 Nairobi, Kenya
Branches:	**Milimani Road Branch** Mebank Tower Milimani Road P.O Box 47387 – 00100 Nairobi, Kenya **Industrial Area Branch** Butere Road Off Dar es Salaam Road P.O Box 18973 – 00400 Nairobi, Kenya **Nkrumah Road Branch** Nkurumah Road P.O Box 90343 – 80100 Mombasa, Kenya **Eldoret Branch** Ronald Ngala Street P.O Box 7847 – 30100 Eldoret, Kenya

Board and senior management committees

Board Audit Committee

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

Board Credit Committee

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

Board Risk & Compliance Committee

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

Senior Management & ICT Steering Committees

I Mwige	-	Managing Director *(Senior Management Committee only)*
M Kausya	-	Head, Finance & Strategy
F Chumo	-	Head, Governance
M Gitahi	-	Head, Internal Audit
E Omolo	-	Head, Compliance
C Mbela	-	Head, Corporate
J Ndwiga	-	Head, Institutional Banking
J Muchangi	-	Head, Treasury
G Settim	-	Head, ICT
E Ong'are	-	Manager, Credit

Assets & Liabilities Committee

Managing Director - Chairman
Head, Treasury
Head, Finance & Strategy
Head, Credit
Head, Operations
Head, Corporate
Head, Institutional Banking
Head, Compliance
Head, Governance

Management Credit Committee

Managing Director - Chairman
Head, Credit
Head, Corporate

Risk Management Committee

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

Meetings of the Board of Directors and Committees of the Board in 2022

Board of Directors Meetings in 2022

The Board of Directors held four ordinary meetings in 2022

Director	March 2022	July 2022	October 2022	December 2022
A A K Esmail	√	√	√	√
I Mwige	√	√	√	√
D Rana	√	√	√	√
N Kaminchia	√	√	√	√
T Ibui	√	√	√	√
T Mulwa	√	√	√	√
F Kibowen	√	√	√	√

Board Audit Committee Meetings in 2022

The Board Audit Committee held four meetings in 2022

Director	March 2022	June 2022	September 2022	December 2022
F Kibowen	√	√	√	√
N Kaminchia	√	√	√	√
T Ibui	√	√	√	√
T Mulwa	√	√	√	x
D Rana	√	√	√	√
I Mwige*	√	√	√	√

Board Risk and Compliance Committee Meetings in 2022

The Board Risk and Compliance Committee held five meetings in 2022

Director	February 2022	May 2022	June-Special 2022	August 2022	November 2022
N Kaminchia	√	√	√	√	√
T Ibui	√	√	√	√	√
A A K Esmail	x	√	√	√	x
D Rana	√	√	√	√	√
I Mwige	√	√	√	√	√

Board Credit Committee Meetings in 2022

The Board Credit Committee held five meetings in 2022

Director	March 2022	May 2022	September 2022	November 2022	December 2022-Special
A A K Esmail	√	√	√	√	√
D Rana	√	√	√	√	x
T Ibui	√	√	√	√	√
T Mulwa	√	√	√	√	√
I Mwige	√	√	√	√	√

√ Attended Meeting x Absent from meeting with apology

On behalf of the Board of Directors, it gives me great pleasure to present to you our 42nd Annual Report and Financial Statements for the year ended 31st December 2022.

Despite the macroeconomic headwinds, insecurity, and the aftermath of the COVID-19 pandemic, we remained true to our commitment to strengthen our institution and enhance the value that accrues to our shareholders.

Despite these problems, I am happy to confirm that the Bank has delivered commendable results.

The Macroeconomic and Operating Environment

Kenya's economy grew by about 5.3% in 2022 from the 7.5% expansion recorded in 2021. The slowdown primarily came as a result of the negative impact of the general elections held in August 2022 as well as increased energy prices following the Ukraine – Russia war.

The 2022 economic performance and environment in Kenya were defined by the below major factors:

- The Russia -Ukraine war, led to a sharp increase in commodity prices (food and fuel) as a result of trade supply-chain disruptions and increased global inflation.
- High inflation in the global economy as a result of measures taken by governments to mitigate the effects of the COVID-19 pandemic. As economies recovered, economic growth was suppressed due to increased inflation.
- Low demand for Kenyan exports. This resulted in a reduction in export earnings and remittances leaving the economy vulnerable to exchange rate shocks.
- The general election in Kenya was a transition, coming with uncertainties on the transfer of power, dampened business confidence and capital flight experienced by the economy.
- The long drought experienced in arid and semi-arid areas resulted in reduced agriculture production and millions facing starvation.

The outlook for 2023 remains challenging, with declines in economic activity expected and with it a further tightening of consumer spending and real incomes.

Global economic activity is experiencing a broad-based and sharper-than-expected slowdown, with inflation higher than seen in several decades. The cost-of-living crisis, tightening financial conditions in most regions, Russia's invasion of Ukraine, and the lingering COVID-19 pandemic all weigh heavily on the outlook.

Global growth is projected to fall from an estimated 3.4 per cent in 2022 to 2.9 per cent in 2023, then rise to 3.1 per cent in 2024 as per the World Economic Outlook survey by the IMF. The 2023 forecast is below the historical average of 3.8 per cent. Rising interest rates and the war in Ukraine continue to weigh on economic activity. China's recent reopening has paved the way for a faster-than-expected recovery. Global inflation is expected to fall to 6.6 per cent in 2023 and 4.3 per cent in 2024, still above pre-pandemic levels.

The Bank's Performance

Our underlying profit before tax at Shs 544 million, grew by 261%. This was supported by low levels of impairment, recovery on the legacy NPL book, growth on Non-funded income in 2022 and cost control.

Interest income grew by 19% to Shs 1.22 billion (2021: Shs 1.02 billion). Non-funded income grew by 170% to Shs 596 million (2021: Shs 221 million).

The profit before tax was Shs 544 million (2021: Shs 151 million) while the profit after tax was Shs 403 million (2021: Shs 123 million).

Total assets closed at Shs 12.96 billion (2021: Shs 11.19 billion). Customer deposits held were Shs 9.33 billion (2021 Shs 9.47 billion), Loans and advances balance grew by 4% to Shs 5.8 billion (2021: Shs 5.6 billion) and Government securities grew by 32% to Shs 4.4 billion (2021: Shs 3.4 billion).

As a Bank, we continue to support the interest of our shareholders while maintaining adequate capital to support the sustainable growth of the business. We remain committed to delivering value to our shareholders as we continue to strengthen our balance sheet and uplift our service delivery to our customers. While we are cautiously optimistic of prospects, especially due to the uncertain landscape that we are currently operating in: I am confident that Bank's strategy will continue to ensure that we can support all of our stakeholders through the challenges and opportunities in the years to come.

CBK Ratios

The Bank reported strong capital adequacy ratios which continue to be well above the minimum statutory ratios. The Bank's core capital grew by 29% to Shs 1.69 billion (2021: Shs 1.31 billion) against a minimum capital requirement of Shs 1 billion.

The Bank complied with all other regulatory ratios throughout the year.

Dividend

Based on the Bank's performance, the Board of Directors recommends the payment of a total dividend of Shs 10 million (2021: 10 million) equivalent to 2.5% (2021: 8.1%) of the profit after tax to the shareholders who were on the register of members as at 31 December 2022. This will be subject to shareholders' approval at the forthcoming Annual General Meeting (AGM).

Corporate Social Responsibility (CSR)

As part of its CSR activities for 2022, the Bank focused on supporting those made more vulnerable by the effects of the COVID-19 pandemic. The Bank continued to support various charities and secondary school education of up to 100 top-performing children from financially challenged backgrounds. This is in line with one of the Bank's values "Being a responsible Corporate Citizen". We believe that investing in the youth of Kenya is investing in the future of the country. This is also aligned with the Bank's ESG beliefs & plans to be rolled out in the coming months.

The Board

The Board will continue to oversee the task of striking the right balance between the opportunities and risks that we see. The Board of Directors remains committed to all stakeholders and maintains the highest standards of corporate governance.

Appreciation

In closing, I hereby reiterate our Bank's commitment to taking full advantage of the opportunities that will be presented in 2023. The Bank will grow its earnings, improve profitability and asset quality, and deliver good return to our shareholders.

On behalf of the Board, I would like to express our sincere gratitude to our shareholders, our regulators, our business partners, and all our external stakeholders. The Board is grateful for your support.

To our Management, our staff and our colleagues on the Board, I say a big thank you for your diligence, hard work, passion, and commitment to achieving our collective goals.

Thank you.

AAK Esmail
Chairman

The directors submit their report together with the audited financial statements of Middle East Bank Kenya Limited (the "Bank") for the year ended 31 December 2022.

BUSINESS REVIEW

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

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

The Bank's performance grew year on year. There was 261% growth in profit before tax, mainly driven by increase in total income and decline in the provisions charge. Profit before tax increased from Shs 151 million to Shs 544 million. Interest income was Shs 1,216 million (2021: Shs 1,024 million) while interest expense was Shs 672 million (2021: Shs 570 million).

The balance sheet grew by 16% from Shs 11.19 billion to Shs 12.96 billion. Customer deposits held were Shs 9.33 billion (2021: Shs 9.47 billion), Loans and advances balances grew by 4% to Shs 5.79 billion (2021: Shs 5.57 billion) and Government securities grew by 32% to Shs 4.42 billion (2021: Shs 3.36 billion).

The Bank reported strong capital adequacy ratios which continue to be well above the minimum statutory ratios.

The profit for the year of Shs 403,307,000 (2021: Shs 123,400,000) has been added to retained earnings.

RECOMMENDED DIVIDEND

The directors recommend the approval of a final dividend of Shs 0.39 per share (2021: Shs 0.39 per share) amounting to Shs 10,000,000 (2021: Shs 10,000,000).

DIRECTORS

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

A A K Esmail	Chairman
I Mwige	Managing Director
D Rana	
N Kaminchia	
T Mulwa	
F Kibowen	
T Ibui	

In line with Central Bank of Kenya Prudential Guidelines, all directors attended over 75% of board meetings. Evaluation of the directors was through peer and self-evaluation.

STATEMENT AS TO DISCLOSURES TO THE COMPANY'S AUDITORS

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

(a) there is, as far as each director is aware, no relevant audit information of which the company's auditors are unaware; and

(b) the director has taken all steps that ought to have been taken as a director, so as to be aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

TERMS OF APPOINTMENT OF AUDITORS

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

The directors monitor the effectiveness, objectivity and independence of the auditor. The directors also approve the annual audit engagement contract which sets out the terms of the auditor's appointment and the related fees.

By order of the Board
ZAINASH REGISTRARS
....SECRETARY
Zainash Registrars
Secretary
16 March 2023

The Kenyan Companies Act, 2015 requires the directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Bank as at the end of the financial year and of its profit or loss for that year. It also requires the directors to ensure that the Bank keeps proper accounting records that: (a) show and explain the transactions of the Bank; (b) disclose, with reasonable accuracy, the financial position of the Bank; and (c) enable the directors to ensure that every financial statement required to be prepared complies with the requirements of the Companies Act, 2015.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 accounting estimates and judgements that are reasonable in the circumstances.

Having made an assessment of the ability of the Bank 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 use of going concern basis for preparation of these financial statements.

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

Approved by the Board of Directors on 16 March 2023 and signed on its behalf by:

Isaac Mwige
Director

Akber Esmail
Director

pwc

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

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Middle East Bank Kenya Limited (the "Bank") set out on pages 13 to 77 which comprise the statement of financial position at 31 December 2022, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and the notes to the financial statements, which include a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 31 December 2022 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 Code of Ethics for Professional Accountants (including International Independence Standards) issued by the International Ethics Standards Board for Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our other ethical responsibilities in accordance with 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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Partners: E Kerich B Kimacia M Mugasa A Murage F Muriu P Ngahu B Ngunjiri R Njoroge S O Norbert's B Okundi K Saiti

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF MIDDLE EAST BANK KENYA 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 judgment and maintain professional scepticism throughout the audit. We also:

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

- 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.

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

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

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

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

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

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

In our opinion the information given in the report of the directors on page 7 to 8 is consistent with the financial statements.

Richard Njoroge

FCPA Richard Njoroge, Practising certificate No. 1244
Engagement partner responsible for the audit

For and on behalf of PricewaterhouseCoopers LLP
Certified Public Accountants
Nairobi **21 March 2023**

Statement of comprehensive income

	Notes	2022 Shs'000	2021 Shs'000
Interest income	5(a)	1,216,432	1,024,018
Interest expense	5(b)	(671,881)	(569,686)
Net interest income		544,551	454,332
Fee and commission income		207,514	138,744
Foreign exchange income		106,748	41,189
Other operating income	6	281,966	40,721
Total income		1,140,779	674,986
Credit impairment charges	16	(34,500)	(32,114)
Operating expenses	7	(561,938)	(491,883)
Profit before income tax		544,341	150,989
Income tax charge for the year	9	(141,034)	(27,589)
Profit for the year		403,307	123,400
Other comprehensive income		-	-
Total comprehensive income for the year		403,307	123,400
Basic earnings per share	10	15.91	4.87

Statement of financial position

	Notes	2022 Shs'000	2021 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	12	1,054,585	749,081
Government securities at amortized cost	13	4,422,569	3,360,211
Deposits and balances due from banking institutions	14	1,094,971	963,905
Loans and advances to customers	16	5,788,334	5,573,095
Property and equipment	18	189,459	178,824
Prepaid operating lease rentals	19	69,583	70,548
Right of use assets	20	7,547	14,250
Intangible assets	21	30,450	30,464
Other assets and prepayments	15	158,301	114,041
Deferred income tax	17	146,389	131,957
Total assets		12,962,188	11,186,376
LIABILITIES			
Deposits and balances due to banking institutions	22	1,103,334	100,000
Deposits from customers	23	9,326,192	9,465,426
Borrowings	24	408,246	-
Other liabilities and accrued expenses	25	227,694	168,939
Lease liabilities	26	9,754	18,116
Current income tax		93,592	33,826
Total liabilities		11,168,812	9,786,307
SHAREHOLDERS' EQUITY			
Share capital	27	506,831	506,831
Regulatory reserve	28	65,527	23,407
Retained earnings		1,221,018	869,831
Total shareholders' equity		1,793,376	1,400,069
Total equity and liabilities		12,962,188	11,186,376

The financial statements on pages 13 to 77 were approved for issue by the board of directors on 16 March 2023 and signed on its behalf by:

Isaac Mwige
Director

Nancy Kaminchia
Director

ZAINASH REGISTRARS

Akber Esmail
Director

Zainash Registrars
SECRETARY
Company Secretary

Statement of changes in equity

	Notes	Share capital Shs'000	Regulatory reserve Shs'000	Fair value reserve Shs'000	Retained earnings Shs'000	Total Shs'000
Year ended 31 December 2021						
At start of year		506,831	12,336	(2,331)	757,502	1,274,338
Total comprehensive income for the year						
Profit for the year		-	-	-	123,400	123,400
Unwinding of fair value losses		-	-	2,331	-	2,331
Transfer from regulatory reserve	28	-	11,071	-	(11,071)	-
At end of year		506,831	23,407	-	869,831	1,400,069
Year ended 31 December 2022						
At start of year		506,831	23,407	-	869,831	1,400,069
Total comprehensive income for the year						
Profit for the year		-	-	-	403,307	403,307
Transfer from regulatory reserve	28	-	42,120	-	(42,120)	-
Transactions with Owners:						
Final payment of 2021 dividends		-	-	-	(10,000)	(10,000)
		506,831	65,527	-	1,221,018	1,793,376

Statement of cash flows

	Notes	2022 Shs'000	2021 Shs'000
Cash flows from operating activities			
Interest receipts		1,216,432	1,024,018
Interest payments		(671,881)	(567,062)
Fee and commission receipts		207,514	138,744
Foreign exchange receipts		106,748	41,189
Other income received		281,966	45,431
Payments to employees and suppliers		(517,828)	(454,671)
Income tax paid		(95,700)	(23,550)
Cash flows from operating activities before changes in operating assets and liabilities		527,251	204,099
Changes in operating assets and liabilities:			
Gross loans and advances		(249,739)	1,674,495
Cash reserve requirement		(21,894)	60,587
Other assets and prepayments		(44,260)	40,817
Government securities at amortized cost		(1,062,358)	(1,476,738)
Government securities at fair value		-	320,865
Customer deposits		(139,234)	(58,021)
Other liabilities and accrued expenses		58,755	54,927
Net cash generated from operating activities		(931,479)	821,031
Cash flows from investing activities			
Purchase of property and equipment	18	(37,164)	(29,861)
Purchase of intangible assets	21	(7,888)	(5,049)
Net cash used in investing activities		(45,052)	(34,910)
Cash flows from financing activities			
Borrowings	24	407,875	-
Repayment of lease liability	26	(10,002)	(9,632)
Dividends paid	11	(10,000)	-
Cash used in financing activities		387,873	(9,632)
Net decrease in cash and cash equivalents		(588,658)	776,489
Cash and cash equivalents at start of year		1,279,399	502,910
Cash and cash equivalents at end of year	30	690,741	1,279,399

Notes

1 General information

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

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

2 Summary of significant accounting policies

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

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board.

(i) Basis of measurement

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

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

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

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

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

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

Notes (continued)

2 Summary of significant accounting policies

(a) Basis of preparation

(b) Use of estimates

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

(c) *Changes in accounting policy and disclosures*

(i) New and amended standards adopted by the Bank

The following standards and interpretations have been applied by the Bank for the first time for the financial reporting year commencing on or after 1 January 2022:

Number	Effective date	Executive summary
IFRS 16, 'Leases' COVID-19-Related Rent Concessions Amendment	Annual periods beginning on or after 1 April 2021 (early adoption is permitted) (Published March 2021)	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. On 31 March 2021, the IASB published an additional amendment to extend the date of the practical expedient from 30 June 2021 to 30 June 2022. Lessees can elect to account for such 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 variable lease payments in the period(s) in which the event or condition that triggers the reduced payment occurs. The March 2021 amendment will only be available if an entity chose to apply the May 2020 optional practical expedient.
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.

Notes (continued)

2 Summary of significant accounting policies (continued)

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

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

Number	Effective date	Executive summary
		• 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.
Amendments to IAS 37 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.
Amendments to IAS 16 Property, Plant and Equipment: 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.
Amendment to IFRS 3, 'Business combinations' Asset or liability in a business combination clarity	Annual periods beginning on or after 1 January 2022 (Published May 2020)	The Board has updated IFRS 3, 'Business combinations', to refer to the 2018 Conceptual Framework for Financial Reporting, in order to determine what constitutes an asset or a liability in a business combination. In addition, the Board added a new exception in IFRS 3 for liabilities and contingent liabilities. The exception specifies that, for some types of liabilities and contingent liabilities, an entity applying IFRS 3 should instead refer to IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets', or IFRIC 21, 'Levies', rather than the 2018 Conceptual Framework. The Board has also clarified that the acquirer should not recognise contingent assets, as defined in IAS 37, at the acquisition date.
None of these amendments have had a significant impact on the financial statements.		

Notes (continued)

2 Summary of significant accounting policies (continued)

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

New and amended standards not yet adopted by the Bank (continued)

The Bank has not applied the following new or revised Standards and Interpretations that have been published but are not yet effective for the year beginning 1 January 2022, and the Directors do not plan to apply any of them until they become effective.

Number	Effective date	Executive summary
Amendment to IAS 1, 'Presentation of Financial Statements' on Classification of Liabilities as Current or Non-current	Annual periods beginning on or a 1 January 2023 (Published Jan 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. A number of requirements are required to be met in conjunction with this amendment. Further detailed information is available at the following link: In Brief 2020-3
Amendments to IAS 12, Income Taxes: Deferred Tax related to Assets and Liabilities arising from a Single Transaction	Annual periods beginning on or a 1 January 2023. Earlier applicatio permitted. (Published May 2021)	The amendments require companies to recognise deferred tax on transactions that, on initial recognition give rise to equal amounts of taxable and deductible temporary differences.
Narrow scope amendments to IAS 1 'Presentation of Financial Statements', Practice statement 2 and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'	Annual periods beginning on or after 1 January 2023. Earlier application is permitted. (Published February 2021)	The amendments aim to improve accounting policy disclosures and to help users of the financial statements to distinguish changes in accounting policies from changes in accounting estimates.

The Directors do not plan to apply the above standards, until they become effective. Based on their assessment of the potential impact of application of the above, they don't expect a material impact on the Bank's financial statements.

There are no other standards that are not yet effective that would be expected to have a material impact on the entity in the current or future reporting periods and on near future transactions.

Notes (continued)

2 Summary of significant accounting policies (continued)

(d) Interest income and expense

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

Effective interest rate
Income from Government securities at amortized cost, deposits and balances due from other banking institutions and loans and advances to customers is recognized in profit or loss using the effective interest rate method.

The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

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

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

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

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

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

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Fees and commissions

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

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

(f) Translation of foreign currencies

(a) Functional and presentation currency

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

(b) Transactions and balances

Transactions in foreign currencies during the year are converted into the functional currency using the exchange rate prevailing at the transaction date. Monetary assets and liabilities at the balance sheet date denominated in foreign currencies are translated into the functional currency using the exchange rate prevailing as at that date.

The resulting foreign exchange gains and losses from the settlement of such transactions and from year-end translation are recognised on a net basis in the income statement in the year in which they arise, except for differences arising on translation of non-monetary assets measured at fair value through other comprehensive income, which are recognised in other comprehensive income.

(g) Financial assets and liabilities

Classification and measurement of financial instruments

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

Classification of financial instruments

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

<table>
<tr><th colspan="2">Category
(as defined by IFRS 9)</th><th>Class (as determined by the Bank)</th><th>Subclasses</th></tr>
<tr><td rowspan="10"></td><td rowspan="7">Financial assets at amortized cost</td><td>Cash and balances with Central Bank of Kenya</td><td></td></tr>
<tr><td>Government securities at amortized cost</td><td></td></tr>
<tr><td>Deposits and balances due from banking institutions</td><td></td></tr>
<tr><td rowspan="4">Loans and advances to customers</td><td>Commercial loans</td></tr>
<tr><td>Overdrafts</td></tr>
<tr><td>Personal loans</td></tr>
<tr><td>Mortgages</td></tr>
<tr><td rowspan="4">Financial liabilities at amortized cost</td><td>Deposits and balances due to banking institutions</td><td></td></tr>
<tr><td rowspan="3">Customer deposits</td><td>Current accounts and demand deposits</td></tr>
<tr><td>Savings and transaction accounts</td></tr>
<tr><td></td><td>Fixed deposit accounts</td></tr>
<tr><td rowspan="3">Off-balance sheet financial Instruments</td><td colspan="3">Acceptances and letters of credit</td></tr>
<tr><td colspan="3">Guarantees and performance bonds</td></tr>
<tr><td colspan="3">Undrawn formal stand-by facilities, credit lines and other commitments to lend</td></tr>
</table>

Initial recognition and measurement

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Initial recognition and measurement (continued)

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

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

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

Financial assets

(i) Classification and subsequent measurement

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

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

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

Debt instruments

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

Classification and subsequent measurement of debt instruments depend on:

- 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:

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Debt instruments (continued)

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

- Fair value through profit or loss: Assets that do not meet the criteria for amortized cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognized in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial assets (continued)

i) Classification and subsequent measurement (continued)

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

(ii) Impairment

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

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

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

(iii) Modification of loans

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial assets (continued)

iii) Modification of loans (continued)

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

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

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

(iv) Derecognition other than on a modification

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

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

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial liabilities

(i) Classification and subsequent measurement

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

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

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

- Financial guarantee contracts and loan commitments.

(ii) Derecognition

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

Financial guarantee contracts and loan commitments

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

- The amount of the loss allowance; and

  The premium received on initial recognition less income recognized in accordance with the principles of IFRS 15.

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

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

(h) Impairment of financial assets

The Bank recognises loss allowance at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

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

(i) Assets carried at amortized cost

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

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

(a) significant financial difficulty of the issuer or obligor;
(b) a breach of contract, such as a default or delinquency in interest or principal payments;

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

(i) Assets carried at amortized cost (continued)

(c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

(d) it becomes probable that the borrower will enter bankruptcy or other financial reorganization;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

(i) adverse changes in the payment status of borrowers in the portfolio; and
(ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

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

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

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Impairment of financial assets (continued)

(i) Assets carried at amortized cost (continued)

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

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

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

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

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

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

(i) Property and equipment

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

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

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each reporting date. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit.

Notes (continued)

2 Summary of significant accounting policies (continued)

(j) Intangible assets

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

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

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

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

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

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

(k) Offsetting

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

(l) Income tax

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

(a) Current income tax

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Income tax (continued)

(b) Deferred income tax

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

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

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

(m) Employee benefits

Retirement benefit obligation

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

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

(n) Dividends payable

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

(o) Forward foreign exchange contract

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(p) Acceptances and letters of credit

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

(q) Leases

(i) *Leases under which the Bank is the lessee*

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

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

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

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

Right-of-use assets are subsequently measured at cost less accumulated depreciation and any accumulated impairment losses, adjusted for any remeasurement of the lease liability. Depreciation is calculated using the straight-line method to write down the cost of each asset to its residual value over its estimated useful life. If ownership of the underlying asset is not expected to pass to the Bank at the end of the lease term, the estimated useful life would not exceed the lease term.

Increases in the carrying amount arising on revaluation are recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. Decreases that offset previous increases of the same asset are recognised in other comprehensive income. All other decreases are charged to the profit and loss account. Annually, the difference between the depreciation charge based on the revalued carrying amount of the asset charged to the profit and loss account and depreciation based on the asset's original cost (excess depreciation) is transferred from the revaluation surplus reserve to retained earnings.

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

(ii) Leases under which the Bank 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 recognised 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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(r) Cash and cash equivalents

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

(s) Sale and repurchase agreements

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

(t) Share capital

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

(u) Regulatory reserve

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

3 Financial risk management

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

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

Notes (continued)

3 Financial risk management (continued)

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

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

(a) Credit risk

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

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

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

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

Credit related commitments

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit related commitments (continued)

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

Measurement of expected credit losses

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

- A financial instrument that is not credit impaired at initial recognition is classified in “Stage 1” and has its credit risk continuously monitored by the Bank;
- If a significant increase in credit risk (“SICR” since initial recognition is identified, the financial instrument is moved to “Stage 2” but is not yet deemed to be credit impaired;
- If the financial instrument is credit-impaired, the financial instrument is then moved to “Stage 3;
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stage 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis;
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward- looking information; 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 measurement of the expected credit loss allowance for financial assets measured at amortized cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behavior (e.g. the likelihood of customers defaulting and the resulting losses).

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

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

Determining the appropriate business models and assessing the “solely payments of principal and interest (SPPI)” requirements for financial assets.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Significant increase in credit risk

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

The Bank identifies a significant increase in credit risk where:

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

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

Determining whether credit risk has increased significantly

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

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

The following qualitative criteria is applied:

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

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

Definition of default

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

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

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

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Incorporation of forward-looking information

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

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

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

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

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

Modified financial assets

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

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

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Modified financial assets (continued)

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

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

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

Inputs into measurement of ECLs

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

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

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

Probability of default (PD)

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

PD estimates for loans and advances are estimates at a certain date, calculated based on statistical migration matrices that model the chance of an exposure transitioning to default over time and will be assessed at portfolio level for portfolios of assets that have similar characteristics. The Bank has categorised its loans and advances into three segments, real estate, Trade and others.

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

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Inputs into measurement of ECLs (continued)

Loss Given Default (LGD)

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

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

Exposure at Default

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

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

The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

For guarantee facilities, overdrafts and other revolving facilities that include both a drawn and an undrawn commitment component, the Bank will measure ECLs over a period of one year unless the expected life of the exposure can be reasonably determined.

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

- Product type; and
- Industry.

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

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

In measuring expected credit losses the bank has segmented its loans and advances to customers into several segments: Trade, Real Estate and Others based on their different risk characteristics.

The following tables set out information about the credit quality and credit risk exposure of financial assets measured at amortized cost. Unless specifically indicated, the amounts in the table represent gross carrying amounts at 31 December 2022. For loan commitments and non-financial guarantees the amounts in the table represent the undrawn portion of amounts committed. Loan commitments are overdraft facilities.

Maximum exposure to credit risk before collateral held

	2022 Shs'000	2021 Shs'000
Balances with Central Bank of Kenya (Note 12)	881,458	637,380
Mobile money balances (Note 12)	54,153	33,430
Government securities at amortized cost (Note 13)	4,422,569	3,360,211
Deposits and balances due from banking institutions (Note 14)	1,094,971	963,905
Loans and advances to customers (Note 16)	5,788,334	5,573,095
Other assets (Note 15)	113,276	94,477
Credit risk exposures relating to off-balance sheet items (Note 29):		
- Acceptances and letters of credit	938,775	964,610
- Guarantee and performance bonds	1,146,149	1,151,287
- Commitments to lend	2,531,151	2,486,882
	16,970,836	15,265,277

The maximum exposure table represents a worst-case scenario of credit risk exposure to the Bank at 31 December 2022 and 2021, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on carrying amounts as reported in the balance sheet. As shown above, 46% (2021: 47%) of the total maximum exposure is derived from loans and advances to customers, balances with Central Bank of Kenya and deposits and balances from banking institutions. 26% (2021: 22%) represents investments in government securities.

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

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

The Bank exercises stringent controls over the granting of new loans;

- 79% of the loans and advances portfolio are neither past due nor impaired (2021: 91%);
- 98% of the loans and advances portfolio are backed by collateral; and
- 100% of the investments in debt securities are government securities.

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Credit risk exposure

Financial assets that are past due or impaired

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

Accounts are classified into five categories as follows:

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

Loans and advances are summarised as follows:

	2022 Shs'000	2021 Shs'000
Neither past due nor impaired	4,800,583	5,289,568
Past due but not impaired	891,457	9,631
Impaired	395,536	538,638
Gross	6,087,576	5,837,837
Less: allowance for impairment	(299,242)	(264,742)
Net	5,788,334	5,573,095

Loans and advances neither past due nor impaired

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

	2022 Shs'000	2021 Shs'000
Normal – neither past due nor impaired	4,719,540	4,615,199
Normal – renegotiated loans	81,043	674,369
Watch – renegotiated loans (past due but not impaired)	333,891	-
Watch (past due but not impaired)	557,566	9,631
	5,692,040	5,299,199

Notes (continued)

3 Financial risk management (continued)

(a) Credit risk (continued)

Loans and advances renegotiated

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

	2022 Shs'000	2021 Shs'000
Renegotiated loans and advances	414,934	674,369

Loans and advances renegotiated in 2022 and 2021 were neither past due nor impaired.

Loans and advances past due but not impaired

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

	2022 Shs'000	2021 Shs'000
Past due up to 30 days	449,106	68,773
Past due 31 - 90 days	278,516	629,405
	727,622	698,178

Loans and advances individually impaired

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

	Loans		Overdrafts	
	2022 Shs'000	2021 Shs'000	2022 Shs'000	2021 Shs'000
Individually assessed impaired loans and advances	189,724	274,938	205,805	263,699
Fair value of collateral	360,474	418,051	501,393	849,068

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

Notes (continued)

3 Financial risk management (continued)

(b) Concentration risk

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

	2022		2021	
	Loans and advances	Unused credit commitments	Loans and advances	Unused credit commitments
	%	%	%	%
Manufacturing	7.05	2.51	2.97	5.75
Wholesale and retail trade	24.84	58.46	28.43	32.17
Transport and communications	4.38	2.88	2.84	7.96
Business services	0.05	0.5	0.05	-
Agricultural	0.77	0.12	0.75	-
Individuals	12.33	16.07	12.81	0.64
Foreign Trade	3.19	-	0.32	4.42
Real estate	32.37	17.49	37.67	31.42
Building and construction	7.78	1.97	7.96	0.15
Other	7.24	-	6.2	17.49
	100	100	100	100

Customer deposits	2022	2021
	%	%
Insurance companies	2.78	2.54
Private enterprise	46.73	48.39
Non-profit institutions & individuals	33.67	33.78
Resident foreign currency	10.42	10.66
Non-resident foreign currency	6.40	4.63
	100	100

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk

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

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

Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose, net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month.

The Central Bank of Kenya minimum liquidity ratio is 20%. Details of the reported Bank ratio of net liquid assets to deposits from customers at the reporting date and during the reporting period were as follows:

	2022	**2021**
At 31 December	49.9	52.1
Average for the year	51.1	50.9
Maximum for the year	55.5	53.7
Minimum for the year	45.7	44.5

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

The table below analyses assets and liabilities into relevant maturity brackets based on the remaining period at 31 December 2022 to the contractual maturity date. All figures are in thousands of Kenya Shillings.

At 31 December 2022	Up to 1 Month	1-6 Months	6-12 Months	1-5 Years	Over 5 Years	Total
Assets						
Cash and balances with Central Bank of Kenya	1,054,585	-	-	-	-	1,054,585
Government securities at amortized cost	186,460	124,241	-	550,703	4,842,984	5,704,388
Deposits and balances due from banking institutions	1,094,971	-	-	-	-	1,094,971
Other assets	21,123	14,900	99,932	22,346	-	158,301
Loans and advances to customers	2,395,695	170,294	567,026	2,858,109	912,444	6,903,568
Total assets	4,752,834	309,435	666,958	3,431,158	5,755,428	14,915,813
Liabilities and equity						
Deposits from banks	1,103,334	-	-	-	-	1,103,334
Deposits from customers	4,487,660	3,728,091	1,220,665	43,924	-	9,480,340
Borrowings	-	45,205	45,205	361,640	-	452,050
Other liabilities and accrued expenses	150,999	16,757	59,938	-	-	227,694
Current income tax	-	93,592	-	-	-	93,592
Lease liabilities	-	13,599	8,387	7,268	-	29,254
Total liabilities	5,741,993	3,897,244	1,334,195	412,832	-	11,386,264
Net liquidity gap	(989,159)	(3,587,809)	(667,237)	3,018,326	5,755,428	3,529,549

Notes (continued)

3 Financial risk management (continued)

(c) Liquidity risk (continued)

At 31 December 2021	Up to 1 Month	1-6 Months	6-12 Months	1-5 Years	Over 5 Years	Total
Assets						
Cash and balances with Central Bank of Kenya	749,081	-	-	-	-	749,081
Government securities at amortized cost	-	503,029	92,420	371,230	3,155,464	4,122,143
Deposits and balances due from banking institutions	963,905	-	-	-	-	963,905
Other assets	19,198	11,805	83,038	-	-	114,041
Loans and advances to customers	1,631,891	11,329	1,340,651	3,168,000	609,005	6,760,876
Total assets	3,364,075	526,163	1,516,109	3,539,230	3,764,469	12,710,046
Liabilities and equity						
Deposits from banks	100,000	-	-	-	-	100,000
Deposits from customers	3,494,272	4,482,002	1,454,067	40,699	-	9,471,040
Other liabilities and accrued expenses	53,690	2,568	112,681	-	-	168,939
Current income tax	-	33,826	-	-	-	33,826
Lease liabilities	-	30,334	21,758	29,254	-	81,346
Total liabilities	3,647,962	4,548,730	1,588,506	69,953	-	9,855,151
Net liquidity gap	(283,887)	(4,022,567)	(72,397)	3,469,277	3,764,469	2,854,895

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

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

Notes (continued)

3 Financial risk management (continued)

(d) Market risk

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

(i) Currency risk

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

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

At 31 December 2022	**USD**	**GBP**	**Euro**	**Other**	**Total**
Assets					
Cash and balances with Central Bank of Kenya	181,258	11,539	10,485	28	203,310
Deposits and balances due from banking institutions	661,348	2,737	8,399	97	672,581
Loans and advances to customers	672,399	126	50	-	672,575
Other assets and prepayments	28,622	-	-	-	28,622
Total assets	1,543,627	14,402	18,934	125	1,577,088
Liabilities					
Customer deposits	1,495,358	58,324	14,830	-	1,568,512
Borrowings	408,246	-	-	-	408,246
Other liabilities and accrued expenses	11,332	1,423	2,785	-	15,540
Total liabilities	1,914,936	59,747	17,615	-	1,992,298
Net on-balance sheet position	(371,309)	(45,345)	1,319	125	(415,210)
Net off-balance sheet position	1,313	-	(1,314)	-	(1)
Overall net position	(369,996)	(45,345)	5	125	(415,211)

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(i) Currency risk (continued)

At 31 December 2021	USD	GBP	Euro	Other	Total
Assets					
Total assets	1,374,710	57,565	42,506	219	1,475,000
Total liabilities	1,363,129	56,087	42,602	-	1,461,818
Net on-balance sheet position	11,581	1,478	(96)	219	13,182
Net off-balance sheet position	(2,262)	-	-	-	(2,262)
Overall net position	9,319	1,478	(96)	219	10,920

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

At 31 December 2022, if the Shilling had strengthened/weakened by 5% against the major currencies with all other variables held constant, pre-tax profit for the year would have been lower/higher by Shs 20,761,000 (2021: Shs 659,000) as illustrated below:

Impact on shilling strengthening per currency (Shs '000)

	USD	GBP	Euro	Other	Total
At 31 December 2022 (5%)	18,565	2,267	(66)	(6)	20,760
At 31 December 2021 (5%)	579	74	(5)	11	659

Impact on shilling weakening per currency (Shs '000)

	USD	GBP	Euro	Other	Total
At 31 December 2022 (5%)	(18,565)	(2,267)	66	6	(20,760)
At 31 December 2021 (5%)	(579)	(74)	5	(11)	(659)

(ii) Interest rate risk

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

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

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

At 31 December 2022	Up to 1 Month	1-3 Months	3-12 Months	Over 1 Year	Non-interest bearing	Total
Assets						
Cash and balances with Central Bank of Kenya	-	-	-	-	1,054,585	1,054,585
Government securities at amortized cost	186,460	-	124,241	4,111,868	-	4,422,569
Deposits and balances due from banking institutions	1,094,970	-	-	-	-	1,094,970
Other assets and prepayments	-	-	-	-	158,301	158,301
Loans and advances to customers	5,788,334	-	-	-	-	5,788,334
Total assets	7,069,764	-	124,241	4,111,868	1,212,886	12,518,759
Liabilities						
Deposits from banks	1,103,334	-	-	-	-	1,103,334
Customer deposits	1,508,574	3,728,091	1,220,665	43,924	2,824,938	9,326,192
Borrowings	-	45,205	45,205	317,836	-	408,246
Other liabilities and accrued expenses	-	-	-	-	227,693	227,693
Lease liabilities	-	-	-	18,116	-	18,116
Current income tax payable	-	-	-	-	93,592	93,592
Total liabilities	2,611,908	3,773,296	1,265,870	379,876	3,146,223	11,177,173
Interest sensitivity gap	4,457,856	(3,773,296)	(1,141,629)	3,731,992	(1,933,337)	1,341,586

Notes (continued)

3 Financial risk management (continued)

(d) Market risk (continued)

(ii) Interest rate risk (continued)

At 31 December 2021	Up to 1 Month	1-3 Months	3-12 Months	Over 1 Year	Non-interest bearing	Total
Total assets	2,595,796	1,933	1,547,076	5,752,406	863,122	10,760,333
Total liabilities	1,814,986	2,600,622	3,335,447	53,201	1,982,051	9,786,307
Interest sensitivity gap	780,810	(2,598,689)	(1,788,371)	5,699,205	(1,118,929)	974,026

Fair values and effective interest rates of financial assets and liabilities

The effective interest rates by major currency for monetary financial instruments at 31 December 2022 and 2021 were in the following ranges:

	2022		2021	
	Shs	USD and Euro	Shs	USD and Euro
Assets				
Government securities (%)	12.19	-	11.69	-
Deposits with banking institutions (%)	6.29	2.47	-	2.41
Loans and advances to customers (%)	13.71	10.47	12.68	9.97
Liabilities				
Customer deposits (%)	7.73	2.59	7.46	1.93
Deposits and balances due to banking institutions (%)	6.60	2.07	6.90	2.34
Borrowings (%)	-	3.46	-	-

Cash flow and fair value interest rate risk

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

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

The Bank regularly monitors financial assets and liabilities. As at 31 December 2022, a 10 basis points increase in interest rates would have resulted in an increase in pre-tax profit of Shs 2,427,216 (2021: Shs 974,026).

Notes (continued)

3 Financial risk management (continued)

(e) Fair value estimation (continued)

The table below represents the fair value of the financial assets and liabilities as at 31 December 2022.

	Level 1	Level 2	Level 3	Fair value	Carrying value
At 31 December 2022	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
Assets					
Cash and balances with Central Bank of Kenya	-	-	1,054,585	1,054,585	1,054,585
Government securities at amortized cost	4,408,180	-	-	4,408,180	4,422,569
Deposits and balances due from banking institutions	-	-	1,094,971	1,094,971	1,094,971
Loans and advances to customers	-	-	5,788,334	5,788,334	5,788,334
Other financial assets	-	-	158,301	158,301	158,301
	4,408,180	**-**	**8,096,191**	**12,504,371**	**12,518,760**
Liabilities					
Deposits from banks	-	-	1,103,334	1,103,334	1,103,334
Customer deposits	-	-	9,326,192	9,326,192	9,326,192
Borrowings	-	-	408,246	408,246	408,246
Other financial liabilities	-	-	227,694	227,694	227,694
	-	**-**	**11,065,466**	**11,065,466**	**11,065,466**
At 31 December 2021					
Assets					
Cash and balances with Central Bank of Kenya	-	-	749,081	749,081	749,081
Government securities at amortized cost	3,127,281	-	-	3,127,281	3,360,211
Deposits and balances due from banking institutions	-	-	963,905	963,905	963,905
Loans and advances to customers	-	-	5,573,095	5,573,095	5,573,095
Other financial assets	-	-	114,041	114,041	114,041
	3,127,281	**-**	**7,400,122**	**10,527,403**	**10,760,333**
Liabilities					
Deposits from banks	-	-	100,000	100,000	100,000
Customer deposits	-	-	9,465,426	9,465,426	9,465,426
Other financial liabilities	-	-	168,939	168,939	168,939
	-	**-**	**9,734,365**	**9,734,365**	**9,734,365**

Notes (continued)

3 Financial risk management (continued)

(f) Capital management

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

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

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

The Central Bank of Kenya requires each Bank to:

a) hold the minimum level of regulatory capital of Shs 1 billion;
b) Maintain a ratio of total regulatory capital; to risk weighted assets plus risk weighted off balance assets at above the required minimum of 10.5%;
c) Maintain a core capital of not less than 8 % of total deposit liabilities; and
d) Maintain total capital of not less than 14.5% 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, retained earnings plus 50% un-audited after tax profit; 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.

Notes (continued)

3 Financial risk management (continued)

(f) Capital management (continued)

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

	2022 Shs'000	2021 Shs'000
Tier 1 capital	1,693,030	1,310,619
Tier 1 + Tier 2 capital	1,758,557	1,334,026
Risk-Weighted assets		
On-balance sheet	4,140,003	3,516,527
Off-balance sheet	643,532	489,244
Market risk weighted assets	8,489	20,841
Operational risk weighted assets	1,485,345	1,101,526
Total Risk-Weighted assets	6,277,369	5,128,138
Basel ratio		
Tier 1 (minimum – 10.5%)	27.0%	25.6%
Tier 1 + Tier 2 (minimum – 14.5%)	28.0%	26.0%

4 Critical accounting estimates and judgements in applying accounting policies

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

Measurement of expected credit losses

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

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

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

Notes (continued)

5 Net Interest income

(a) Interest income

	2022 Shs'000	2021 Shs'000
Loans and advances to customers	776,799	681,970
Government securities at amortized cost	422,279	319,906
Cash and short-term funds	17,354	22,142
	1,216,432	1,024,018

(b) Interest expense

	2022 Shs'000	2021 Shs'000
Customer deposits	633,500	559,606
Deposits and balances due to banking institutions	36,370	7,456
Borrowings (Note 24)	371	-
Interest on lease liability (Note 26)	1,640	2,624
	671,881	569,686

6 Other operating income

	2022 Shs'000	2021 Shs'000
Rental income	35,159	38,554
Gain on sale of bonds	-	3,514
Loss on disposal of assets	(27)	(4,710)
Other income	4,550	3,363
Loan recoveries	242,284	-
	281,966	40,721

7 Operating expenses

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

	2022 Shs'000	2021 Shs'000
Employees benefits (Note 8)	288,727	261,558
Depreciation on property and equipment (Note 18)	26,384	18,680
Depreciation on right of use asset (Note 20)	6,703	6,703
Amortisation of intangible assets (Note 21)	7,902	8,533
Rent expense	1,945	1,949
Auditors' remuneration	3,969	3,780
Amortisation of prepaid operating lease (Note 19)	965	965
Other operating expenses	225,343	189,715
	561,938	491,883

Notes (continued)

8 Employee benefits

The following items are included within employees' benefits expense:

	2022 Shs'000	2021 Shs'000
Salaries	253,030	237,521
Retirement benefits cost	11,565	9,184
National Social Security Fund	151	144
Medical costs	13,539	12,246
Other staff costs	10,442	2,463
	288,727	261,558

The average number of employees during the year was 63 (2021: 60)

9 Income tax expense

	2022 Shs'000	2021 Shs'000
Current income tax	153,696	54,579
Deferred income tax (Note 17)	(14,432)	(26,990)
Under provision of current tax in prior years	1,770	-
Income tax expense	141,034	27,589

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

	2022 Shs'000	2021 Shs'000
Profit before income tax	544,341	150,989
Tax calculated at the statutory income tax rate of 30% (2021: 30%)	163,302	45,297
Tax effect of:		
Expenses not deductible for tax purposes	29,669	27,391
Interest income on infrastructure bonds not subject to tax	(53,707)	(45,099)
Effect of change in tax rate	-	-
Under provision of current income tax in prior year	1,770	-
Under provision of deferred income tax in prior year	-	-
Income tax expense	141,034	27,589

Notes (continued)

10 Earnings per share

Basic earnings per share are calculated on the profit attributable to shareholders of Shs 403,307,000 (2021: Shs 123,400,000) and on the weighted average number of ordinary shares outstanding during the period.

	2022	2021
Net profit attributable to shareholders (Shs '000)	403,307	123,400
Number of ordinary shares in issue (Note 27)	25,341,547	25,341,547
Basic earnings per share (Shs)	15.91	4.87

11 Dividends per share

At the forthcoming annual general meeting, a dividend for the year ended 31 December 2022 of Shs 0.39 per share amounting to Shs 10,000,000 (2021: Shs 0.39 per share amounting to Shs 10,000,000) is to be proposed.

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

12 Cash and balances with Central Bank of Kenya

	2022 Shs'000	2021 Shs'000
Cash in hand	118,974	78,271
Local currency balances with Central Bank of Kenya	732,139	427,684
Foreign currency balances with Central Bank of Kenya	149,319	209,696
Mobile money balances	54,153	33,430
	1,054,585	749,081

13 Government securities at amortized cost

Treasury bills and bonds:		
Maturing after 90 days of the date of acquisition	4,422,569	3,360,211

Treasury bills and bonds are debt securities issued by the Central Bank of Kenya. Treasury bonds with a par value of Shs 915 million are under lien in favor of Cooperative Bank of Kenya.

Notes (continued)

14 Deposits and balances due from banking institutions

	2022 Shs'000	2021 Shs'000
Local currency deposits	466	149
Foreign currency balances with local banks	603,044	34,070
Foreign currency balances with foreign banks	491,461	929,686
	1,094,971	963,905

15 Other assets and prepayments

Uncleared effects	10,286	8,566
Stationeries	3,221	2,424
Prepayments	45,025	19,564
Other debtors	99,769	83,487
	158,301	114,041

16 Loans and advances to customers

Corporate	3,084,629	3,592,967
SME	2,113,331	1,730,597
Retail	691,794	389,917
Personal	197,822	124,356
Gross loans and advances	6,087,576	5,837,837
Less: Provision for impairment of loans and advances		
- Stage 1	56,736	52,536
- Stage 2	14,827	604
- Stage 3	227,679	211,602
	299,242	264,742
Net loans and advances	5,788,334	5,573,095

Notes (continued)

16 Loans and advances to customers (continued)

i) Loans and advances to customers at amortized cost

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
Gross carrying amount at 1 January 2022	5,289,568	9,631	538,638	5,837,837
Changes in the gross carrying amount				
- Transfer from stage 1 to stage 2	(859,460)	859,460	-	-
- Transfer from stage 1 to stage 3	(9,083)	-	9,083	-
- Transfer from stage 2 to stage 1	-	-	-	-
- Transfer from stage 2 to stage 3	-	(5,154)	5,154	-
- Transfer from stage 3 to stage 1	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Write-offs	-	-	-	-
Net remeasurement of loan balance	76,932	337,638	364	414,934
New financial assets originated or purchased	2,499,916	(305,721)	5,508	2,199,703
Financial assets that have been derecognized	(2,197,290)	(4,397)	(163,211)	(2,364,898)
Gross carrying amount at 31 December 2022	4,800,583	891,457	395,536	6,087,576
Gross carrying amount at 1 January 2021	6,699,517	28	812,787	7,512,332
Changes in the gross carrying amount				
- Transfer from stage 1 to stage 2	(9,453)	9,453	-	-
- Transfer from stage 1 to stage 3	(9,523)	-	9,523	-
- Transfer from stage 2 to stage 1	-	-	-	-
- Transfer from stage 2 to stage 3	-	-	-	-
- Transfer from stage 3 to stage 1	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Write-offs	-	-	(163)	(163)
Net remeasurement of loan balance	674,368	-	-	674,368
New financial assets originated or purchased	2,630,295	167	44,447	2,674,909
Financial assets that have been derecognized	(4,695,636)	(17)	(327,956)	(5,023,609)
Gross carrying amount at 31 December 2021	5,289,568	9,631	538,638	5,837,837

Notes (continued)

16 Loans and advances to customers (continued)

ii) ii) Provisions – Loans and advances to customers

	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
At 1 January 2022	52,536	604	211,602	264,742
- Transfer from stage 1 to stage 2	(10,099)	10,099	-	-
- Transfer from stage 1 to stage 3	(1)	-	1	-
- Transfer from stage 2 to stage 1	-	-	-	-
- Transfer from stage 2 to stage 3	-	(1,761)	1,761	-
- Transfer from stage 3 to stage 1	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Write-offs	-	-	-	-
Net remeasurement of loss allowance	2,183	-	353	2,536
New financial assets originated or purchased	40,603	4,812	34,891	80,306
Financial assets that have been derecognized	(28,486)	1,073	(20,929)	(48,342)
At 31 December 2022	56,736	14,827	227,679	299,242
At 1 January 2021	103,031	20	129,577	232,628
- Transfer from stage 1 to stage 2	(590)	590	-	-
- Transfer from stage 1 to stage 3	(5,224)	-	5,224	-
- Transfer from stage 2 to stage 1	-	-	-	-
- Transfer from stage 2 to stage 3	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Transfer from stage 3 to stage 2	-	-	-	-
- Write-offs	-	-	(3,623)	(3,623)
Net remeasurement of loss allowance	5,522	-	-	5,522
New financial assets originated or purchased	29,725	-	90,866	120,591
Financial assets that have been derecognized	(79,928)	(6)	(10,442)	(90,376)
At 31 December 2021	52,536	604	211,602	264,742

Notes (continued)

16 Loans and advances to customers (continued)

Movements in expected credit losses on 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 2022				
At 1 January 2022	52,536	604	211,602	264,742
Increase in impairment provision	4,200	14,223	16,077	34,500
At 31 December 2022	56,736	14,827	227,679	299,242
Charge to profit or loss				
Increase in impairment provision	4,200	14,223	16,077	34,500
Year ended 31 December 2021				
At 1 January 2021	103,031	20	129,577	232,628
Write-off in the year	-	-	(3,623)	(3,623)
Increase in impairment provision	(50,495)	584	85,648	35,737
At 31 December 2021	52,536	604	211,602	264,742
Charge to profit or loss				
(Decrease)/increase in impairment provision	(50,495)	584	82,025	32,114

All loans are written down to their estimated recoverable amount. The amount of non-performing loans (net of impairment losses) at 31 December 2022 was Shs 167,857,000 (2021: Shs 327,036,000). There were no receivables under hire purchase contracts in 2022 and 2021.

Notes (continued)

16 Loans and advances to customers (continued)

Loan book movement

The following tables show reconciliations from the opening to the closing balance of the loans and advances by segment:

	Stage 1	Stage 2	Stage 3	Total
TRADE	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
At 1 January 2022	**1,296,054**	**334**	**363,159**	**1,659,547**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(1,927)	-	1,927	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	63,929	-	-	63,929
Net financial assets originated or purchased	814,506	2	4,701	819,209
Financial assets derecognized	(938,456)	(323)	(104,107)	(1,042,886)
At 31 December 2022	**1,234,106**	**13**	**265,680**	**1,499,799**

REAL ESTATE

At 1 January 2022	**2,154,156**	-	**45,109**	**2,199,265**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(859,460)	859,460	-	-
Transfer to Lifetime ECL credit impaired	(559)	-	559	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	-	-	-	-
Net financial assets originated or purchased	288,188	28,169	-	316,357
Financial assets derecognized	(544,088)	-	(12,058)	(556,146)
At 31 December 2022	**1,038,237**	**887,629**	**33,610**	**1,959,476**

OTHERS

At 1 January 2022	**1,839,358**	**9,297**	**130,370**	**1,979,025**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(6,597)	(5,154)	11,751	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	13,003	-	-	13,003
Net financial assets originated or purchased	1,397,222	4,232	1,170	1,402,624
Financial assets derecognized	(714,746)	(4,560)	(47,045)	(766,351)
At 31 December 2022	**2,528,240**	**3,815**	**96,246**	**2,628,301**

Total loans and advances

At 1st January 2022	**5,289,568**	**9,631**	**538,638**	**5,837,837**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(859,460)	859,460	-	-
Transfer to Lifetime ECL credit impaired	(9,083)	(5,154)	14,237	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	76,932	-	-	76,932
Net financial assets originated or purchased	2,499,916	32,403	5,871	2,538,190
Financial assets derecognized	(2,197,290)	(4,883)	(163,210)	(2,365,383)
At 31 December 2022	**4,800,583**	**891,457**	**395,536**	**6,087,576**

Notes (continued)

16 Loans and advances to customers (continued)

	Stage 1	Stage 2	Stage 3	Total
TRADE	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
At 1 January 2021	**2,801,741**	**28**	**627,035**	**3,428,804**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(323)	323	-	-
Transfer to Lifetime ECL credit impaired	(6,015)	-	6,015	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	59,364	-	-	59,364
Net financial assets originated or purchased	906,222	-	33,606	939,828
Financial assets derecognized	(2,464,935)	(17)	(303,497)	(2,768,449)
At 31 December 2021	**1,296,054**	**334**	**363,159**	**1,659,547**

REAL ESTATE				
At 1 January 2021	**1,736,201**	**-**	**50,609**	**1,786,810**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(3,004)	-	3,004	-
Write-offs	-	-	(163)	(163)
Net remeasurement of loan balance	615,004	-	-	615,004
Net financial assets originated or purchased	875,839	-	5,552	881,391
Financial assets derecognized	(1,069,884)	-	(13,893)	(1,083,777)
At 31 December 2021	**2,154,156**	**-**	**45,109**	**2,199,265**

OTHERS				
At 1 January 2021	**2,161,575**	**-**	**135,143**	**2,296,718**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(9,130)	9,130	-	-
Transfer to Lifetime ECL credit impaired	(505)	-	505	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	-	-	-	-
Net financial assets originated or purchased	775,762	167	5,288	781,217
Financial assets derecognized	(1,088,344)	-	(10,566)	(1,098,910)
At 31 December 2021	**1,839,358**	**9,297**	**130,370**	**1,979,025**

Total loans and advances				
At January 2021	**6,699,517**	**28**	**812,787**	**7,512,332**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(9,453)	9,453	-	-
Transfer to Lifetime ECL credit impaired	(9,523)	-	9,523	-
Write-offs	-	-	(163)	(163)
Net remeasurement of loan balance	674,368	-	-	674,368
Net financial assets originated or purchased	2,557,823	167	44,448	2,602,438
Financial assets derecognized	(4,623,164)	(17)	(327,957)	(4,951,138)
At 31 December 2021	**5,289,568**	**9,631**	**538,638**	**5,837,837**

Notes (continued)

16 Loans and advances to customers (continued)

Loss allowance

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

	Stage 1	Stage 2	Stage 3	Total
TRADE	**Shs'000**	**Shs'000**	**Shs'000**	**Shs'000**
At 1 January 2022	18,911	14	146,933	165,858
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	1,927	-	-	1,927
Net financial assets originated or purchased	10,333	1	3,777	14,111
Financial assets derecognized	(12,604)	(6)	(15,875)	(28,485)
At 31 December 2022	18,567	9	134,835	153,411

REAL ESTATE

At 1 January 2022	8,098	-	1,331	9,429
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(10,099)	10,099	-	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	-	-	-	-
Net financial assets originated or purchased	3,782	387	9	4,178
Financial assets derecognized	2,733	-	-	2,733
At 31 December 2022	4,514	10,486	1,340	16,340

OTHERS

At 1 January 2022	25,526	590	63,338	89,454
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(1)	(1,761)	1,762	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	256	-	-	256
Net financial assets originated or purchased	17,741	5,503	31,457	54,701
Financial assets derecognized	(9,867)	-	(5,053)	(14,920)
At 31 December 2022	33,655	4,332	91,504	129,491

Total ECL loss allowance

At 1 January 2022	52,535	604	211,602	264,741
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(10,100)	8,338	1,762	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	2,183	-	-	2,183
Net financial assets originated or purchased	31,856	5,891	35,243	72,990
Financial assets derecognized	(19,738)	(6)	(20,928)	(40,672)
At 31 December 2022	56,736	14,827	227,679	299,242

Notes (continued)

16 Loans and advances to customers (continued)

TRADE	Stage 1 Shs'000	Stage 2 Shs'000	Stage 3 Shs'000	Total Shs'000
At 1 January 2021	63,492	20	69,563	133,075
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	(5,078)	-	5,078	-
Write-offs	-	-	-	-
Net remeasurement of Loss allowance	1,897	-	-	1,897
Net financial assets originated / purchased	4,921	-	73,066	77,987
Financial assets derecognized	(46,321)	(6)	(774)	(47,101)
At 31 December 2021	18,911	14	146,933	165,858

REAL ESTATE				
At 1 January 2021	8,729	-	5,173	13,902
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Write-offs	-	-	(3,623)	(3,623)
Net remeasurement of Loss allowance	3,625	-	0	3,625
Net financial assets originated / purchased	3,956	-	0	3,956
Financial assets derecognized	(8,212)	-	(219)	(8,431)
At 31 December 2021	8,098	-	1,331	9,429

OTHERS				
At 1 January 2021	30,810	-	54,841	85,651
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(590)	590	-	-
Transfer to Lifetime ECL credit impaired	(146)	-	146	-
Write-offs	-	-	-	-
Net remeasurement of loan balance	-	-	-	-
Net financial assets originated or purchased	20,849	-	12,340	33,189
Financial assets derecognized	(25,397)	-	(3,989)	(29,386)
At 31 December 2021	25,526	590	63,338	89,454

Total ECL loss allowance				
At 1 January 2021	103,031	20	129,577	232,628
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	(590)	590	-	-
Transfer to Lifetime ECL credit impaired	(5,224)	-	5,224	-
Write-offs	-	-	(3,623)	(3,623)
Net remeasurement of loan balance	5,522	-	-	5,522
Net financial assets originated or purchased	29,726	-	85,406	115,132
Financial assets derecognized	(79,929)	(6)	(4,982)	(84,917)
At 31 December 2021	52,536	604	211,602	264,742

Notes (continued)

16 Loans and advances to customers (continued)

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

Loan commitments				
At 1 January	-	-	-	-
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	-	-	-	-
Net financial assets originated or purchased	-	-	-	-
Financial assets derecognized	-	-	-	-
At 31 December	-	-	-	-

Total off-balance sheet				
At 1 January	**1,158**	-	-	**1,158**
Transfer to 12 months ECL	-	-	-	-
Transfer to Lifetime ECL not credit impaired	-	-	-	-
Transfer to Lifetime ECL credit impaired	-	-	-	-
Net remeasurement of Loss allowance	-	-	-	-
Net financial assets originated or purchased	-	-	-	-
Financial assets derecognized	-	-	-	-
At 31 December	**1,158**	-	-	**1,158**

ECL of Shs 3,925,718 (2021: Shs 1,925,718) and Shs 855,582 (2021: Shs 855,582) has been recorded for Government securities at amortized cost and balances due from other banking institutions.

Notes (continued)

17 Deferred income tax

Deferred income tax is calculated using the enacted income tax rate of 30% (2021: 30%). The movement on the deferred income tax account is as follows:

	2022 Shs'000	2021 Shs'000
At start of year	131,957	104,967
Credit to the statement of comprehensive income (Note 9)	14,432	26,990
At end of year	146,389	131,957

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

	1 January Shs'000	Credited/ (charged) to SOCI Shs'000	31 December Shs'000
31 December 2022			
Deferred income tax asset			
Provisions	91,284	12,714	103,998
Accelerated tax depreciation	2,793	500	3,293
Accrued interest on customer deposits	36,721	1,715	38,436
Lease liability	5,435	(2,509)	2,926
Deferred income tax liability			
Unrealized exchange gain	(1)	1	-
Right of use asset	(4,275)	2,011	(2,264)
Net deferred income tax asset	131,957	14,432	146,389
31 December 2021			
Deferred income tax asset			
Provisions	69,962	21,322	91,284
Accelerated tax depreciation	2,209	584	2,793
Accrued interest on customer deposits	31,581	5,140	36,721
Lease liability	7,537	(2,102)	5,435
Deferred income tax liability			
Unrealized exchange gain	(36)	35	(1)
Right of use asset	(6,286)	2,011	(4,275)
Net deferred income tax asset	104,967	26,990	131,957

Notes (continued)

18 Property and equipment

	Buildings Shs'000	Leasehold Improvements Shs'000	Motor vehicles Shs'000	Fixtures, fittings and equipment Shs'000	Capital work in progress Shs'000	Total Shs'000
Year ended 31 December 2021						
Cost						
At 1 January 2021	235,984	35,961	6,467	153,603	6,491	438,506
Additions	-	862	238	28,023	738	29,861
Transfers (Note 21)	-	177	-	3,600	(6,491)	(2,714)
Disposals	-	(7,809)	-	-	-	(7,809)
At 31 December 2021	235,984	29,191	6,705	185,226	738	457,844
Depreciation						
At 1 January 2021	93,922	20,161	6,467	142,889	-	263,439
Charge for the year	4,721	3,935	40	9,984	-	18,680
On disposals	-	(3,099)	-	-	-	(3,099)
At 31 December 2021	98,643	20,997	6,507	152,873	-	279,020
Net book value						
At 31 December 2021	137,341	8,194	198	32,353	738	178,824
Year ended 31 December 2022						
Cost						
At 1 January 2022	235,984	29,191	6,705	185,226	738	457,844
Additions	-	-	14,198	22,966	-	37,164
Transfers from WIP	-	-	-	738	(738)	-
Disposals	-	-	-	(272)	-	(272)
At 31 December 2022	235,984	29,191	20,903	208,658	-	494,736
Depreciation						
At 1 January 2022	98,643	20,997	6,506	152,873	-	279,019
Charge for the year	4,721	3,474	3,313	14,876	-	26,384
On disposals	-	-	-	(126)	-	(126)
At 31 December 2022	103,364	24,471	9,819	167,623	-	305,277
Net book value						
At 31 December 2022	132,620	4,720	11,084	41,035	-	189,459

Notes (continued)

19 Prepaid operating lease rentals

	2022 Shs'000	2021 Shs'000
At start of year	70,548	71,513
Amortization charge for the year	(965)	(965)
At end of year	69,583	70,548
Cost	93,715	93,715
Accumulated amortization	(24,132)	(23,167)
	69,583	70,548

20 Right of Use Assets

At start of year	14,250	20,953
Depreciation charge for the year (Note 7)	(6,703)	(6,703)
At end of year	7,547	14,250

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

21 Intangible assets

	2022 Shs'000	2021 Shs'000
At start of year	30,464	31,234
Additions	7,888	5,049
Transfers (Note 18)	-	2,714
Amortisation charge for the year (Note 7)	(7,902)	(8,533)
At end of year	30,450	30,464

22 Deposits and balances due to banking institutions

Local currency deposits from banks	-	100,000
Deposits due to CBK	1,103,334	-
	1,103,334	100,000

Notes (continued)

23 Deposits from customers

	2022 Shs'000	2021 Shs'000
Current accounts and demand deposits	1,413,510	2,474,769
Savings and transaction accounts	280,247	290,491
Fixed deposit accounts	7,632,435	6,700,166
	9,326,192	9,465,426

24 Borrowings

At start of year	-	-
Additions in the year	407,875	-
Accrued interest	371	-
At end of year	408,246	-

The weighted effective interest rate on the borrowings at 31 December 2022 was 3.46%. The borrowings are measured at amortised cost.

A term loan of USD 3.25 million was received from Impact for Northern Kenya Fund in December 2022 at a fixed interest rate of 4% p.a. The loan has a tenor of 5 years with interest repayable quarterly. The loan is for on-lending exclusively in agriculture and related activities portfolio within the ten Frontier Counties Development Council (FCDC) region that includes 10 Northern Kenya counties namely Garissa, Isiolo, Lamu, Mandera, Marsabit, Samburu, Tana River, Turkana, Wajir and West Pokot.

25 Other liabilities and accrued expenses

	2022 Shs'000	2021 Shs'000
Bills Payable	16,789	2,304
Outstanding Banker's drafts	175	158
Other accruals and liabilities	210,730	166,477
	227,694	168,939

26 Lease liabilities

At start of year	18,116	25,124
Interest expenses (Note 5(b))	1,640	2,624
Payments in the year	(10,002)	(9,632)
At end of year	9,754	18,116

Notes (continued)

27 Share capital	Number of Shares	Ordinary shares Shs'000
At 1 January 2021, 1 January 2022 and 31 December 2022	25,341,547	506,831

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

28 Reserves

(a) Regulatory reserve	2022 Shs'000	2021 Shs'000
At start of year	23,407	12,336
Transfer from retained earnings	42,120	11,071
At end of year	65,527	23,407

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

(b) Fair value reserve

The fair value reserve comprises of the cumulative net change in the fair value of available for sale financial assets until the investment is derecognised or impaired. The reserve is non-distributable.

29 Off balance sheet financial instruments, contingent liabilities and commitments

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

Contingent liabilities

	2022 Shs'000	2021 Shs'000
Acceptances and letters of credit	938,775	964,610
Guarantee and performance bonds	1,146,149	1,151,287
Currency Bought & Sold	2,649	2,264
	2,087,573	2,118,161

Notes (continued)

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

Nature of contingent liabilities

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

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

Commitments	2022 Shs'000	2021 Shs'000
Undrawn formal stand-by facilities, credit lines and other commitments to lend	2,531,151	2,486,882

Nature of commitments

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

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

Bank facility

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

Notes (continued)

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

	2022 Shs'000	2021 Shs'000
Cash and balances with Central Bank of Kenya (Note 12)	1,054,585	749,081
Deposits and balances due from banking institutions (Note 14)	1,094,971	963,905
Less: overnight deposits due to banks (Note 22)	(1,103,334)	(100,000)
Less: cash reserve requirement	(355,481)	(333,587)
	690,741	1,279,399

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

Banks are required to maintain a prescribed minimum average cash balance with the Central Bank of Kenya that is not available to finance the Bank's day-to-day activities. At year end, the amount was determined as 8.06% (2021: 5.51%) of the average outstanding customer deposits over a cash reserve cycle period of one month.

Notes (continued)

31 Related party disclosures

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

(i) Loans and advances to related parties

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

	2022 Shs'000	2021 Shs'000
At start of year	283,376	242,323
Advances during the year	318,433	54,124
Repayments during the year	(8,733)	(13,071)
At end of year	593,076	283,376
Advances to Bank employees at end of year	158,089	123,506
Interest income earned on advances to employees, directors or entities controlled by directors	44,216	29,356

(ii) Guarantees to directors of the Bank (and their families) and companies controlled by directors:

	2022 Shs'000	2021 Shs'000
At start of year	31,591	2,200
Issues	38,353	-
Retirement	(16,335)	29,391
At end of year	53,609	31,591

(iii) Deposits from related parties

	2022 Shs'000	2021 Shs'000
Deposits from staff and directors or entities controlled by directors	1,088,172	819,842
Interest expense paid on deposits by directors or entities connected to directors	73,352	42,155

Notes (continued)

31 Related party disclosures (continued)

(iv) Other transactions

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

	2022 Shs'000	2021 Shs'000
Insurance premium paid	31,216	22,241

(v) Key management compensation

	2022 Shs'000	2021 Shs'000
Salaries and other short-term employment benefits	106,672	92,824
Other long-term benefits	5,691	4,934
	112,363	97,758

The Bank has a compensation policy that is market oriented and is effective in ensuring that required skills are always available. The policy ensures compensation consistency within business units. The policy also provides employment stability, healthcare benefits and provident fund plan to employees. Bank's policy honours any Collective Bargaining Agreements that are applicable. The policy is non-discriminatory in nature.

(vi) Directors' remuneration

	2022 Shs'000	2021 Shs'000
Fees and other emoluments	44,175	43,030

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

32 Other contingencies

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

The Bank lodged a claim with its insurers for the fraud loss above. The total claim was Shs 104 million. The matter is currently in arbitration. An asset of Shs 40.7 million has been recognized in these financial statements (2021: Shs 40.7 million).

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