# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

**ANNUAL REPORT AND FINANCIAL STATEMENTS**

**AT**

**31 DECEMBER 2021**

# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## ANNUAL REPORT AND FINANCIAL STATEMENTS
## FOR THE YEAR ENDED 31 DECEMBER 2021

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# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## PRINCIPAL OFFICERS AND STATUTORY INFORMATION

### SENIOR MANAGEMENT

| | |
|---|---|
| Mr. Asim Basharullah | Chief Executive Officer |
| Ms. Rosalid Njuguna-Ng'ang'a | Chief Finance Officer (Left in May 2021) |
| Mrs. Hannah Kinyanjui | Head of Credit |
| Ms. Patience Santa | Head of Compliance |
| Mr. Richard Mambo | Head of Financial Institutions |
| Mr. Shahzad Sultan | Chief Manager – Nairobi Branch |
| Ms. Bindi Haria | Head of Treasury |

### AUDITOR

KPMG Kenya
Certified Public Accountants
8th Floor, ABC Towers
Waiyaki Way
PO Box 40612 – 00100
Nairobi

### REGISTERED OFFICE

Habib House
Koinange Street
PO Box 30584 – 00100
Nairobi

### BRANCHES

Main Branch
Habib House
Koinange Street
Nairobi

Industrial Area Branch
MKI House
Dar es Salaam Road
Nairobi

Westlands Branch
Jetro Chambers
Mpaka Road, Westlands
Nairobi

Mombasa Branch
Unity House
Nkrumah Road
Mombasa

Nyali Branch - Closed on 31 August 2019
Ratna Square
Nyali Road
Mombasa

### ADVOCATES

Anjarwalla & Khanna
Coulson Harney Advocates
Ogola Okello & Co. Advocates
M. A. Khan Advocates
Macharia Mwangi & Njeru Advocates

### MAJOR CORRESPONDENT BANKS

Habib American Bank, New York
Habib Bank AG Zurich, Zurich
Standard Chartered Bank, London
Habib Bank AG Zurich, Dubai
Habib Canadian Bank
Habib Metropolitan Bank, Karachi
Habib Bank Zurich PLC, London

# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## CHIEF EXECUTIVE OFFICER'S REPORT

### Economic environment

The Kenyan economy recorded 5.6% GDP growth in 2021 compared to negative 0.3% in 2020. The economy partly recovered from Covid-19, with the services sector leading the rebound. During the period, we saw the KShs depreciate from approximately 106.5 to 109.6 against the USD widening the current account deficit to 4.9%. The country recorded real GDP of negative 0.4% in 2021, caused by sustained inflation of 6%. Despite the current account deficit, the country collected recorded diaspora remittances supported by the buoyancy in the agriculture sector chiefly tea and flowers. Foreign exchange reserves stood at USD 8.7 billion, equivalent to 5.4 months of imports, or more than the East African Community convergence criterion of 4.5 months. Public debt rose to 65.8% est. of GDP in 2021, up from 62.1% in 2020, arising from the external financial support from the World Bank and the IMF during the course in 2021.

### Banking sector

The banking sector profitability improved in 2021 largely recovery from the pandemic. Asset quality improved in December 2021 with the gross non-performing loans ratio declined by 50 bps to 13.1% from 13.6% in 2020. The major sectors contributing largely to NPLs include transport and communication, energy and water, tourism, restaurant and hotels, and real estate. The decline in NPLs was supported by recovery in the economic activities owed to the increased take-up of the vaccine and accommodative monetary policy stance.

Since March 2020, a package of measures was deployed by the Central Bank of Kenya to mitigate the adverse effects of the pandemic on the banking sector and businesses. The measures have provided the intended relief to borrowers; as at December 2021, there were outstanding restructured loans amounting to Kshs. 523 billion (13% of the gross loans). Of this amount, 92.3% were performing as per the restructuring terms. The onset of the global pandemic also paved way for the banking sector to offer many of its services on digital platforms.

### Year 2022 outlook

We remain cautiously optimistic for the Kenyan economy, with a possible slowdown in economic activity as we draw closer to the general elections only for an uptick later in the year; a wait-and-see approach may be adopted by borrowers. Much of the global and regional economic growth also depends on the uncertainty of the end of the Russia-Ukraine crisis; the volatility in the price and disruption of the supply of oil, and the shortage of wheat that may occur in the world given both countries are the biggest exporters of wheat and price escalation of crude palm oil attributed to increased demand due to shortage of sunflower oil from Russia and Ukraine.

The banking industry is determined to adopt risk-based credit pricing to be cognizant of, and responsive to, the unique socio-economic realities of the Kenyan populace. This will be achieved through customer-centric business models.

The gradual removal of rate caps by CBK might result in more credit uptake as banks adopt risk based pricing based on client profile. Banks will be able to serve sectors and clients previously termed as risky by applying the appropriate pricing based on specific risk parameters while low risk clients continue enjoying lower lending rates.

# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## CHIEF EXECUTIVE OFFICER'S REPORT (CONTINUED)

**Relevant audit information**

Management in office at the date of this report confirm that:

(i) There is no relevant audit information of which the Bank's auditor is unaware; and
(ii) Each Director has taken all the steps that they ought to have taken as a director so as to be aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

**Attendance of management committee meetings**

The Local Management Committee performs the duties of the Board of Directors. The Committee meets at regular intervals to discuss the strategic, performance and operational results for each quarter. Other business and operational meetings are held in between the scheduled meetings on a regular basis to discuss specific matters. During the year ended 31 December 2021, the Local Management Committee relayed its deliberations to the Board in Zurich through the General Management. Feedback provided by the General Management was considered and, appropriate action taken by the Local Management Committee.

Each member has achieved the attendance requirement of minimum 75% for the meetings held during the year 2021. The attendance during the year was as follows:

| Name | Position | % of meetings attended |
|---|---|---|
| Mr. Asim Basharullah | Chief Executive Officer | 100% |
| Mr. Shahzad Sultan | Branch Manager, Nairobi Main | 100% |
| Mrs. Hannah Kinyanjui | Head of Credit Risk | 50% (on maternity leave)* |
| Ms. Patience Santa | Head of Compliance | 100% |
| Ms. Bindi Haria | Head of Treasury | 100% |
| Mr. Richard Mambo | Head of Financial Institutions | 75% |

*attended by the CEO in the absence of Head of Credit Risk during the period of maternity leave.

Mr Asim Basharullah
*Chief Executive Officer*

**Date: 30 March 2022**

# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES

Management is responsible for the preparation and presentation of the financial statements of Habib Bank AG Zurich (Kenya Branches) (the "Bank") ) set out on pages 8 to 91 which comprise the statement of financial position as at 31 December 2021 and statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows, for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

Management's responsibility includes: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015 and for such internal control as the Management determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

Under the Kenyan Companies Act, 2015 the Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank as at the end of the financial year and of their profit or loss for that year. It also requires Management to ensure the Kenya branches keep proper accounting records which disclose with reasonable accuracy the financial position of the Bank.

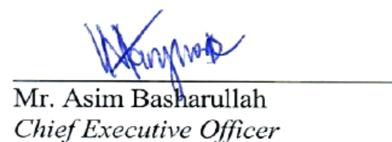
Management accepts responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act, 2015. Management are of the opinion that the financial statements give a true and fair view of the financial position of the Bank and of its profit or loss.

Management further accepts responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

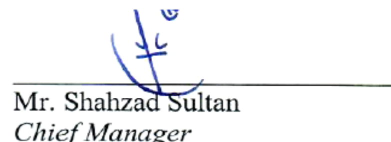
Management has made an assessment of the Bank's ability to continue as a going concern and have no reason to believe the branches will not be a going concern for at least the next twelve months from the date of this statement.

**Approval of the financial statements**

The financial statements, as indicated above, were approved and authorised for issue by the management on 30 March 2022.



Mr. Asim Basharullah
*Chief Executive Officer*



Mr. Shahzad Sultan
*Chief Manager*

**Date: 30 March 2022**

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF**
# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## Report on the audit of the financial statements

### *Opinion*

We have audited the financial statements of Habib Bank AG Zurich (Kenya Branches) (the "Bank") set out on pages 8 to 91 which comprise the statement of financial position of the Bank as at 31 December 2021, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Habib Bank AG Zurich (Kenya Branches) as at 31 December 2021, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) and in the manner required by the Kenyan Companies Act, 2015.

### *Basis for opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (*IESBA Code*) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Other information*

Management is responsible for the other information. The other information obtained at the date of this auditor's report is information included in the *Principal officers and statutory information*, *Chief executive officer's report and Statement of management's responsibilities,* but does not include the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, 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.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF**
# HABIB BANK AG ZURICH
# (KENYA BRANCHES) (CONTINUED)

**Report on the audit of the financial statements (Continued)**

***Responsibilities of management for the financial statements***

As stated on page 4, Management are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRSs) and Kenyan Companies Act, 2015, and for such internal control as the Management 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 Management 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 Management either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so. The Management are responsible for overseeing the Bank's financial reporting process.

***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 Management.
- Conclude on the appropriateness of Managements' 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.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF**
**HABIB BANK AG ZURICH**
**(KENYA BRANCHES) (CONTINUED)**

**Report on the audit of the financial statements (Continued)**

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

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

We communicate with the Management 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 legal and regulatory requirements**

As required by the Kenyan Companies Act, 2015 we report to you, based on our audit that in our opinion the information given in the Chief Executive Officer's report on pages 2 to 3 is consistent with the financial statements.

*The engagement Partner responsible for the audit resulting in this independent auditor's report is CPA Alexander Mbai – Practicing Certificate No. P/2172.*

*For and on behalf of:*
**KPMG Kenya**
**Certified Public Accountants**
**PO Box 40612 – 00100**
**Nairobi**
**Date:** 30 March 2022

# HABIB BANK AG ZURICH
# (KENYA BRANCHES)

## STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2021

| | Note | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|---|
| Interest income | 7 | 2,356,442 | 2,210,747 |
| Interest expense | 8 | (1,095,703) | (1,058,964) |
| **Net interest income** | | **1,260,739** | **1,151,783** |
| Non-interest income | 9(a) | 117,593 | 104,249 |
| **Operating income** | | **1,378,332** | **1,256,032** |
| Impairment on loans and advances | 15(c) | (44,055) | (65,950) |
| Non-interest expense | 9(b) | (791,851) | (739,157) |
| **Profit before taxation** | 10 | **542,426** | **450,925** |
| Income tax expense | 11(a) | (118,791) | (143,871) |
| **Profit for the year** | | **423,635** | **307,054** |
| Other comprehensive income for the year, net of tax | | - | - |
| **Total comprehensive income for the year** | | **423,635** | **307,054** |

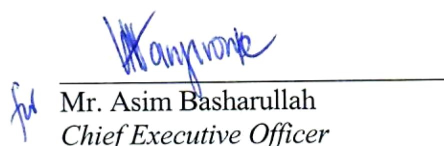
The notes on pages 12 to 91 form an integral part of these financial statements.

**HABIB BANK AG ZURICH**
**(KENYA BRANCHES)**

**STATEMENT OF FINANCIAL POSITION**
**AT 31 DECEMBER 2021**

| ASSETS | Note | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|---|
| Cash and balances with Central Bank of Kenya | 12 | 924,586 | 860,897 |
| Investments in government securities | 13 | 20,122,613 | 18,140,960 |
| Placements with other banks | 14 | 385,178 | 638,940 |
| Loans and advances to customers (Net) | 15(a) | 5,840,875 | 6,373,424 |
| Amounts due from other Habib Bank AG Zurich branches | 16(a) | 194,369 | 279,605 |
| Tax recoverable | 11(c) | 190,664 | 125,346 |
| Other assets | 17 | 236,257 | 215,798 |
| Deferred tax asset | 18 | 249,755 | 206,492 |
| Property and equipment | 20 | 370,762 | 311,116 |
| Right of use assets | 28(a) | 38,904 | 59,306 |
| **TOTAL ASSETS** | | **28,553,963** | **27,211,884** |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Deposits from other banks and banking institutions | 21 | 899,453 | 333,293 |
| Customers deposits | 22 | 23,683,972 | 21,749,013 |
| Amounts due to other Habib Bank AG Zurich branches | 16(b) | 507,916 | 1,725,727 |
| Lease liabilities | 28(b) | 25,220 | 41,061 |
| Other liabilities | 23 | 109,935 | 159,128 |
| **Total liabilities** | | **25,226,496** | **24,008,222** |
| **Equity (Page 10)** | | | |
| Assigned capital | | 350,000 | 350,000 |
| Revenue reserves | | 2,658,046 | 2,684,058 |
| Statutory credit risk reserve | 29 | 319,421 | 169,604 |
| **Total equity** | | **3,327,467** | **3,203,662** |
| **TOTAL LIABILITIES AND EQUITY** | | **28,553,963** | **27,211,884** |

The financial statements set on pages 9 to 91 were approved and authorised for issue by management on 30 March 2022.



Mr. Asim Basharullah
*Chief Executive Officer*

The notes on pages 12 to 91 form an integral part of these financial statements.

# HABIB BANK AG ZURICH
## (KENYA BRANCHES)

## STATEMENT OF CHANGES IN EQUITY
## FOR THE YEAR ENDED 31 DECEMBER 2021

| **2020:** | **Assigned capital KShs '000** | **Revenue reserves KShs '000** | **Statutory credit risk reserve KShs '000** | **Total KShs '000** |
|---|---|---|---|---|
| Balance at 1 January 2020 | 350,000 | 2,674,270 | 53,049 | 3,077,319 |
| Profit for the year | - | 307,054 | - | 307,054 |
| Transfer to statutory credit risk reserve | - | (116,555) | 116,555 | - |
| **Total comprehensive income** | **350,000** | **2,981,324** | **53,049** | **3,384,373** |
| **Transactions with owners of the Branch** | | | | |
| Remittance to head office | - | (180,711) | - | (180,711) |
| **Balance at 31 December 2020** | **350,000** | **2,684,058** | **169,604** | **3,203,662** |
| **2021:** | | | | |
| Balance at 1 January 2021 | 350,000 | 2,684,058 | 169,604 | 3,203,662 |
| Profit for the year | - | 423,635 | - | 423,635 |
| Transfer to statutory credit risk reserve | - | (149,817) | 149,817 | - |
| **Total comprehensive income** | **350,000** | **3,107,693** | **169,604** | **3,627,297** |
| **Transactions with owners of the Branch** | | | | |
| Remittance to head office | - | (299,830) | - | (299,830) |
| **Balance at 31 December 2021** | **350,000** | **2,658,046** | **319,421** | **3,327,467** |

The notes on pages 12 to 91 form an integral part of these financial statements.

# HABIB BANK AG ZURICH
## (KENYA BRANCHES)

## STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2021

| | Note | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|---|
| **Net cash flows generated from operating activities** | 25(a) | **(104,536)** | **473,805** |
| **Investing activities** | | | |
| Purchase of property and equipment | 20 | (87,078) | (66,023) |
| Additions to right of use assets | 28(a) | (883) | (883) |
| Proceeds from disposal of property and equipment | | 962 | 860 |
| **Cash flows from investing activities** | | **( 86,999)** | **( 66,046)** |
| **Financing activities** | | | |
| Repatriation to Habib AG Zurich | | ( 299,830) | ( 180,710) |
| Payment of lease liabilities | | ( 19,548) | ( 10,688) |
| **Cash flows from financing activities** | | **( 319,378)** | **( 191,398)** |
| Decrease in cash and cash equivalents | | ( 510,913) | 216,361 |
| Cash and cash equivalents at 1 January | | 1,628,282 | 1,411,921 |
| **Cash and cash equivalents at 31 December** | 25(b) | **1,117,369** | **1,628,282** |

The notes on pages 12 to 91 form an integral part of these financial statements.

## 1. REPORTING ENTITY

The Habib Bank AG Zurich (Kenya Branches) is a branch of Habib Bank AG Zurich, which is incorporated in Switzerland.

Habib Bank AG Zurich (Kenya Branches) is licensed to operate as a bank under the Kenyan Banking Act, 2015, and is domiciled in Kenya. The address of the branches registered offices are shown on Page 1. The branches are primarily involved in commercial banking.

## 2. BASIS OF PREPARATION

### (a) Statement of compliance

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

Details of the Bank's significant accounting policies are included in Note 3.

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

### (b) Basis of measurement

The financial statements have been prepared on the historical cost basis, except where otherwise stated in the accounting policies below.

### (c) Functional and presentation currency

These financial statements are presented in Kenya shillings (KShs), which is the branches' functional currency. Except as otherwise indicated, financial information presented in Kenya shillings has been rounded to the nearest thousand (KShs'000).

### (d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

The estimates and assumptions are based on the Directors' best knowledge of current events, actions, historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

## 2. BASIS OF PREPARATION (Continued)

### (d) Use of estimates and judgments (continued)

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

In particular, information about significant areas of estimation and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements is described in Note 6.

## 3. SIGNIFICANT ACCOUNTING POLICIES

### (a) Revenue recognition

#### *(i) Net interest income*

**Effective interest rate and amortised cost**

Interest income and expense are recognised in profit or loss using the effective interest method. The ‘effective interest rate’ is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

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

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

**Amortised cost and gross carrying amount**

The ‘amortised cost’ of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

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

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (a) Revenue recognition (continued)

#### *(i) Net interest income - continued*

**Amortised cost and gross carrying amount - continued**

**Calculation of interest income and expense**

In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability.

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

**Presentation**

Interest income and expense presented in the statement of profit or loss and OCI include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on debt instruments measured at FVOCI calculated on an effective interest basis;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period as the hedged cash flows affect interest income/expense; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

#### *(ii) Net fee and commission income*

Fee and commission income and expenses that are integral to the effective interest rate of a financial asset or liability are included in the measurement of the effective interest rate.

Other fee and commission income – including account servicing fees, investment management fees, sales commission, placement fees and syndication fees – is recognised overtime as the related services are performed. If a loan commitment is not expected to result in the draw-down of a loan, then the related loan commitment fee is recognised on a straight-line basis over the commitment period.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (a) Revenue recognition (continued)

#### *(ii) Net fee and commission income - continued*

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fee and commission expenses relate mainly to transaction and service fees, which are recognised at a point in time or over time as the service is performed.

Gains and losses arising from changes in the fair value of financial assets and liabilities at fair value through profit or loss, as well as any interest receivable or payable, were included in profit or loss in the period in which they arise.

Gains and losses arising from changes in the fair value of available-for-sale financial assets, other than foreign exchange gains or losses from monetary items, were recognised directly in other comprehensive income, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income was recognised in profit or loss.

### (b) Transactions in foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the rates ruling at the transaction dates. Monetary assets and liabilities at the reporting date which are expressed in foreign currencies are translated into Kenya shillings at rates ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the date of the transaction.

### (c) Property and equipment

#### *(i) Recognition and measurement*

Freehold land is included in the financial statements at its historical cost and is not depreciated. Items of leasehold improvements, motor vehicles, office equipment and furniture and fittings are stated at historical cost less accumulated depreciation and impairment losses.

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of the expenditure will flow to the bank. Ongoing repairs and maintenance are expensed.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (c) Property and equipment (continued)

#### *(ii) Depreciation*

Freehold land is not depreciated.

Depreciation charge is on a straight-line basis to allocate the cost of assets to less the residual values over the estimated useful lives of the assets. The annual rates of depreciation used are as follows:

| | |
|---|---|
| Leasehold improvements | 20% |
| Motor vehicles | 20% |
| Office furniture and fittings | 15% |
| Office equipment | 25% |
| Buildings | 4% |

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

#### *(iii) Disposal of property and equipment*

Gains and losses on disposal of property and equipment are determined by reference to the carrying amount and are recognized in the profit or loss in the year in which they arise.

### (d) Leases

The Bank applies IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 4. The details of accounting policies under IAS 17 and IFRIC 4 are disclosed separately.

**Policy applicable from 1 January 2019**

At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definition of a lease in IFRS 16.

This policy is applied to contracts entered (or changed) on or after 1 January 2019.

**Bank acting as a lessee**

At commencement or on modification of a contract that contains a lease component, the Bank allocates consideration in the contract to each lease component on the basis of its relative stand- alone price.

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to branches or office premises.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (d) Leases (continued)

**Bank acting as a lessee - continued**

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate.

The Bank determines its incremental borrowing rate by analysing its bank borrowings and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payments included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Bank is reasonably certain to exercise, lease payments in an optional renewal period if the Bank is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Bank is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Bank's estimate of the amount expected to be payable under a residual value guarantee, if the Bank changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

**Short-term leases and leases of low-value assets**

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

**Policy applicable before 1 January 2019**

For contracts entered before 1 January 2019, the Bank determined whether the arrangement was or contained a lease based on the assessment of whether:

**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**(d) Leases (continued)**

**Policy applicable before 1 January 2019 (continued)**

- fulfilment of the arrangement was dependent on the use of a specific asset or assets; and
- the arrangement had conveyed a right to use the asset.

**As a lessee**

The Bank did not have any finance leases under IAS 17.

Assets held under other leases were classified as operating leases and were not recognised in the Bank's statement of financial position. Payments made under operating leases were recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received were recognised as an integral part of the total lease expense, over the term of the lease.

**(e) Financial instruments**

***(i) Recognition***

The Bank initially recognises loans and advances, trade receivables, deposits and debt securities on the date at which they are originated. All other financial assets and liabilities (including assets designated at fair value through profit or loss) are initially recognised on the trade date on which the Bank becomes a party to the contractual provision of the instrument.

A financial asset (unless it is a trade receivable without a significant financing component) or liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue. Subsequent to initial recognition, financial liabilities (deposits and debt securities) are measured at their amortized cost using the effective interest method.

***(ii) Classification***

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ii) Classification - continued*

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management’s strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank’s management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank’s stated objective for managing the financial assets is achieved and how cash flows are realised.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ii) Classification - continued*

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

**Assessment whether contractual cash flows are Solely Payments of Principal and Interest (SPPI Test)**

For the purposes of this assessment, ‘principal’ is defined as the fair value of the financial asset on initial recognition. ‘Interest’ is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.
In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- prepayment and extension terms;
- terms that limit the Bank’s claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

The Bank holds a portfolio of long-term fixed rate loans for which the Bank has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty.

The Bank has determined that the contractual cash flows of these loans are solely payments of principal and interest because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

**Debt instruments measured at amortised cost**

Debt instruments are measured at amortized cost if they are held within a business model whose objective is to hold for collection of contractual cash flows where those cash flows represent solely payments of principal and interest. After initial measurement, debt instruments in this category are carried at amortized cost. Interest income on these instruments is recognized in interest income using the effective interest rate method.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ii) Classification - continued*

**Debt instruments measured at amortised cost – continued**

The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial asset to the gross carrying amount of a financial asset. Amortized cost is calculated by taking into account any discount or premium on acquisition, transaction costs and fees that are an integral part of the effective interest rate.

Impairment on debt instruments measured at amortized cost is calculated using the expected credit loss approach. Loans and debt securities measured at amortized cost are presented net of the allowance for credit losses (ACL) in the statement of financial position.

**Debt instruments measured at FVOCI**

Debt instruments are measured at FVOCI if they are held within a business model whose objective is to hold for collection of contractual cash flows and for selling financial assets, where the assets' cash flows represent payments that are solely payments of principal and interest. Subsequent to initial recognition, unrealized gains and losses on debt instruments measured at FVOCI are recorded in other comprehensive income (OCI), unless the instrument is designated in a fair value hedge relationship. When designated in a fair value hedge relationship, any changes in fair value due to changes in the hedged risk are recognized in non-interest income in the Consolidated Statement of profit or loss and other comprehensive income. Upon derecognition, realized gains and losses are reclassified from OCI and recorded in non-interest income in the consolidated Statement of Profit or Loss and Other Comprehensive Income on an average cost basis. Foreign exchange gains and losses that relate to the amortized cost of the debt instrument are recognized in the consolidated statement of profit or loss and other comprehensive income.

Premiums, discounts and related transaction costs are amortized over the expected life of the instrument to Interest income in the consolidated statement of profit or loss and other comprehensive income using the effective interest rate method.

Impairment on debt instruments measured at FVOCI is calculated using the expected credit loss approach. The ACL on debt instruments measured at FVOCI does not reduce the carrying amount of the asset in the Consolidated Statement of Financial Position, which remains at its fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI with a corresponding charge to Provision for credit losses in the Consolidated Statement of Profit or Loss and Other Comprehensive Income. The accumulated allowance recognised in OCI is recycled to the Consolidated Statement of Profit or Loss and Other Comprehensive Income upon derecognition of the debt instrument.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ii) Classification - continued*

**Debt instruments measured at FVTPL**

Debt instruments are measured at FVTPL if assets:

(i) Are held for trading purposes;
(ii) Are held as part of a portfolio managed on a fair value basis; or
(iii) Whose cash flows do not represent payments that are solely payments of principal and interest.

These instruments are measured at fair value in the Consolidated Statement of Financial Position, with transaction costs recognized immediately in the Consolidated Statement of Profit or Loss and Other Comprehensive Income as part of Non-interest income. Realized and unrealized gains and losses are recognized as part of Non-interest income in the Consolidated Statement of Profit or Loss and Other Comprehensive Income.

**Debt instruments designated at FVTPL**

Financial assets classified in this category are those that have been designated by the Bank upon initial recognition, and once designated, the designation is irrevocable. The FVTPL designation is available only for those financial assets for which a reliable estimate of fair value can be obtained.

Financial assets are designated at FVTPL if doing so eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Financial assets designated at FVTPL are recorded in the Consolidated Statement of Financial Position at fair value. Changes in fair value are recognized in Non-interest income in the statement of profit or loss.

**Equity instruments**

The Bank has elected at initial recognition to irrevocably designate an equity investment, held for purposes other than trading, at FVOCI. The fair value changes, including any associated foreign exchange gains or losses, are recognized in OCI and are not subsequently reclassified in the Consolidated Statement of Profit or Loss and Other Comprehensive Income, including upon disposal. Realized gains and losses are transferred directly to retained earnings upon disposal. Consequently, there is no review required for impairment. Dividends will normally be recognized in the Consolidated Statement of Profit or Loss and Other Comprehensive Income.

**Reclassifications**

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ii) Classification - continued*

**Financial liabilities**

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised.

#### *(iii) Impairment on financial assets*

The Bank recognises loss allowances for Expected Credit Losses (ECL) on the following financial instruments that are not measured at FVTPL:

- financial assets (amortised cost and FVOCI) including debt instruments, loans and advances and trade receivables from Bancassurance.
- financial guarantee contracts issued; and
- loan commitments issued.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date i.e. balances held with central banks, domestic government bills and bonds, and loans and advances to banks; and
- other financial instruments (other than lease receivables) on which credit risk (i.e. the risk of default occurring over the expected life of the financial instrument) has not increased significantly since their initial recognition i.e. stage 1.

Loss allowances for trade receivables (bancassurance) are always measured at an amount equal to lifetime ECL.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECLs, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and informed credit assessment and including forward-looking information.

The Bank assumes that the credit risk on a financial asset has increased significantly if it is more than 30 days past due.

The Bank considers 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 realizing security (if any is held); or
- the financial asset is more than 90 days past due.

The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(iii) Impairment on financial assets - continued*

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

**Significant Increase in Credit Risk (SICR)**

At each reporting date, the Bank performs both qualitative and quantitative assessments whether there has been a significant increase in credit risk for exposures since initial recognition by comparing the risk of default occurring over the remaining expected life from the reporting date and the date of initial recognition. The assessment considers borrower-specific quantitative and qualitative information without consideration of collateral, and the impact of forward-looking macroeconomic factors.

The common assessments for SICR is largely determined by the Central Bank of Kenya Prudential Guidelines classification augmented by macroeconomic outlook, management judgement, and delinquency and monitoring.

Quantitative models may not always be able to capture all reasonable and supportable information that may indicate a significant increase in credit risk. Qualitative factors may be assessed to supplement the gap. Examples of situations include a significant departure from the primary source of repayment, changes in adjudication criteria for a particular group of borrowers; changes in portfolio composition; and legislative changes impacting certain portfolios.

With regards to delinquency and monitoring, there is a rebuttable presumption that delinquency backstop when contractual payments are more than 30 days past due.

**Measurement of ECL**

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- *financial assets that are not credit-impaired at the reporting date(stage 1 and 2):* as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- *financial assets that are credit-impaired at the reporting dat*e (stage 3): as the difference between the gross carrying amount and the present value of estimated future cash flows;

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(iii) Impairment on financial assets - continued*

**Measurement of ECL (continued)**

- *undrawn loan commitments:* as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- *financial guarantee contracts*: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

**Restructured financial assets**

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

**Credit-impaired financial assets**

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired (referred to as stage 3 financial assets). A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; and
- the disappearance of an active market for a security because of financial difficulties.

A loan that is overdue for 90 days or more is considered impaired. In addition, a loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit-impaired.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(iii) Impairment on financial assets - continued*

**Credit-impaired financial assets (continued)**

Unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

**Government securities (debt instruments)**

In making an assessment of whether an investment in sovereign debt (government bills and bonds, balances due from central banks) is credit-impaired, the Bank considers the following factors;

(i) The country's ability to access own local capital markets for new debt issuance;
(ii) The respective government ability to maintain sovereignty on its currency; and
(iii) The intentions and capacity, reflected in public statements, of governments and agencies honor these commitments.

**Presentation of allowance for ECL in the statement of financial position**

Loss allowances for ECL are presented in the statement of financial position as follows:

- *financial assets measured at amortised cost:* as a deduction from the gross carrying amount of the assets;
- *loan commitments and financial guarantee contracts:* generally, as a provision;
- *where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component:* the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- *debt instruments measured at FVOCI:* no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

**Write-off**

Financial assets at both amortised and FVOCI are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(iv) De-recognition*

**Financial assets**

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to sale-and-repurchase transactions, because the Bank retains all or substantially all of the risks and rewards of ownership of such assets
In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

Before 1 January 2018, retained interests were primarily classified as available-for-sale investment securities and measured at fair value.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(iv) De-recognition - continued*

**Financial liabilities**

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

#### *(v) Modifications of financial assets and financial liabilities*

**Financial assets**

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value.

If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

**Financial liabilities**

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in profit or loss.

#### *(vi) Offsetting of financial assets and financial liabilities*

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

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank’s trading activity.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(vii) Recognition*

The Bank initially recognises loans and advances, deposits and debt securities on the date at which they are originated. All other financial assets and liabilities (including assets designated at fair value through profit or loss) are initially recognised on the trade date at which the Bank becomes a party to the contractual provision of the instrument.

A financial asset or liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue. Subsequent to initial recognition, financial liabilities (deposits and debt securities) are measured at their amortized cost using the effective interest method.

#### *(viii) Classification*

The Bank classifies its financial assets on initial recognition into three principal classification categories based on the cash flow characteristics of the asset and the business model assessment:

- measured at Amortised Cost;
- Fair Value through Other Comprehensive Income (FVOCI); and
- Fair Value through Profit or Loss (FVTPL).

The previous categories of Held to Maturity, Loans and Receivables and Available for Sale under IAS 39 have been replaced.

**Amortised cost**

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

The Bank recognises cash and balances with Central Bank, placements with other banks, investments in government securities, loans and advances to customers and other assets at amortised cost.

**Fair Value through Other Comprehensive Income (FVOCI) – Debt**

A financial asset which is a debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(viii) Classification – continued*

**Fair Value through Other Comprehensive Income (FVOCI) – Debt - continued**

— its contractual terms give rise on specified dates to cash flows that are solely payments of principal and Interest (SPPI) on the principal amount outstanding.

The Bank has no financial assets classified at FVOCI.

**Fair Value through Other Comprehensive Income (FVOCI) – Equity**

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by investment basis. The Bank currently does not have any equity investments.

**Fair Value through Profit or Loss (FVTPL)**

All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. In addition, on initial recognition the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Bank does not have financial assets classified at FVTPL.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of IFRS 9 are not separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

**Assessment of whether contractual cash flows are solely payments of principal and Interest (SSPI)**

To determine whether a financial asset should be classified as measured at amortised cost, FVOCI or FVTPL, an entity assesses whether the cash flows from the financial asset represent, on specified dates, solely payments of principal and interest on the principal amount outstanding - i.e. the SPPI criterion. A financial asset that does not meet the SPPI criterion is always measured at FVTPL, unless it is an equity instrument for which an entity applies the FVOCI election.

For the purposes of this assessment, ‘principal’ is defined as the fair value of the financial asset on initial recognition. The definition of principal reflects the economics of the financial asset from the perspective of the current holder. This means that an entity assesses the asset's contractual cash flow characteristics by comparing the contractual cash flows to the amount that it actually invested.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(viii) Classification – continued*

**Assessment of whether contractual cash flows are solely payments of principal and Interest (SSPI) - continued**

'Interest' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considered the contractual terms of the instrument. This included assessing whether the financial asset contained a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considered:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets – e.g. non-recourse asset arrangements; and
- features that modify consideration for the time value of money – e.g. periodic reset of interest rates.

Contractual features that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, give rise to contractual cash flows that do not meet the SPPI criterion.

**Business model assessment**

The Bank makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice, including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

*(viii) Classification – continued*

**Business model assessment (continued)**

- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

The Bank's financial assets are all held within a business model whose objective is to hold assets to collect contractual cash flows.

**Financial liabilities**

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. However, although under IAS 39 fair value changes of liabilities designated under the fair value option were recognised in profit and loss, under IFRS 9, fair value changes are generally presented as follows:

- the amount of change in fair value that is attributable to changes in credit risk of the liability is presented in OCI and;
- the remaining amount of change in fair value is presented in profit or loss.

The Bank classifies all financial liabilities as subsequently measured at amortised cost.
Customer deposits, balances due to banking institutions and other liabilities are classified at amortised cost.

**Reclassification**

The Bank only reclassifies financial assets when management changes the business model for managing the financial assets. In that instance all affected financial assets are reclassified. Such changes are expected to be very infrequent, and are determined by the Bank's senior management as a result of external or internal changes.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ix) Identification and measurement of impairment of financial assets*

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset than can be estimated reliably.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. Significant assets found not to be specifically impaired are then collectively assessed for any impairment that may have been incurred but not yet identified. Assets that are not individually significant are collectively assessed for impairment by grouping together financial assets with similar risk characteristics.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would otherwise not consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Bank.

In assessing collective impairment the Bank uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

Default rate, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate.

Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

Impairment losses on available-for-sale securities are recognised by reclassifying the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss recognised previously in profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (e) Financial instruments (continued)

#### *(ix) Identification and measurement of impairment of financial assets - continued*

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

#### *(x) De-recognition*

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are The Bank enters into transactions whereby it transfers assets recognized on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them.

If all or substantially all risks and rewards are retained, then the transferred assets are not derecognized from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include repurchase transactions.

#### *(xi) Fair value of financial assets and financial liabilities*

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, in the principal, or in its absence, the most advantageous market to which the group has access at that date.

#### *(xii) Amortized cost measurement*

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

### (f) Impairment of non-financial assets

The carrying amounts of the Bank non-financial assets other than deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (f) Impairment of non-financial assets (continued)

Impairment losses recognised in respect of cash-generating units reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis. The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### (g) Employee benefits

#### *(i) Retirement benefits scheme*

The majority of the Bank's employees are eligible for retirement benefits under a defined contribution plan.

Obligations for contributions to the defined contribution plan are recognised as an expense in the profit or loss. Any difference between the charge to the profit or loss and the contributions payable is recorded in the statement of financial position under other assets or liabilities.

#### *(ii) Gratuity*

The bank has a gratuity scheme for expatriate staff in which the benefit provided is a cash lump sum of one month's basic salary for each completed year of service with the bank up to a maximum of twenty four years.

#### *(iii) Short term employee benefits*

Short term employee benefit is expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the bank has present legal or constructive obligation to pay this amount as a result of past service provide by the employee and the obligation can be estimated by reliability.

### (h) Income tax

Income tax expense comprises current tax and deferred tax. Current tax is provided on the results in the year as shown in the financial statements adjusted in accordance with tax legislation.

Deferred tax is recognized in respect of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes except differences relating to the initial recognition of assets or liabilities which affect neither accounting nor taxable profit.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (h) Income tax (continued)

A deferred tax asset is recognised only to the extent that it is probable that future taxable profit will be available against which the tax asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax is calculated on the basis of the tax rates enacted at the reporting date.

### (i) Cash and cash equivalents

For purpose of presentation of cash flows in the financial statements, the cash and cash equivalents include balances with Central Bank of Kenya, net of cash ratio reserve, net balances from banking institutions and investments with maturities of three months or less from the date of acquisition. Cash and cash equivalents are highly liquid assets subject to insignificant risk of changes in their fair value. They are used by the bank in the management of short term commitments. They are measured at amortised cost using effective interest method.

### (j) Financial guarantees

Financial guarantees are contracts that require the bank 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 the debt instrument.

### (k) Related parties

In the normal course of business, transactions have been entered into with certain related parties. These transactions are at arm's length.

### (l) New standards, amendments and interpretations

***(i) New standards, amendments and interpretations effective and adopted during the year***

| New standard or amendments | Effective for annual periods beginning on or after |
|---|---|
| — COVID-19-Related Rent Concessions (Amendment to IFRS 16) | 1 June 2020 |
| — Interest Rate Benchmark Reform Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) | 1 January 2021 |

These standards did not have a material impact on the financial statements of the Bank.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

#### *(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021*

| New standards or amendments | Effective for annual period beginning or after |
|---|---|
| — Onerous Contracts Cost of Fulfilling a Contract Jan 2022 (Amendments to IAS 37) | 1 January 2022 |
| — COVID-19 Related Rent Concession beyond 30 June 2021 (Amendment to IFRS 16) | 1 April 2021 |
| — Annual Improvements to IFRS Standards 2018-2020 | 1 January 2022 |
| — Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16) | 1 January 2022 |
| — Reference to the Conceptual Framework (Amendments to IFRS 3) | 1 January 2022 |
| — IFRS 17 Insurance Contracts | 1 January 2023 |
| — Classification of liabilities as current or non-current (Amendments to IAS 1) | 1 January 2023 |
| — Amendments to IFRS 17 | 1 January 2023 |
| — Disclosure of Accounting Policy (Amendments to IAS 1 and IFRS Practice Statement 2). | 1 January 2023 |
| — Definition of Accounting Estimate (Amendments to IAS 8). | 1 January 2023 |
| — Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12 income taxes) | 1 January 2023 |
| — Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28). | Optional. |

All standards and interpretations will be adopted at their effective date (except for those standards and interpretations that are not applicable to the entity). Management is in the process of assessing the impact of these standards to the Bank.

**Onerous Contracts - Cost of Fulfilling a Contract (Amendments to IAS 37)**

The amendment to IAS 37 clarifies that the direct costs of fulfilling a contract include both the incremental costs of fulfilling the contract and an allocation of other costs directly related to fulfilling contracts. Before recognising a separate provision for an onerous contract, the entity recognises any impairment loss that has occurred on assets used in fulfilling the contract.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

#### *(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued*

**COVID-19-Related Rent Concessions beyond 30 June 2021 – Amendment to IFRS 16 Leases**

In May 2020, the Board issued COVID-19-Related Rent Concessions (the 2020 amendments), which amended IFRS 16 Leases. The 2020 amendments introduced an optional practical expedient that simplifies how a lessee accounts for rent concessions that are a direct consequence of COVID-19. Under that practical expedient, a lessee is not required to assess whether eligible rent concessions are lease modifications, instead accounting for them in accordance with other applicable guidance.

The practical expedient introduced in the 2020 amendments only applies to rent concessions for which any reduction in lease payments affects solely payments originally due on or before 30 June 2021. If the Board had taken no further action, the practical expedient would have expired in a few months.

The economic challenges presented by the COVID-19 pandemic have persisted longer than anticipated. As a result, lessors and lessees are negotiating rent concessions that extend beyond 30 June 2021.

The Board has therefore extended the practical expedient by 12 months – i.e. permitting lessees to apply it to rent concessions for which any reduction in lease payments affects only payments originally due on or before 30 June 2022.

The 2021 amendments are effective for annual reporting periods beginning on or after 1 April 2021. Lessees are permitted to apply it early, including in financial statements not authorised for issue. In effect, it is available to be applied now, subject to any local endorsement requirements.

The 2021 amendments are applied retrospectively with the cumulative effect of initially applying it being recognised in opening retained earnings. The disclosure requirements of Paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors do not apply on initial application.

The original version of the practical expedient was, and remains, optional. However, the 2021 amendments are, in effect, not optional. This is because a lessee that chose to apply the practical expedient introduced by the 2020 amendments has to consistently apply the extension to eligible contracts with similar characteristics and in similar circumstances.

This means that lessees will need to reverse previous lease modification accounting if a rent concession was ineligible for the original practical expedient under the 2020 amendments but becomes eligible as a result of the extension.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Annual Improvement cycle (2018 – 2020) – various standards**

The following improvements were finalised in May 2020:

| | |
|---|---|
| IFRS 9 Financial Instruments | IFRS 9 *Financial Instruments* - clarifies which fee should be included in the 10% test for derecognition of financial liabilities. |
| IFRS 16 Leases | IFRS 16 Leases - amendment of illustrative example 13 to remove the illustration of payments from the lessor relating to leasehold improvements, to remove any confusion about the treatment of lease incentives. |
| IFRS 1 First-time Adoption of International Financial Reporting Standards | IFRS I First-time Adoption of International Financial Reporting Standards - allows entities that have measured their assets and liabilities at carrying amounts recorded in their parent's books to also measure any cumulative translation differences using the amounts reported by the parent. This amendment will also apply to associates and joint ventures that have taken the same IFRS I exemption. |

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

**Property, Plant and Equipment: Proceeds before intended use (Amendments to IAS 16)**

The amendment to IAS 16 Property, Plant and Equipment (PP&E) prohibits an entity from deducting from the cost of an item of PP&E any proceeds received from selling items produced while the entity is preparing the asset for its intended use. It also clarifies that an entity is 'testing whether the asset is functioning properly' when it assesses the technical and physical performance of the asset. The financial performance of the asset is not relevant to this assessment.

Entities must disclose separately the amounts of proceeds and costs relating to items produced that are not an output of the entity's ordinary activities.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Reference to the Conceptual Framework (Amendments to IFRS 3)**

Minor amendments were made to IFRS 3 Business Combinations to update the references to the Conceptual Framework for Financial Reporting and add an exception for the recognition of liabilities and contingent liabilities within the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets and interpretation 21 Levies. The amendments also confirm that contingent assets should not be recognised at the acquisition date.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

**IFRS 17 Insurance Contracts**

IFRS 17 Insurance Contracts sets out the requirements that an entity should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds.

An entity shall apply IFRS 17 Insurance Contracts to:

- insurance contracts, including reinsurance contracts, it issues;
- reinsurance contracts it holds; and
- investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

IFRS 17 requires an entity that issues insurance contracts to report them on the statement of financial position as the total of:

- the fulfilment cash flows—the current estimates of amounts that the entity expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and
- the contractual service margin—the expected profit for providing insurance coverage. The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

IFRS 17 requires an entity to recognise profits as it delivers insurance services, rather than when it receives premiums, as well as to provide information about insurance contract profits that the Company expects to recognise in the future. IFRS 17 requires an entity to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be loss making.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**IFRS 17 Insurance Contracts – continued**

Any expected losses arising from loss-making, or onerous, contracts are accounted for in profit or loss as soon as the Company determines that losses are expected. IFRS 17 requires the entity to update the fulfilment cash flows at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates. The entity:

- accounts for changes to estimates of future cash flows from one reporting date to another either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it; and
- chooses where to present the effects of some changes in discount rates—either in profit or loss or in other comprehensive income.

IFRS 17 also requires disclosures to enable users of financial statements to understand the amounts recognised in the entity's statement of financial position and statement of profit or loss and other comprehensive income, and to assess the risks the Company faces from issuing insurance contracts.

IFRS 17 replaces IFRS 4 Insurance Contracts. IFRS 17 is effective for financial periods commencing on or after 1 January 2021. An entity shall apply the standard retrospectively unless impracticable. A Company can choose to apply IFRS 17 before that date, but only if it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.

The adoption of these changes will not have a material impact on the amounts and disclosures of the Bank's financial statements.

**Classification of Liabilities as Current or Non-current (Amendments to IAS l)**

The narrow-scope amendments to IAS 1 Presentation of Financial Statements clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. Classification is unaffected by the expectations of the entity or events after the reporting date (e.g. the receipt of a waver or a breach of covenant). The amendments also clarify what IAS 1 means when it refers to the 'settlement' of a liability.

The amendments could affect the classification of liabilities, particularly for entities that previously considered management's intentions to determine classification and for some liabilities that can be converted into equity.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Classification of Liabilities as Current or Non-current (Amendments to IAS l) - continued**

They must be applied retrospectively in accordance with the normal requirements in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. In May 2020, the IASB issued an Exposure Draft proposing to defer the effective date of the amendments to 1 January 2023.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank’s financial statements.

**Definition of Accounting Estimates – Amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors**

The Board has now issued amendments to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to clarify how companies should distinguish changes in accounting policies from changes in accounting estimates, with a primary focus on the definition of and clarifications on accounting estimates.

The amendments introduce a new definition for accounting estimates: clarifying that they are monetary amounts in the financial statements that are subject to measurement uncertainty.

The amendments also clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy.

Developing an accounting estimate includes both:

- selecting a measurement technique (estimation or valuation technique) – e.g. an estimation technique used to measure a loss allowance for expected credit losses when applying IFRS 9 Financial Instruments; and
- choosing the inputs to be used when applying the chosen measurement technique – e.g. the expected cash outflows for determining a provision for warranty obligations when applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

The effects of changes in such inputs or measurement techniques are changes in accounting estimates.

The definition of accounting policies remains unchanged.
The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Disclosure Initiative: Accounting Policies – Amendments to IAS 1 Presentation of Financial Statements and IFRS Practice Statement 2 Making Materiality Judgements**

The Board has recently issued amendments to IAS 1 *Presentation of Financial Statements* and an update to IFRS Practice Statement 2 *Making Materiality Judgements* to help companies provide useful accounting policy disclosures.

The key amendments to IAS 1 include:

- requiring companies to disclose their *material* accounting policies rather than their *significant* accounting policies;
- clarifying that accounting policies related to immaterial transactions, other events or conditions are themselves immaterial and as such need not be disclosed; and
- clarifying that not all accounting policies that relate to material transactions, other events or conditions are themselves material to a company's financial statements.
- The Board also amended IFRS Practice Statement 2 to include guidance and two additional examples on the application of materiality to accounting policy disclosures.

The amendments are consistent with the refined definition of material:

*"Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements".*

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

**Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction – Amendments to IAS 12 *Income Taxes***

Targeted amendments to IAS 12 Income Taxes clarify how companies should account for deferred tax on certain transactions – e.g. leases and decommissioning provisions.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction – Amendments to IAS 12 *Income Taxes* – continued**

The amendments narrow the scope of the initial recognition exemption (IRE) so that it does not apply to transactions that give rise to equal and offsetting temporary differences.

As a result, companies will need to recognise a deferred tax asset and a deferred tax liability for temporary differences arising on initial recognition of a lease and a decommissioning provision. Currently, there is diversity in practice when accounting for deferred tax on transactions that involve recognising both an asset and a liability with a single tax treatment related to both.

For example, a company may be entitled to a tax deduction on a cash basis for a lease transaction that involves recognising a right-of-use (ROU) asset and a corresponding lease liability under IFRS 16 *Leases*. A temporary difference may then arise on initial recognition of the ROU asset and the lease liability. When applying the IRE to this temporary difference, a company may currently apply one of the following approaches.

| **Approach** | **Outcome** |
|---|---|
| Apply the IRE separately to the ROU asset and lease liability | Recognise the tax impacts in profit or loss when they are incurred and therefore recognise no deferred tax on the lease |
| Assess the ROU asset and lease liability together as a single or 'integrally linked' transaction on a net basis | Recognise deferred tax on a net temporary difference that arises after the initial recognition and is not subject to the IRE |
| Choose not to apply the IRE | Recognise deferred tax |

In short, not all companies reflect the future tax impacts of leases in their financial statements.

The amendments clarify that the exemption does not apply to transactions such as leases and decommissioning obligations. These transactions give rise to equal and offsetting temporary differences. All companies will now need to reflect the future tax impacts of these transactions and recognise deferred tax.

The amendments apply for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted.

For leases and decommissioning liabilities, the associated deferred tax asset and liabilities will need to be recognised from the beginning of the earliest comparative period presented, with any cumulative effect recognised as an adjustment to retained earnings or other components of equity at that date.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (l) New standards, amendments and interpretations (continued)

***(ii) New standards, amendments and interpretations in issue but not yet effective for the year ended 31 December 2021 – continued***

**Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction – Amendments to IAS 12 *Income Taxes* – continued**

If a company previously accounted for deferred tax on leases and decommissioning liabilities under the net approach, then the impact on transition is likely to be limited to the separate presentation of the deferred tax asset and the deferred tax liability.

For all other transactions, the amendments apply to transactions that occur after the beginning of the earliest period presented.

The Directors of the Bank do not anticipate that the application of the amendments in the future will have an impact on the Bank's financial statements.

**Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28)**

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The effective date of the amendments has yet to be set by the IASB; however, earlier application of the amendments is permitted.

The Directors of the Bank anticipate that the application of these amendments may have an impact on the Bank's financial statements in future periods should such transactions arise.

### (m) Derivatives held for risk management purposes and hedge accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. All derivatives are measured at fair value in the statement of financial position. The Bank designates certain derivatives held for risk management as well as certain no derivative financial instruments as hedging instruments in qualifying hedging relationships.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Derivatives held for risk management purposes and hedge accounting (continued)

**Policy applicable generally to hedging relationships**

On initial designation of the hedge, the Bank formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship.

The Bank makes an assessment, both on inception of the hedging relationship and on an ongoing basis, of whether the hedging instrument(s) is (are) expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item(s) during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80–125%. For a cash flow hedge of a forecast transaction, the Bank makes an assessment of whether the forecast transaction is highly probable to occur and presents an exposure to variations in cash flows that could ultimately affect profit or loss.

The Bank normally designates a portion of the cash flows of a financial instrument for cash flow or fair value changes attributable to a benchmark interest rate risk, if the portion is separately identifiable and reliably measurable.

***(i) Fair value hedges***

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss. The change in fair value of the hedged item attributable to the hedged risk is recognised in profit or loss. If the hedged item would otherwise be measured at cost or amortised cost, then its carrying amount is adjusted accordingly.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a CCP by both parties as a consequence of laws or regulations without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated.

Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as an adjustment to the recalculated effective interest rate of the item over its remaining life.

On hedge discontinuation, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to profit or loss by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. If the hedged item is derecognised, then the adjustment is recognised immediately in profit or loss when the item is derecognised.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Derivatives held for risk management purposes and hedge accounting (continued)

**Policy applicable generally to hedging relationships (continued)**

***(ii) Cash flow hedges***

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability or highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in OCI and presented in the hedging reserve within equity.

Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss. The amount recognised in the hedging reserve is reclassified from OCI to profit or loss as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the statement of profit or loss and OCI.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for cash flow hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively.

However, if the derivative is novated to a CCP by both parties as a consequence of laws or regulations without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated.

If the hedged cash flows are no longer expected to occur, then the Bank immediately reclassifies the amount in the hedging reserve from OCI to profit or loss.

For terminated hedging relationships, if the hedged cash flows are still expected to occur, then the amount accumulated in the hedging reserve is not reclassified until the hedged cash flows affect profit or loss; if the hedged cash flows are expected to affect profit or loss in multiple reporting periods, then the Group reclassifies the amount in the hedging reserve from OCI to profit or loss on a straight-line basis.

***(iii) Net investment hedges***

When a derivative instrument or a non-derivative financial liability is designated as the hedging instrument in a hedge of a net investment in a foreign operation, the effective portion of changes in the fair value of a derivative or the foreign exchange gains and losses of a non-derivative is recognised in OCI and presented in the translation reserve within equity.

The effective portion of the change in fair value of the hedging instrument is computed with reference to the functional currency of the parent entity against whose functional currency the hedged risk is measured. Any ineffective portion of the changes in the fair value of the derivative or foreign exchange gains and losses on the non-derivative is recognised immediately in profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Derivatives held for risk management purposes and hedge accounting (continued)

**Policy applicable generally to hedging relationships (continued)**

***(iii) Net investment hedges - continued***

The amount recognised in OCI is fully or partially reclassified to profit or loss as a reclassification adjustment on disposal or partial disposal of the foreign operation, respectively.

**Specific Policies for hedges affected by IBOR reform**

***(i) Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7) Issued September 2019 (the Phase 1 amendments)***

If a hedging relationship is directly affected by IBOR reform, then the Bank applies certain exceptions (referred to as 'the Phase 1 amendments') to the general hedge accounting policy. The Bank considers that a hedging relationship is directly affected by IBOR reform if it is subject to the following uncertainty arising from the reform:

- an interest rate benchmark subject to the reform is designated as the hedged risk, regardless of whether the rate is contractually specified; and/or
- the timing or amounts of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument are uncertain.

When the uncertainty arising from IBOR reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item or hedging instrument or when the hedging relationship is discontinued, the Bank ceases to apply the respective Phase 1 amendments.

However, when determining whether a previously designated forecast transaction is no longer expected to occur, the Bank continues to assume that the hedged interest rate benchmark cash flows will not be altered as a result of IBOR reform in accordance with the Phase 1 exemption. The Bank has concluded that as at 31 December 2021 there is no uncertainty in relation to IBOR reform in respect of its hedging relationships.

***(ii) Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS, IFRS 7, IFRS 4 and IFRS 16) Issued August 2020 (the Phase 2 amendments)***

When the basis for determining the contractual cash flows of the hedged item or hedging instrument changes as a result of IBOR reform and therefore there is no longer uncertainty arising about the cash flows of the hedged item or the hedging instrument, the Bank amends the hedge documentation of that hedging relationship to reflect the change(s) required by IBOR reform. For this purpose, the hedge designation is amended only to make one or more of the following changes:

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Derivatives held for risk management purposes and hedge accounting (continued)

**Specific Policies for hedges affected by IBOR reform - continued**

***(ii) Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS, IFRS 7, IFRS 4 and IFRS 16) Issued August 2020 (the Phase 2 amendments) - continued***

- designating an alternative benchmark rate as the hedged risk;
- updating the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged;
- updating the description of the hedging instrument; or
- updating the description of how the entity will assess hedge effectiveness.

The Bank amends the description of the hedging instrument only if the following conditions are met:

- it makes a change required by IBOR reform by changing the basis for determining the contractual cash flows of the hedging instrument;
- the chosen approach that is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument; and
- the original hedging instrument is not derecognised.

The Bank amends the formal hedge documentation by the end of the reporting period during which a change required by IBOR reform is made to the hedged risk, hedged item or hedging instrument. These amendments in the formal hedge documentation do not constitute the discontinuation of the hedging relationship or the designation of a new hedging relationship.

If changes are made in addition to those changes required by IBOR reform described above, then the Bank first considers whether those additional changes result in the discontinuation of the hedge accounting relationship. If the additional changes do not result in the discontinuation of the hedge accounting relationship, then the Bank amends the formal hedge documentation for changes required by IBOR reform as mentioned above.

**Policies specific to non-contractually specified risk portions**

When the Bank designates an alternative benchmark rate as a hedged risk and the alternative benchmark rate is a non-contractually specified risk portion that is not separately identifiable at the date it is designated, the Bank deems that the rate meets the separately identifiable criterion if it reasonably expects that the alternative benchmark rate will be separately identifiable within a 24-month period. The 24-month period applies on a rate-by-rate basis and starts from the date when the Bank first designates the alternative benchmark rate as a hedged risk.

If the Bank subsequently expects that a non-contractually specified alternative benchmark rate risk component will not be separately identifiable within the 24-month period, then it discontinues hedge accounting prospectively from the date of that reassessment for all hedging relationships in which the alternative benchmark rate is designated as a non-contractually specified risk portion.

## 3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (m) Derivatives held for risk management purposes and hedge accounting (continued)

**Policies specific to non-contractually specified risk portions (continued)**

***(ii) Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS, IFRS 7, IFRS 4 and IFRS 16) Issued August 2020 (the Phase 2 amendments) - continued***

When the interest rate benchmark on which the hedged future cash flows had been based is changed as required by IBOR reform, for the purpose of determining whether the hedged future cash flows are expected to occur, the Bank deems that the hedging reserve recognised in OCI for that hedging relationship is based on the alternative benchmark rate on which the hedged future cash flows will be based.

**Other non-trading derivatives**

Other non-trading derivatives are recognised on balance sheet at fair value. If a derivative is not held for trading, and is not designated in a qualifying hedging relationship, then all changes in its fair value are recognised immediately in profit or loss as a component of net income from other financial instruments at FVTPL.

**Embedded derivatives**

Derivatives may be embedded in another contractual arrangement (a host contract).

The Bank accounts for an embedded derivative separately from the host contract when:

- the host contract is not an asset in the scope of IFRS 9;
- the host contract is not itself carried at FVTPL;
- the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and
- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contract.

## 4. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Bank establishes fair value using a valuation technique. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants group consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.

## 4. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES (Continued)

The table below sets out the Bank's classification of each class of financial assets and liabilities, and their fair values (including accrued interest). A substantial proportion of the financial assets and liabilities mature/re-price within 12 months hence fair value approximates their carrying amounts.

| 2021: | Amortised cost KShs '000 | Loans and receivables KShs '000 | Other liabilities KShs '000 | Total carrying amount KShs '000 | Fair value amount KShs '000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 924,586 | - | - | 924,586 | 924,586 |
| Deposits and balances due from other banks | 385,178 | - | - | 385,178 | 385,178 |
| Investments in government securities | 20,122,613 | - | - | 20,122,613 | 20,122,613 |
| Amounts due from other branches | 194,369 | - | - | 194,369 | 194,369 |
| Loans and advances to customers | - | 5,840,875 | - | 5,840,875 | 5,840,875 |
| Other assets | 236,257 | - | - | 236,257 | 236,256 |
| **Total assets** | **21,863,003** | **5,840,875** | **-** | **27,703,878** | **27,703,878** |
| **Liabilities** | | | | | |
| Deposits from other banks | - | - | 899,453 | 899,453 | 899,453 |
| Amounts due to other branches | - | - | 507,916 | 507,916 | 507,916 |
| Customers' deposits | - | - | 23,683,972 | 23,683,972 | 23,683,972 |
| Other liabilities | - | - | 109,935 | 109,935 | 109,935 |
| **Total liabilities** | **-** | **-** | **25,201,276** | **25,201,276** | **25,201,276** |

## 4. FINANCIAL ASSETS AND LIABILITIES AND THEIR FAIR VALUES (Continued)

| 2020: | Amortised cost KShs '000 | Loans and receivables KShs '000 | Other liabilities KShs '000 | Total carrying amount KShs '000 | Fair value amount KShs '000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | 860,897 | - | - | 860,897 | 860,897 |
| Deposits and balances due from other banks | 638,940 | - | - | 638,940 | 638,940 |
| Investments in government securities | 18,140,960 | - | - | 18,140,960 | 18,140,960 |
| Amounts due from other branches | 279,605 | - | - | 279,605 | 279,605 |
| Loans and advances to customers | - | 6,373,424 | - | 6,373,424 | 6,373,424 |
| Other assets | 215,798 | - | - | 215,798 | 215,798 |
| **Total assets** | **20,136,200** | **6,373,424** | - | **26,509,624** | **26,509,624** |
| **Liabilities** | | | | | |
| Deposits from other banks | - | - | 333,293 | 333,293 | 333,293 |
| Amounts due to other branches | - | - | 1,725,727 | 1,725,727 | 1,725,727 |
| Customers' deposits | - | - | 21,749,013 | 21,749,013 | 21,749,013 |
| Other liabilities | - | - | 159,128 | 159,128 | 159,128 |
| **Total liabilities** | **-** | **-** | **23,967,161** | **23,967,161** | **23,967,161** |

The standard requires disclosure of fair values of all financial instruments. Financial instruments have been disclosed at either original cost amortised cost or fair value. Loans and advances are not actively traded in the market. Consequently, these have been disclosed at amortised cost.

## 5. FINANCIAL RISK MANAGEMENT

### (a) Introduction and overview

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks

This note presents information about the bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the bank's management of capital.

***Risk management framework***

Being a branch of a foreign bank, the Bank has the Local Management Committee instead of a Board of Directors.

The Local Management Committee has overall responsibility for the establishment and oversight of the bank's risk management framework. The committee has established the Bank Asset and Liability (ALCO), Credit and Operational Risk committees, which are responsible for developing and monitoring Bank risk management policies in their specified areas.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Bank's Head Office Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Bank Audit Committee is assisted in these functions by an Internal Audit function. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

### (b) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers, other banks and investment securities cash and bank balances and amounts due from other branches. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

*Coronavirus (COVID-19) pandemic*

As part of the credit risk management processes, the Bank has restructured various facilities with customers in order to support them navigate through the economic disruptions. The restructure of facilities includes extension of repayments and moratorium for certain periods. The Bank has also incorporated the Government's directives on the pandemic in providing relief to customers and other measures put in place by the Central Bank of Kenya.

In determining when a significant increase in credit risk has occurred the bank uses quantitative test based on movement in PD, qualitative indicators, and a backstop of 90 days past due for all financing arrangements.

For facilities subject to the COVID-19 restructure and modifications, an assessment of the significant increase in credit risk has been determined based on various measures of the customer's current financial position and earnings capacity as well as the qualitative and quantitative considerations

As a result of COVID-19 pandemic, the Bank restructured facilities with customers as support measures by extending repayments to customer facilities for certain durations. These modifications were based on customers' requests for restructures as a result of the pandemic. For facilities subject to COVID-19 deferral arrangements, an assessment of significant increase in credit risk has been determined based on various measures of the customer's financial position and earning capacity from which the facilities were categorised into stage 1, stage 2 or stage 3.

The Bank has tested its business strategy and resolved it remains relevant to create long-term sustainable value for our stakeholders, notwithstanding changes caused by the impact of COVID-19 including restructured facilities.

***Management of credit risk***

The Local Management Committee has delegated responsibility for the management of credit risk to its Credit Committee. The Credit Officer, reporting to the Credit Committee, is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation of credit facilities vest with the Credit Committee. Larger facilities require approval by Head Office as appropriate.
- Reviewing and assessing credit risk. Credit Committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

***Management of credit risk (continued)***

- Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).
- Developing and maintaining the Bank's risk gradings in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of five grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the Credit Committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

Each business unit is required to implement Bank credit policies and procedures, with credit approval authorities delegated from the Credit Committee. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios, including those subject to central approval.

**Credit quality**

The following tables sets out information about the credit quality and credit risk exposure of financial assets measured at amortised. Unless specifically indicated, the amounts in the table represent gross carrying amounts. For loan commitments the amounts in the table represent the undrawn portion of amounts committed. Loan commitments are overdraft facilities. Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3' is described on Note 3(e)(iii).

*Loans and advances to customers*

| | 2021 | | | | 2020 |
|---|---|---|---|---|---|
| **KShs'000** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** | **Total** |
| Normal (Stage 1) | 5,268,612 | - | - | **5,268,612** | 5,537,604 |
| Watch (Stage 2) | - | 351,610 | - | **351,610** | 472,874 |
| Non-performing (Stage 3) | - | - | 739,193 | **739,193** | 836,206 |
| | **5,268,612** | **351,610** | **739,193** | **6,359,415** | **6,846,684** |
| Loss allowance (ECL) | ( 38,528) | (37,673) | (175,967) | ( **252,168**) | ( 473,260) |
| Statutory loan loss reserve* | - | ( 1,237) | (265,135) | ( **266,372**) | - |
| **Carrying amount** | **5,230,084** | **312,700** | **298,091** | **5,840,875** | **6,373,424** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Credit quality – continued**

* The Management has adopted a conservative approach in regard to provisions and has decided to hold the additional provisions above the IFRS9 ECL up to the level of Central Bank of Kenya (CBK) Prudential Guidelines provisions held (See note 15(a)).

*Off balance sheet*

| | 2021 | | | | 2020 |
|---|---|---|---|---|---|
| **In '000 of KShs** | **Stage 1** | **Stage 2** | **Stage 3** | **Total** | **Total** |
| Performing | 813,552 | - | - | 813,552 | 1,400,456 |
| Under performing | - | 2,000 | - | 2,000 | 4,999 |
| Non-performing | - | - | 4,380 | 4,380 | 17,737 |
| | **813,552** | **2,000** | **4,380** | **819,932** | **1,423,192** |
| Loss allowance | ( 150) | ( 12) | ( 1078) | ( 1,240) | ( 7,134) |
| **Carrying amount** | **813,402** | **1,988** | **3,302** | **818,692** | **1,416,058** |

*Credit quality analysis – Other assets*

The Bank has estimated that the ECL for the following financial assets is not material as at 31 December 2021. These financial assets have been assessed to be in Stage 1 (low credit risk).

| | 2021 | | | 2020 |
|---|---|---|---|---|
| | **Gross KShs'000** | **Loss allowance KShs'000** | **Net carrying amount KShs'000** | **Carrying amount KShs'000** |
| Cash and balances with the Central Bank of Kenya (Note 12) | 924,586 | - | 924,586 | 860,897 |
| Investment in government securities (Note 13) | 20,122,613 | - | 20,122,613 | 18,140,960 |
| Placements with other banks and Amounts due other Habib Bank AG Zurich branches | 579,547 | - | 579,547 | 918,545 |
| **Total** | **21,626,746** | **-** | **21,626,746** | **19,920,402** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Credit quality – continued**

**Loans & advances to customers**

| *Exposure to credit risk* | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Carrying amount | 5,840,875 | 6,373,424 |
| Stage 3 | 739,193 | 836,206 |
| Allowance for impairment | ( 175,967) | ( 397,331) |
| Statutory loan loss | ( 265,135) | - |
| **Carrying amount** | **298,091** | **438,875** |
| Stage 1 | 5,268,612 | 5,537,604 |
| Stage 2 | 351,610 | 472,874 |
| | **5,620,222** | **6,010,478** |
| Allowance for impairment | ( 76,201) | ( 75,929) |
| Statutory loan loss | ( 1,237) | - |
| **Carrying amount** | **5,542,784** | **5,934,549** |
| **Total carrying amount** | **5,840,875** | **6,373,424** |

**Write-off policy**

The Bank writes off a loan/security balance (and any related allowances for impairment losses) when it determines that the loans/securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower/issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Set out below is an analysis of the gross and net (of allowances for impairment and statutory loan loss) amounts of individually impaired assets by risk grade.

| At 31 December 2021 | Gross KShs '000 | Impairment allowance KShs '000 | Net KShs '000 |
|---|---|---|---|
| Substandard | 1,445 | - | 1,445 |
| Doubtful | 516,203 | 272,596 | 243,607 |
| Loss | 221,545 | 168,506 | 53,039 |
| | **739,193** | **441,102** | **298,091** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Loans & advances to customers – continued**

**Write-off policy - continued**

| At 31 December 2020 | Gross KShs '000 | Impairment allowance KShs '000 | Net KShs '000 |
|---|---|---|---|
| Substandard | 100,622 | 12,292 | 88,330 |
| Doubtful | 525,782 | 264,716 | 261,066 |
| Loss | 209,802 | 120,323 | 84,479 |
| | **836,206** | **397,331** | **438,875** |

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2021 or 2020.

***Inputs, assumptions and techniques used for estimating impairment***

*Determining whether credit risk has increased significantly*

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

| ***Fair value of collateral*** | **Loans and advances to customers** | |
|---|---|---|
| | **2021 KShs '000** | **2020 KShs '000** |
| **Against Stage 3 loans:** | | |
| Property | 1,914,000 | 1,972,200 |
| Others | 5,000 | 8,840 |
| **Against Stage 1& 2 loans:** | | |
| Property | 19,758,425 | 19,028,216 |
| Debt securities | 2,560,446 | 3,169,582 |
| Equities | - | 2,057 |
| Others | - | - |

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. Also see note 3(e).

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Loans & advances to customers – continued**

***Fair value of collateral - continued***

*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 realizing 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.

***Inputs, assumptions and techniques used for estimating impairment***

*Incorporation of forward-looking information*

Under IFRS 9, the Bank will incorporate 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.

**5. FINANCIAL RISK MANAGEMENT (Continued)**

**(b) Credit risk (continued)**

**Loans & advances to customers – continued**

***Inputs, assumptions and techniques used for estimating impairment – continued***

*Modified financial assets*

The contractual terms of loans and advances may be modified for 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 derecognised and the renegotiated loans and advances recognised 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.

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.

*Coronavirus (COVID-19) pandemic and expected credit losses*

The economic uncertainties caused by COVID-19 pandemic have required the Bank to update the inputs and assumptions used for the determination of expected credit losses (ECL) as at 31 December 2021. ECLs were estimated based on a range of forecasted economic conditions as at that date and considering that the situation is continuously changing. The following represents the key judgements and assumptions in relation to the model inputs and the interdependencies between those inputs and highlights the significant changes during the year.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Loans & advances to customers – continued**

***Inputs, assumptions and techniques used for estimating impairment – continued***

*Coronavirus (COVID-19) pandemic and expected credit losses - continued*

- Grouping of financial arrangements portfolio using exposures to various economic sectors, from the previous customer groupings of business units of corporate, SME and retail;
- Point –in-time PDs updated using latest available macro-economic factors forecasts which correlate with Bank’s non-performing financing arrangements (%);
- Probability weights updated under the different economic sectors, from the prior group weightages;

*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 two portfolios, Corporate and Personal loans.

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

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

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Loans & advances to customers – continued**

***Inputs, assumptions and techniques used for estimating impairment - continued***

*Loss Given Default (LGD)*

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

The LGD models will 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.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (b) Credit risk (continued)

**Loans & advances to customers – continued**

***Inputs, assumptions and techniques used for estimating impairment - continued***

*Exposure at Default - continued*

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.

**Amount arising from ECL**

***Sensitivity of ECL to future economic conditions***

*Inflation to default rate relationship*

The relationship was established based on expert’s judgement basis that increase in inflation will happen due to the overall positive sentiment on the economy which in turn will boost the GDP and reduce the default rate in the portfolio.

*Current account balance (% of GDP) to default rate relationship*

The relationship was established based on expert’s judgement increase in deficit will be evidenced during the increased activity in imports when compared to exports. This shows the positive impact on the economy which in turn will boost the GDP and reduce the default rate in the portfolio.

*GDP to default rate relationship*

The relationship was established based on expert’s judgement that increase in GDP will reflect the positive impact on the economy which in turn will reduce the default rate in the portfolio.

***Loss allowance***

The following tables show reconciliations from the opening to the closing balance of the expected credit loss allowance.

## 5. FINANCIAL RISK REVIEW AND MANAGEMENT (Continued)

### (b) Credit risk (continued)

| | Provisions (ECL allowance + additional provisions) | | | | Exposure (Gross balance) | | | |
|---|---|---|---|---|---|---|---|---|
| | 12 month ECL (Stage 1) KShs'000 | Lifetime ECL not credit impaired (Stage 2) KShs'000 | Lifetime ECL credit impaired (Stage 3) KShs'000 | Total KShs'000 | 12 month ECL (Stage 1) KShs'000 | Lifetime ECL not credit impaired (Stage 2) KShs'000 | Lifetime ECL credit impaired (Stage 3) KShs'000 | Total KShs'000 |
| **Balance at 1 January 2021** | **60,444** | **15,485** | **397,331** | **473,260** | **5,537,604** | **472,874** | **836,206** | **6,846,684** |
| Transfer from 12 months ECL (Stage 1) | ( 4,740) | 9,816 | | **5,076** | ( 394,991) | 280,452 | | **( 114,539)** |
| Transfer from Lifetime ECL not credit impaired (Stage 2) | 541 | (2,008) | 3,568 | **2,100** | 45,050 | ( 57,381) | 10,011 | **( 2,320)** |
| Transfer from Lifetime ECL credit impaired (Stage 3) | - | - | - | **-** | - | - | - | **-** |
| Net re-measurement of loss allowance | - | - | - | **-** | - | - | - | **-** |
| New financial assets originated or purchased | 15,302 | 4,743 | - | **20,045** | 1,275,190 | 135,505 | 1,445 | **1,412,140** |
| Changes in models/risk parameters | - | - | - | **-** | - | - | - | **-** |
| Foreign exchange and other movements | 1,949 | (7,803) | 43,404 | **37,550** | ( 324,663) | (312,558) | (105,428) | **( 742,649)** |
| Financial assets derecognised | (10,435) | (5,855) | ( 3,201) | **(19,490)** | ( 869,578) | (167,282) | ( 3,041) | **(1,039,901)** |
| **Balance at 31 December 2021** | **63,061** | **14,377** | **441,102** | **518,540** | **5,268,612** | **351,610** | **739,193** | **6,359,415** |

## 5. FINANCIAL RISK REVIEW AND MANAGEMENT (Continued)

### (b) Credit risk (continued)

| | Provisions (ECL allowance + additional provisions) | | | | Exposure (Gross balance) | | | |
|---|---|---|---|---|---|---|---|---|
| | 12 month ECL (Stage 1) KShs'000 | Lifetime ECL not credit impaired (Stage 2) KShs'000 | Lifetime ECL credit impaired (Stage 3) KShs'000 | Total KShs'000 | 12 month ECL (Stage 1) KShs'000 | Lifetime ECL not credit impaired (Stage 2) KShs'000 | Lifetime ECL credit impaired (Stage 3) KShs'000 | Total KShs'000 |
| **Balance at 1 January 2020** | **22,148** | **1,562** | **303,043** | **326,753** | **5,930,318** | **307,795** | **787,312** | **7,025,425** |
| Transfer from 12 months ECL (Stage 1) | ( 892) | 1,052 | - | **160** | ( 160,791) | 261,271 | - | **100,480** |
| Transfer from Lifetime ECL not credit impaired (Stage 2) | | ( 396) | 136,321 | **135,925** | - | ( 79,569) | 58,691 | **( 20,878)** |
| Transfer from Lifetime ECL credit impaired (Stage 3) | - | - | - | - | - | - | - | **-** |
| Net re-measurement of loss allowance | - | - | - | - | - | - | - | **-** |
| New financial assets originated or purchased | 4,415 | - | 15,683 | **20,098** | 1,262,855 | 761 | 46,271 | **1,309,887** |
| Changes in models/risk parameters | - | - | - | **-** | - | - | - | **-** |
| Foreign exchange and other movements | 39,554 | 13,668 | ( 50,849) | **2,373** | ( 376,097) | 26,441 | ( 40,425) | **( 390,081)** |
| Financial assets derecognised | ( 4,781) | ( 401) | ( 6,867) | **( 12,049)** | (1,118,680) | ( 43,826) | ( 15,643) | **(1,178,149)** |
| **Balance at 31 December 2020** | **60,444** | **15,485** | **397,331** | **473,260** | **5,537,604** | **472,873** | **836,206** | **6,846,684** |

## 5. FINANCIAL RISK REVIEW AND MANAGEMENT (Continued)

### (b) Credit risk (continued)

The Bank monitors concentrations of credit risk by sector. An analysis of concentrations of credit risk at the reporting date is shown below:

***(i) Loans and advances concentration by business***

| | 2021 | 2021 | 2020 | 2020 |
|---|---|---|---|---|
| | KShs '000 | % | KShs '000 | % |
| Agriculture | 14,634 | 0.2% | 0 | 0.0% |
| Manufacturing | 2,114,768 | 33.3% | 2,235,261 | 32.6% |
| Wholesale and retail trade | 1,336,253 | 21.0% | 1,411,960 | 20.6% |
| Transport and communication | 364,867 | 5.7% | 208,086 | 3.0% |
| Electricity and Water | 28,775 | 0.5% | 14,019 | 0.2% |
| Mining and quarrying | 43,597 | 0.7% | 56,696 | 0.8% |
| Building and construction | 103,456 | 1.6% | 118,726 | 1.7% |
| Real estate | 1,902,123 | 29.9% | 2,148,100 | 31.4% |
| Personal household | 169,463 | 2.7% | 145,644 | 2.1% |
| Tourism, restaurant and hotels | 281,479 | 4.4% | 508,192 | 7.4% |
| | **6,359,415** | **100%** | **6,846,684** | **100%** |

***(ii) Other financial assets***

| | 2021 | 2020 |
|---|---|---|
| | KShs '000 | KShs '000 |
| Cash and balances with Central Bank of Kenya | 924,586 | 860,897 |
| Investment in Government securities | 20,122,613 | 18,140,960 |
| Placements with other banks | 385,178 | 638,940 |
| Other assets | 236,256 | 215,798 |
| Amounts from other Habib Zurich AG Zurich Branches | 194,369 | 279,605 |
| | **21,863,002** | **20,136,200** |

The carrying amounts of cash and bank balances, investments in Government securities, placements and balances with other banking institutions, and amounts due from related companies equal the maximum exposure to credit risk. In addition, these balances are neither past due nor impaired.

### (c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities.

***Management of liquidity risk***

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

## 5. FINANCIAL RISK REVIEW AND MANAGEMENT (Continued)

### (c) Liquidity risk (continued)

***Management of liquidity risk – continued***

Treasury receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury then maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole (The liquidity requirements of business units and subsidiaries are met through short-term loans from Treasury to cover any short-term fluctuations and longer term funding to address any structural liquidity requirements).

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Bank (A summary report, including any exceptions and remedial action taken, is submitted regularly to 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. 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:

| ***Liquidity ratio*** | **2021** | **2020** |
|---|---|---|
| At 31 December | 85.1% | 81.5% |
| Average for the period | 84.3% | 80.1% |
| Maximum for the period | 86.2% | 82.2% |
| Minimum for the period | 82.3% | 78.9% |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (c) Liquidity risk (continued)

The following are the contractual maturities of financial liabilities:

| **As at 31 December 2021 – KShs '000**<br>**Liabilities** | **On demand** | **Due within 3 months** | **Due between 3 and 12 months** | **Due between 1 and 5 years** | **Due after 5 years** | **Total** |
|---|---|---|---|---|---|---|
| Deposits from other banks and banking institutions | - | 899,453 | - | - | - | 899,453 |
| Amounts due to other Habib Bank AG Zurich branches | - | 507,916 | - | - | - | 507,916 |
| Customer deposits | 3,026,246 | 14,654,318 | 6,003,408 | - | - | 23,683,972 |
| Lease liabilities | - | - | - | 25,220 | - | 25,220 |
| Other liabilities | - | - | - | - | 109,935 | 109,935 |
| **Total liabilities** | **3,026,246** | **16,061,687** | **6,003,408** | **25,220** | **109,935** | **25,226,496** |

| **As at 31 December 2020 – KShs '000**<br>**Liabilities** | **On demand** | **Due within 3 months** | **Due between 3 and 12 months** | **Due between 1 and 5 months** | **Due after 5 years** | **Total** |
|---|---|---|---|---|---|---|
| Deposits from other banks and banking institutions | - | 333,293 | - | - | - | 333,293 |
| Amounts due to other Habib Bank AG Zurich branches | - | 1,725,727 | - | - | - | 1,7257,27 |
| Customer deposits | 3,920,377 | 12,660,208 | 5,168,428 | - | - | 21,749,013 |
| Lease liabilities | - | - | - | 41,061 | - | 41,061 |
| Other liabilities | - | 159,128 | - | - | - | 159,12 |
| **Total liabilities** | **3,920,377** | **14,878,356** | **5,168,428** | **41,061** | **-** | **24,008,222** |

Customer deposits on demand relate mostly to savings accounts, current accounts and short notice time deposits. Although classified in this band, previous experience has shown that customers do not generally withdraw in significant amounts and are therefore of a long term nature.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

***Management of market risks***

The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios mainly are held by the corporate banking unit, and include positions arising from market making and proprietary position taking, together with financial assets and liabilities that are managed on a fair value basis.

Foreign exchange risk within the Bank is transferred and sold down by Treasury to the corporate Banking unit. Accordingly, the foreign exchange position is treated as part of the Bank's trading portfolios for risk management purposes.

Overall authority for market risk is vested in ALCO. Bank Risk is responsible for the development of detailed risk management policies (subject to review and approval by ALCO) and for the day-to-day review of their implementation.

***Exposure to interest rate risk***

The principal risk to which financial assets and liabilities are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. ALCO is the monitoring body for compliance with these limits.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks (continued)

***Contractual maturity analysis of assets and liabilities***

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

**At 31 December 2021 – KShs '000**

| | Effective interest rate | On demand | Due within 3 months | Due between 3 and 12 months | Due between 1 and 5 years | Non interest bearing | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with the Central Bank | 0.00% | - | - | - | - | 924,586 | 924,586 |
| Investments in government securities | 9.41% | - | 1,864,152 | 9,263,957 | 8,994,504 | - | 20,122,613 |
| Placements with other banks | 0.34% | - | 385,178 | - | - | - | 385,178 |
| Loans and advances to customers (net) | 7.78% | 720,706 | 1,683,433 | 541,896 | 2,894,840 | - | 5,840,875 |
| Amounts due from other branches | 0.34% | - | 194,369 | - | - | - | 194,369 |
| Other assets | 0.00% | - | - | - | - | 236,257 | 236,257 |
| **Total assets** | | **720,706** | **4,127,132** | **9,805,853** | **11,889,344** | **1,160,843** | **27,703,878** |
| **Liabilities** | | | | | | | |
| Deposits from other banks | 4.84% | - | 899,453 | - | - | - | 899,453 |
| Amounts due to foreign branches | 1.20% | - | 507,916 | - | - | - | 507,916 |
| Customer deposits | 4.98% | 3,026,246 | 14,654,318 | 6,003,408 | - | - | 23,683,972 |
| Lease liabilities | 13.00% | - | - | - | 25,220 | | 25,220 |
| Other liabilities | 0.00% | - | - | - | - | 109,935 | 109,935 |
| **Total liabilities** | | **3,026,246** | **16,061,687** | **6,003,408** | **25,220** | **109,935** | **25,226,496** |
| **On balance sheet interest sensitivity gap** | | **(2,305,540)** | **(11,934,555)** | **3,802,445** | **11,864,124** | **1,050,908** | **2,477,382** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks (continued)

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates assuming no asymmetrical movement in yield curves and a constant financial position is as follows:

| | 1% change in 2021 Full year KShs'000 | 1% change in 2020 Full year KShs'000 |
|---|---|---|
| As at 31 December | 44,920 | 51,506 |

The table below summarises the exposure to interest rate risks. Included in the table below are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

| At 31 December 2020 – KShs '000 | Effective Interest rate | on demand | Due within 3 months | Due between 3 and 12 months | Due between 1 and 5 years | Non interest bearing | Total |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with the Central Bank | | - | - | - | - | 860,897 | 860,897 |
| Investments in government securities | | - | 2,869,414 | 7,168,190 | 8,103,256 | - | 18,140,860 |
| Placements with other banks | | - | 638,940 | - | - | - | 638,940 |
| Loans and advances to customers (net) | | 1,389,136 | 172,742 | 333,137 | 4,478,409 | - | 6,373,424 |
| Amounts due from other branches | | - | 279,605 | - | - | - | 279,605 |
| Other assets | | - | - | - | - | 215,798 | 215,798 |
| **Total assets** | | **1,389,136** | **3,960,701** | **7,501,327** | **12,581,665** | **1,076,695** | **26,509,524** |
| **Liabilities** | | | | | | | |
| Deposits from other banks | | - | 333,293 | - | - | - | 333,293 |
| Amounts due to foreign branches | | - | 1,725,727 | - | - | - | 1,725,727 |
| Customer deposits | | 3,920,377 | 12,660,208 | 5,168,428 | - | - | 21,749,013 |
| Lease liabilities | | - | - | - | - | 41,061 | 41,061 |
| Other liabilities | | - | - | - | - | 159,128 | 159,428 |
| **Total liabilities** | | **3,920,377** | **14,719,228** | **5,168,428** | **-** | **200,189** | **24,008,222** |
| **On balance sheet interest sensitivity gap** | | **(2,531,241)** | **(10,758,527)** | **2,332,899** | **12,581,665** | **876,506** | **2,501,302** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks (continued)

*Currency risk*

The bank is exposed to currency risk through transactions in foreign currencies. The bank's transactional exposures give rise to foreign currency gains and losses that are recognised in the profit or loss. In respect of monetary assets and liabilities in foreign currencies, the bank ensures that its net exposure is kept to an acceptable level by buying and selling foreign currencies at spot rates when considered appropriate.

The Bank operates wholly within Kenya and its assets and liabilities are reported in the local currency. The table below analyses the currencies to which the bank is exposed as at 31 December 2021:

| At 31 December 2021 – KShs '000 | USD | GBP | EURO | OTHERS | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with Central Bank | 88,127 | 18,413 | 3,463 | 2,702 | 112,705 |
| Placements with other banks | 244,274 | 8,878 | - | 8,964 | 262,116 |
| Amounts due from other Habib Bank AG Zurich branches | 1,986 | 134,310 | 3,153 | 54,922 | 194,371 |
| Loans and advances to customers (net) | 3,475,218 | - | 183,897 | - | 3,659,115 |
| Other foreign assets | 705 | 45,968 | 77,047 | -` | 123,720 |
| **Total foreign currency assets** | **3,810,310** | **207,569** | **267,560** | **66,588** | **4,352,027** |
| **Liabilities** | | | | | |
| Customer deposits | 3,175,460 | 202,449 | 81,425 | 14,177 | 3,473,511 |
| Deposits from other banks and other banking institutions | 43,686 | - | - | - | 43,686 |
| Amounts due to other Habib Bank | 374,629 | - | 115,582 | 17,705 | 507,916 |
| AG Zurich branches | 371,388 | 2,941 | 68,216 | 24,294 | 466,839 |
| Other liabilities | - | - | - | - | - |
| **Total foreign currency liabilities** | 3,965,163 | 205,390 | 265,223 | 56,176 | 4,491,952 |
| **Foreign currency exposure** | **(154,853)** | **2,179** | **2,337** | **10,412** | **(139,925)** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks (continued)

***Currency risk - continued***

| At 31 December 2020 – KShs '000 | USD | GBP | EURO | OTHERS | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with Central Bank | 42,414 | 8,104 | 7,629 | 3,112 | 61,259 |
| Placements with other banks | 444,539 | 39,823 | 3,688 | 10,831 | 498,881 |
| Amounts due from other Habib Bank AG Zurich branches | 3,829 | 202,023 | 19,344 | 58,577 | 283,773 |
| Loans and advances to customers (net) | 4,159,515 | - | 152,968 | - | 4,312,483 |
| Other foreign assets | 27,296 | 5,152 | 17,511 | - | 49,959 |
| **Total foreign currency assets** | **4,677,593** | **255,102** | **201,140** | **72,520** | **5,206,355** |
| **Liabilities** | | | | | |
| Customer deposits | 2,505,995 | 243,309 | 109,626 | 30,027 | 2,888,957 |
| Deposits from other banks and other banking institutions | 333,189 | - | - | - | 333,189 |
| Amounts due to other Habib Bank AG Zurich branches | 1,688,079 | 3 | 13,424 | 24,221 | 1,725,727 |
| Other liabilities | 112,556 | 4,082 | 71,439 | 14,614 | 202,691 |
| **Total foreign currency liabilities** | **4,639,819** | **247,394** | **194,489** | **68,862** | **5,150,564** |
| **Foreign currency exposure** | **37,774** | **7,708** | **6,651** | **3,658** | **55,791** |

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (d) Market risks (continued)

***Currency risk - continued***

The following significant exchange rates were applied during the year:

| | Closing | | Average | |
|---|---|---|---|---|
| | **2021 KShs** | **2020 KShs** | **2021 KShs** | **2020 KShs** |
| USD | 113.52 | 109.26 | 109.65 | 106.46 |
| EUR | 128.41 | 134.20 | 129.75 | 121.64 |
| GBP | 153.22 | 148.89 | 150.84 | 136.73 |
| CHF | 124.06 | 123.81 | 119.97 | 113.60 |

**Sensitivity analysis**

A 10 percent strengthening of the Kenya shillings against the following currencies would have increased profit or loss by amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

The analysis is performed on the same basis for 2020.

| | Profit or loss/equity | |
|---|---|---|
| | **2021 KShs '000'** | **2020 KShs '000'** |
| USD | 15,485 | (3,777) |
| GBP | ( 218) | ( 771) |
| Euro | ( 234) | ( 665) |
| Others | ( 1,041) | ( 366) |
| | **(13,992)** | **(5,579)** |

### (e) Operational risks

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

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions.
- requirements for the reconciliation and monitoring of transactions.
- compliance with regulatory and other legal requirements.
- documentation of controls and procedures.
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified.
- requirements for the reporting of operational losses and proposed remedial action.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (e) Operational risks (continued)

- development of contingency plans.
- training and professional development.
- ethical and business standards.
- risk mitigation, including insurance where this is effective.

Compliance with Bank standards is supported by a programme of periodic reviews undertaken by Internal Audit from the head office. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank.

### (f) Capital management

***Regulatory capital***

The Central Bank of Kenya sets and monitors capital requirements for all banks.

The objective of the Central Bank of Kenya is to ensure that a bank maintains a level of capital which:

- is adequate to protect its depositors and creditors;
- is commensurate with the risks associated with its activities and profile; and
- promotes public confidence in the bank.

In implementing current capital requirements, the Central Bank of Kenya requires banks to maintain a prescribed ratio of total capital to total risk-weighted assets.

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 Central Bank of Kenya requires a bank to maintain at all times:

- a core capital of not less than 8% of total risk weighted assets, plus risk weighted off -balance sheet items;
- a core capital of not less than 8% of its total deposit liabilities;
- a total capital of not less than 12% of its total risk weighted assets, plus risk weighted off-balance sheet items; and
- a capital conservation buffer of 2.5% over and above the above minimum ratios.

This brings the minimum core capital to risk weighted assets and total capital to risk weighted assets to 10.5% and 14.5% respectively. The capital conservation buffer requirements are effective 1 January 2016.

Central Bank of Kenya required the Bank to maintain a minimum core capital of KShs 1 billion as at 31 December 2021. The bank is already compliant with this requirement.

Capital is segregated into core capital (Tier 1) and supplementary capital (Tier 2).

Core capital includes assigned capital, irredeemable preference shares, share premium and retained earnings after deductions for goodwill and intangible assets.

Supplementary capital on the other hand includes 25% of revaluation reserves of property and equipment, subordinated debt not exceeding 50% of core capital and any other approved reserves.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (f) Capital management (continued)

Risk weighted assets are arrived at using a framework of four weights applied to both on-balance sheet and off-balance sheet items to reflect the relative risk of each asset and counterparty.

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

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---:|---:|
| **Tier 1 capital** | | |
| Assigned capital | 350,000 | 350,000 |
| Retained earnings | 2,658,046 | 2,684,058 |
| | 3,008,046 | 3,034,058 |
| **Tier 2 capital** | | |
| Statutory credit risk reserve | 319,421 | 169,604 |
| | 319,421 | 169,604 |
| **Total regulatory capital** | **3,327,467** | **3,203,662** |
| **Risk-weighted assets** | | |
| Retail bank, corporate bank and treasury | 8,902,061 | 11,255,122 |
| **Total risk-weighted assets** | **8,902,061** | **11,255,122** |
| **Capital ratios** | | |
| Total capital to total risk weighted assets (CBK minimum 14.5%) | 34.5% | 26.6% |
| Core capital to total risk weighted assets (CBK minimum 10.5%) | 30.9% | 25.1% |
| Core capital to total deposit ratio (CBK minimum 8%) | 11.6% | 13.0% |

**Capital allocation**

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision making. Account also is taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's longer term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the Local Management Committee.

The CBK amended the Banking Act in 2009 which require banks to increase their core capital as follows:

| Compliance date | Minimum core Capital KShs |
|---|---:|
| 31 December 2021 | 1,000 million |
| 31 December 2020 | 1,000 million |

The Bank is in compliance with the above requirements as at 31 December 2021.

## 5. FINANCIAL RISK MANAGEMENT (Continued)

### (g) Climate-related risk management

Climate-related risks' are potential negative impacts on the Bank arising from climate change. Climate-related risks have an impact on the principal risk categories discussed above (i.e. credit, liquidity, market and operational risks), but due to their pervasive nature have been identified and managed by the Bank on an overall basis.

The Bank distinguishes between physical risks and transition risks. Physical risks arise as the result of acute weather events such as hurricanes, floods and wildfires, and longer-term shifts in climate patterns, such as sustained higher temperatures, heat waves, droughts and rising sea levels. Transition risks arise as a result of measures taken to mitigate the effects of climate change and transition to a low-carbon economy – e.g. changes to laws and regulations, litigation due to failure to mitigate or adapt, and shifts in supply and demand for certain commodities, products and services due to changes in consumer behavior and investor demand.

The Bank's Management team is responsible for developing policies, processes and controls to incorporate climate risks in the management of principal risk categories and is in the formative stages of developing the framework which is not only going to be aligned to the strategy, governance and operations requirements at the Habib Bank AG Zurich Group level but will have a dedicated and customized criteria to meet CBK requirements. This will be part of our medium term strategy and governed by the credit risk framework policy and independent board credit committee.

## 6. USE OF ESTIMATES AND JUDGEMENT

### (a) Impairment of loans and receivables

The measurement of the expected credit loss allowance for financial assets measured at amortised cost is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 3(e)(iii) which also sets out key sensitivities of the ECL to changes in these elements.

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

— Determining criteria for significant increase in credit risk;
— Choosing 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; and
— Establishing groups of similar financial assets for the purposes of measuring ECL.

### (b) Taxation

Judgement is required in determining the provision for income taxes due to the complexity of legislation. There are many transactions and calculations for which ultimate tax determination is uncertain during the ordinary course of business. The Bank recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

## 6. USE OF ESTIMATES AND JUDGEMENT (Continued)

### (b) Taxation (continued)

The Bank recognises the net future tax benefit related to deferred income tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred income tax assets requires the Bank to make significant estimates related to expectations of future taxable income. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Bank to realise the net deferred tax assets recorded at the reporting date could be impacted.

### (c) Useful lives and residual values of property and equipment

The Bank tests annually whether the useful life and residual value estimates were appropriate and in accordance with its accounting policy. Useful lives and residual values of property and equipment have been determined based on previous experience and anticipated disposal values when the assets are disposed.

### (d) Critical accounting judgements in applying the Bank's accounting policies

Critical accounting judgements made in applying the Bank's accounting policies include financial asset and liability classification. The Bank's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances.

In classifying financial assets as amortised costs, the Bank has determined that it has both positive intention and ability to hold the assets until their maturity date.

## 7. INTEREST INCOME

| | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|
| **Arising from:** | | |
| Loans and advances to customers | 514,828 | 575,623 |
| Treasury bills | 794,840 | 1,029,348 |
| Treasury bonds | 1,045,189 | 597,554 |
| Placements with other banks | 1,585 | 8,222 |
| | **2,356,442** | **2,210,747** |

Included within various captions under interest income for the year ended 31 December 2021 is a total of KShs 74,597,608 (2020 – KShs 86,623,012) accrued on impaired assets.

## 8. INTEREST EXPENSE

| | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|
| Customer deposits | 1,052,043 | 1,002,581 |
| Deposits from other banks and financial institutions | 39,953 | 51,049 |
| Lease liabilities | 3,707 | 5,334 |
| | **1,095,703** | **1,058,964** |

## 9. (a) NON INTEREST INCOME

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Fees and commissions and other income | 70,786 | 69,466 |
| Income from foreign exchange dealings | 46,807 | 34,783 |
| | **117,593** | **104,249** |

### (b) NON INTEREST EXPENSES

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Salaries and employee benefits | 330,178 | 330,789 |
| Other expenses | 321,399 | 288,009 |
| Depreciation of equipment | 27,303 | 32,924 |
| Depreciation ROU | 18,342 | 10,364 |
| Occupancy expenses | 38,795 | 33,158 |
| Telecommunication charges | 20,353 | 17,915 |
| Deposit protection fund | 32,537 | 25,141 |
| Amortisation of leasehold land | 2,944 | 857 |
| | **791,851** | **739,157** |

The following items are included within salaries and employee benefits:

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Compulsory social welfare contributions | 473 | 202 |
| Contributions to defined contribution scheme | 7,602 | 8,143 |
| Gratuity provision | 4,364 | 3,830 |
| | **12,439** | **12,175** |

The average number of employees engaged during the year were:

| | 2021 | 2020 |
|---|---|---|
| Management | 42 | 49 |
| Unionisable | 38 | 36 |
| | **80** | **85** |

## 10. PROFIT BEFORE TAXATION

| Profit before taxation is arrived at after charging/(crediting): | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Depreciation on equipment (Note 20) | 27,303 | 32,924 |
| Depreciation on right of use assets (Note 28) | 18,342 | 10,364 |
| Auditor's remuneration | 7,506 | 5,775 |
| Gain on disposal of assets | 833 | 440 |
| Amortization of leasehold land | 2,944 | 857 |

## 11. INCOME TAX EXPENSE

### (a) Income tax expense

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Current tax at 37.5% on the adjusted taxable profit | 162,054 | 206,701 |
| Deferred tax charge/(credit)(Note 18): | | |
| Current year | ( 43,263) | ( 62,830) |
| | **( 43,263)** | **( 62,830)** |
| | **118,791** | **143,871** |

### (b) Reconciliation of tax to accounting profit

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| The tax on the Banks' profit differs from the theoretical amount using the basic tax rate as follows: | | |
| Accounting profit before taxation | **542,425** | **450,925** |
| Computed tax using the applicable tax rate (37.5%) | 203,408 | 169,097 |
| Tax effect of non-deductible costs income | ( 84,617) | (25,226) |
| | **118,791** | **143,871** |

The overall effective tax rate in 2021 was 21.9% (2020 - 31.9%).

### (c) Tax recoverable

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Balance at 1 January | (125,346) | (134,599) |
| Charge for the year | 162,054 | 206,701 |
| Paid during the year | (227,372) | (197,448) |
| **Balance at 31 December** | **(190,664)** | **(125,346)** |

## 12. CASH AND BALANCES WITH CENTRAL BANK OF KENYA

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Cash on hand | 81,038 | 72,265 |
| Balances with Central Bank of Kenya: | | |
| - Cash reserve ratio (CRR) | 843,548 | 788,632 |
| | **924,586** | **860,897** |

The cash reserve ratio is non-interest earning and is based on the value of deposits as adjusted for Central Bank of Kenya requirements. At 31 December 2021, the minimum cash reserve requirements was 4.25% (2020 – 4.25%) of all customer deposits. Effective 29 August 2011, banks are required to maintain their CRR based on monthly average basis, free to deviate from 4.25% on any given day but not to allowed to fall below 3%.

During the year, the bank had not placed treasury bills under repo (2020 – Nil).

## 13. INVESTMENTS IN GOVERNMENT SECURITIES

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| **Treasury Bonds – Amortised cost** | | |
| Due within 1 year | 1,329,358 | 324,806 |
| Due after 1 year | 8,994,504 | 7,389,139 |
| | 10,323,862 | 7,713,945 |
| **Treasury Bills – Amortised cost** | | |
| Maturing within 90 days | 1,864,153 | 2,696,492 |
| Maturing after 90 days | 7,934,598 | 7,730,523 |
| | 9,798,751 | 10,427,015 |
| **Total** | **20,122,613** | **18,140,960** |

The weighted average effective interest rate on Government securities for the year ended 31 December 2021 was 9.41%% (2020 – 9.27%).

## 14. PLACEMENTS WITH OTHER BANKS

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Due within 90 days | **385,178** | **638,940** |

The weighted average effective interest rate on placements with other banks for the year ended 31 December 2021 was 1.51% (2020 – 4.68%).

## 15. LOANS AND ADVANCES TO CUSTOMERS

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| **(a) Loans and advances** | | |
| Overdrafts | 1,028,310 | 1,044,155 |
| Loans | 5,323,883 | 5,794,519 |
| Bill discounted | 7,222 | 8,010 |
| **Gross loans and advances** | **6,359,415** | **6,846,684** |
| Less: Provision for impaired loans and advances (Note 15(b)) | ( 252,168) | ( 473,260) |
| Less: Statutory loan loss reserve (Note 29): | | |
| - Current year | ( 149,817) | - |
| - Prior year | ( 116,555) | - |
| | ( 266,372) | - |
| **Net loans and advances** | **5,840,875** | **6,373,424** |

The weighted average effective interest rate on loans and advances to customers for the year ended 31 December 2021 was 7.78% (2020 – 8%).

## 15. LOANS AND ADVANCES TO CUSTOMERS

### (b) Impairment losses

| 2021: | Stage 3 impairment losses KShs '000 | Stage1&2 impairment loss KShs '000 | 2021 Total KShs '000 |
|---|---|---|---|
| At 1 January 2021 | 395,822 | 77,438 | 473,260 |
| Recoveries | ( 90,898) | - | ( 90,898) |
| Impairment made during the year | (133,716) | ( 1,237) | (134,953) |
| Other movements | 4,759 | - | 4,759 |
| **At 31 December 2021 (ECL)** | **175,967** | **76,201** | **252,168** |
| Statutory loan loss reserve | 318,184 | 1,237 | 319,421 |
| **Total impairment losses** | **494,151** | **77,438** | **571,589** |
| Less prior year movements | ( 53,049) | - | ( 53,049) |
| **Net Balance at 31 December 2021** | **441,102** | **77,438** | **518,540** |

| 2020: | Stage 3 impairment losses KShs '000 | Stage1&2 impairment loss KShs '000 | 2020 Total KShs '000 |
|---|---|---|---|
| At 1 January 2020 | 329,872 | 77,438 | 407,310 |
| Recoveries | ( 82,673) | - | ( 82,673) |
| Impairment made during the year | 148,623 | - | 148,623 |
| **At 31 December 2020** | **395,822** | **77,438** | **473,260** |

### (c) Impairment losses

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Recoveries | ( 90,898) | ( 82,673) |
| Impairment loss during the year | 134,953 | 148,623 |
| | **44,055** | **65,950** |

### (d) Non-performing loans and advances

Loans and advances include an amount of KShs 739,192,972 (2020 – KShs 836,206,137) which have been classified as non-performing. The estimated realisable value of securities held against this balance is KShs 298,090,870 (2020 – KShs 448,870,809). The interest in suspense recognized was KShs 74,597,608 (2020 – 86,623,012).

## 16. BALANCES WITH OTHER HABIB BANK AG ZURICH BRANCHES

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| **(a) Amounts due from** | | |
| Habib Bank AG Zurich, Zurich | 24,491 | 45,133 |
| Habib Bank AG Zurich, UAE | 38,659 | 37,442 |
| Habib Bank PLC, U.K | 128,539 | 197,030 |
| Habib Canadian Bank,Canada | 2,595 | - |
| Habib Metropolitan Bank,Pakistan | 15 | - |
| HBZ Bank Ltd.,South Africa | 70 | - |
| | **194,369** | **279,605** |
| **(b) Amounts due to** | | |
| Habib Bank AG Zurich, Zurich | 497,620 | 1,725,727 |
| Habib Bank AG Zurich, UAE | 10,296 | - |
| | **507,916** | **1,725,727** |

Transactions entered with other Habib Bank AG Zurich Branches are in normal course of business and are at arm's length and mature within the next 12 months.

The weighted average effective interest rate on placements with other banks for the year ended 31 December 2021 was 6.66% (2020 – 6.15%).

## 17. OTHER ASSETS

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Prepayments | 49,033 | 29,468 |
| Other receivables | 186,519 | 179,389 |
| Items in transit | 705 | 6,941 |
| | **236,257** | **215,798** |

## 18. DEFERRED TAX ASSET

Deferred tax assets at 31 December 2021 and 2020 are attributable to the items specified below:

| **2021:** | **At 1.1.2021 KShs'000** | **Recognised in profit or loss KShs '000** | **At 31.12.2021 KShs '000** |
|---|---|---|---|
| **Arising from:** | | | |
| Property and equipment | 23,990 | 24,634 | 48,624 |
| General provisions | 182,502 | 18,629 | 201,131 |
| | **206,492** | **43,623** | **249,755** |

| **2020:** | **At 1.1.2020 KShs'000** | **Recognized in profit or loss KShs '000** | **At 31.12.2020 KShs '000** |
|---|---|---|---|
| **Arising from:** | | | |
| Property and equipment | 12,021 | 11,969 | 23,990 |
| General provisions | 131,642 | 50,861 | 182,502 |
| | **143,663** | **62,830** | **206,492** |

## 19. ASSETS PLEDGED AS SECURITY

As at 31 December 2021, there were no assets pledged by the bank to secure liabilities (2020 – Nil).

## 20. PROPERTY AND EQUIPMENT

| 2021: | Freehold land and buildings KShs '000 | Leasehold improvement KShs '000 | Office equipment KShs '000 | Motor vehicles KShs '000 | Furniture, fixtures & fittings KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 January 2021 | 371,265 | 21,220 | 112,617 | 33,015 | 70,915 | 609,032 |
| Additions | 80,000 | - | 6,829 | - | 249 | 87,078 |
| Disposals and write offs | - | - | - | ( 3,915) | ( 931) | ( 4,846) |
| At 31 December 2021 | 451,265 | 21,220 | 119,446 | 29,100 | 70,233 | 691,264 |
| **Depreciation** | | | | | | |
| At 1 January 2021 | 91,626 | 21,141 | 97,810 | 29,491 | 57,848 | 297,916 |
| Charge for the year | 14,307 | 79 | 6,426 | 2,303 | 4,188 | 27,303 |
| Disposals | - | - | - | ( 3,915) | ( 802) | ( 4,717) |
| At 31 December 2021 | 105,933 | 21,220 | 104,236 | 27,879 | 61,234 | 320,502 |
| **Carrying amount** | | | | | | |
| **At 31 December 2021** | **345,332** | **-** | **15,210** | **1,221** | **8,999** | **370,762** |

| 2020: | Freehold land and buildings KShs '000 | Leasehold improvement KShs '000 | Office equipment KShs '000 | Motor vehicles KShs '000 | Furniture, fixtures & fittings KShs '000 | Total KShs '000 |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At 1 January 2020 | 312,025 | 21,220 | 106,785 | 36,510 | 75,377 | 551,917 |
| Additions | 59,240 | - | 5,832 | - | 951 | 66,023 |
| Disposals and write offs | - | - | - | ( 3,495) | ( 5,413) | ( 8,908) |
| At 31 December 2020 | 371,265 | 21,220 | 112,617 | 33,015 | 70,915 | 609,032 |
| **Depreciation** | | | | | | |
| At 1 January 2020 | 79,359 | 21,047 | 89,634 | 28,439 | 50,221 | 268,700 |
| Charge for the year | 12,267 | 94 | 8,176 | 4,547 | 7,840 | 32,924 |
| Disposals | - | - | - | ( 3,495) | ( 213) | ( 3,708) |
| At 31 December 2020 | 91,626 | 21,141 | 97,810 | 29,491 | 57,848 | 297,916 |
| **Carrying amount** | | | | | | |
| **At 31 December 2020** | **279,639** | **79** | **14,807** | **3,524** | **13,067** | **311,116** |

In the opinion of management, there was no indication of impairment of property and equipment.

Included in fixed assets are assets with a gross value of KShs 146,819,554 (2020 – KShs 129,464,481) which are fully depreciated and still in use. Such assets would have attracted a notional depreciation of KShs 36,704,889 (2020 – KShs 32,870,815).

## 21. DEPOSITS FROM OTHER BANKS AND BANKING INSTITUTIONS

| | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|
| Payable within 90 days | **899,453** | **333,293** |

The weighted effective interest rate on deposits from banks for the year ended 31 December 2021 was 4.85% (2020 – 3.86%).

## 22. CUSTOMERS DEPOSITS

| From private sector and individuals | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|
| Payable within 90 days | 17,680,564 | 16,366,394 |
| Payable after 90 days but within one year | 6,003,408 | 5,382,619 |
| | **23,683,972** | **21,749,013** |

The weighted average effective interest rate on interest bearing customer deposits for the year ended 31 December 2021 was 4.98% (2020 – 5.03%).

## 23. OTHER LIABILITIES

| | 2021<br>KShs '000 | 2020<br>KShs '000 |
|---|---|---|
| Items in transit | - | 3,742 |
| Bills payable | 15,826 | 19,251 |
| Other accounts payable | 94,109 | 136,135 |
| | **109,935** | **159,128** |

## 24. RETIREMENT BENEFIT OBLIGATIONS

The bank contributes to a provident fund established for the benefit of its employees. This scheme is classified as a defined contribution scheme, whereby the bank matches contributions to the fund made by employees of 10% of the employee's basic salary. During the year, the bank incurred costs of KShs 7,601,688 as contributions payable (2020 – KShs 8,143,000).

## 25. NOTES TO THE STATEMENT OF CASH FLOWS

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| **(a) Reconciliation of profit before taxation to cash flows from operating activities** | | |
| Profit before taxation | 542,426 | 450,925 |
| Profit on sale of property and equipment | ( 833) | ( 860) |
| Depreciation | 27,303 | 32,924 |
| Depreciation right of use asset | 21,285 | 11,221 |
| Write off of property and equipment | - | 5,200 |
| Interest expense on leases | 3,707 | 5,334 |
| | **593,888** | **504,744** |
| **Change in operating assets** | | |
| Central Bank of Kenya cash reserve | ( 54,916) | ( 119,125) |
| Loans and advances to customers | 532,549 | 325,248 |
| Investments in government securities | (2,813,992) | (2,136,348) |
| Other securities investments | - | - |
| Other assets | ( 20,459) | ( 84,473) |
| | **(2,356,818)** | **(2,014,698)** |
| **Change in operating liabilities** | | |
| Customer deposits | 1,934,959 | 2,167,960 |
| Other liabilities | ( 49,193) | 18,581 |
| | **1,885,766** | **2,186,541** |
| Interest paid on leases | - | ( 5,334) |
| Tax paid | ( 227,372) | ( 197,448) |
| **Net cash outflow from operating activities** | **( 104,536)** | **473,805** |

**(b) Analysis of the balances of cash and cash equivalents**

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Cash in hand and balances with Central Bank of Kenya | 81,038 | 72,265 |
| Placements with other banks | 194,369 | 638,940 |
| Amounts due from other Habib Bank AG Zurich branches | 385,178 | 279,605 |
| Treasury bills maturing within 90 days | 1,864,153 | 2,696,492 |
| Deposits from banking institutions | ( 899,453) | ( 333,293) |
| Amounts due to other Habib Bank AG Zurich branches | ( 507,916) | (1,725,727) |
| | **1,117,369** | **1,628,282** |

## 26. CONTINGENT LIABILITIES AND COMMITMENTS

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

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---:|---:|
| Irrevocable letters of credit | 205,034 | 180,325 |
| Guarantees | 298,787 | 344,508 |
| Acceptances | 288,262 | 898,358 |
| Bills for collection | 27,850 | - |
| | **819,933** | **1,423,191** |

In addition to the above, the Head Office has placed a Domestic Foreign Currency Cheque Clearing (DFCCC) guarantee in favour of CBK for **USD 100,000.00**.

### Nature of the contingent liabilities

*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.

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

*Bills for collection* are cheques, drawn against foreign or local banks, deposited by the Bank's customers which are in the process of clearing with the correspondent banks.

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

## 27. RELATED PARTY TRANSACTIONS

**(a)** In the normal course of business, transactions are entered into with other Habib Bank AG Zurich branches and related banks. These transactions are at arm's length.

**(b) Amounts due from**

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---:|---:|
| Habib Bank AG Zurich, Zurich | 24,491 | 45,133 |
| Habib Bank AG Zurich, UAE | 38,659 | 37,442 |
| Habib Bank PLC, U.K | 128,539 | 197,030 |
| Habib Canadian Bank,Canada | 2,595 | - |
| Habib Metropolitan Bank,Pakistan | 15 | - |
| HBZ Bank Ltd.,South Africa | 70 | - |
| | **194,369** | **279,605** |

## 27. RELATED PARTY TRANSACTIONS (Continued)

| | **2021 KShs '000** | **2020 KShs '000** |
|---|---|---|
| **(c) Amounts due to** | | |
| Habib Bank AG Zurich, Zurich | 497,620 | 1,725,727 |
| Habib Bank AG Zurich, UAE | 10,296 | - |
| | **507,916** | **1,725,727** |

**(d) Contingent liabilities**

(i) Habib Bank AG Zurich, UAE – Banker's Acceptance Export Bills – USD 80,038.

(ii) Habib Bank AG Zurich, UAE – Export LC Confrimed Usance – EUR 49,742.

There was no related interest income in 2021 (2020 – Nil).

**(e)** In the normal course of business, transactions are entered into with other Habib Bank AG Zurich branches and related banks. These transactions are at arm's length.

The related interest expense in 2021 is KShs Nil (2020 – KShs Nil).

| | **2021 KShs '000** | **2020 KShs '000** |
|---|---|---|
| Placement with other banks | | |
| Habib Metropolitan Bank | 15 | 184 |
| Habib Canadian Bank | 2,595 | 3,844 |
| HBZ South Africa | 70 | 140 |
| | **2,680** | **4,168** |

There was no related interest income in 2021 (2020 - Nil).

Transactions entered with other Habib Bank AG Zurich Branches are in normal course of business and are at arm's length. During the year we repatriated KShs 299,830,000 to Head office (2020 – KShs 180,710,000)

| **(f) The loan and advances to employees** | **2021 KShs '000** | **2020 KShs '000** |
|---|---|---|
| Balance at 1 January | 107,174 | 150,115 |
| Loans advanced directors and associates during the year | - | 2,150 |
| Loans advanced employees during the year | 71,824 | 77,775 |
| Loans repayments received | ( 67,445) | (122,866) |
| Balance at 31 December | **111,553** | **107,174** |

The related interest income in 2021 was KShs 5,984,828 (2020 – KShs 8,157,052).

## 27. RELATED PARTY TRANSACTIONS (Continued)

### (g) Key management remuneration

| | 2021 KShs '000 | 2020 KShs '000 |
|---|---|---|
| Salaries and other employee benefits | **93,904** | **68,390** |

Salaries and other employee benefits include those relating to the senior management are included in Note 9.

## 28. RIGHT OF USE ASSETS

### (a) Leasehold land and branch premises

Right of use assets in respect of leasehold land is recognised as an asset and amortised over the lease period. The Bank holds leases over branches in Westlands, Mombasa and Industrial Area. These are being amortised on a straight line basis over 5 years 3 months, 5 years 11 months and 6 years respectively.

| **2021:** | **Branch premises KShs'000** | **Leasehold land KShs'000** | **Total KShs'000** |
|---|---|---|---|
| **Cost** | | | |
| At 1 January | 60,173 | 26,850 | 87,023 |
| Additions | - | 883 | 883 |
| At 31 December | **60,173** | **27,733** | **87,906** |
| **Amortisation** | | | |
| At 1 January | 20,728 | 6,989 | 27,717 |
| Amortisation for the year | 18,341 | 2,944 | 21,285 |
| At 31 December | **39,069** | **9,933** | **49,002** |
| **Carrying amount** | | | |
| **As at 31 December** | **21,104** | **17,800** | **38,904** |
| **2020:** | | | |
| **Cost** | | | |
| At 1 January | 60,173 | 25,967 | 86,140 |
| Additions | - | 883 | 883 |
| At 31 December | 60,173 | 26,850 | 87,023 |
| **Amortisation** | | | |
| At 1 January | 10,364 | 6,132 | 16,496 |
| Amortisation for the year | 10,364 | 857 | 11,221 |
| At 31 December | 20,728 | 6,989 | 27,717 |
| **Carrying amount** | | | |
| **As at 31 December** | **39,445** | **19,861** | **59,306** |

## 28. RIGHT OF USE ASSETS (Continued)

### (b) Lease liabilities

The lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, and Bank's incremental borrowing rate.

| | KShs'000 | KShs'000 |
|---|---|---|
| Balance at January 2021 | 41,061 | 51,749 |
| Interest expense | 3,707 | 5,334 |
| Repayment of the lease liability | (19,548) | (16,022) |
| Lease prepayments | - | - |
| | (15,841) | (10,688) |
| **Balance at 31 December 2021** | **25,220** | **41,061** |

**Maturity analysis – Contractual undiscounted cash flows**

As at 31 December 2021, the future minimum lease payments under non-cancellable operating leases were payable as follows:

| | | 2021<br>KShs'000 |
|---|---|---|
| **Tenancy** | | |
| Less than one year | 20,262 | 15,622 |
| Between one and five years | 10,474 | 29,395 |
| Over 5 years | - | - |
| **Total undiscounted lease liabilities at 31 December** | **30,736** | **45,017** |

**Extension options**

None of the leases for the branches contain extension options exercisable by the Bank. The extension options held are exercisable only by the Bank and not by the lessors. The Bank assesses at lease commencement date whether it is reasonably certain to exercise the extension options. The Bank reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant changes in circumstances within its control.

### (c) Amounts recognised in profit or loss

| | KShs'000 |
|---|---|
| **2021 – Leases under IFRS 16** | |
| Interest in lease liabilities | 3,707 |
| Depreciation of right of use assets | 18,341 |
| **2020 – Leases under IFRS 16** | |
| Interest in lease liabilities | 5,334 |
| Depreciation of right of use assets | 11,221 |

## 28. RIGHT OF USE ASSETS (Continued)

| (d) Amounts recognised in statement of cash flows | 2021 KShs'000 |
|---|---|
| Payment of interest | 3,707 |
| Payment of principal | 19,548 |
| | **23,255** |

## 29. STATUTORY CREDIT RISK RESERVE

This represents an amount set aside to cover additional provisions for loan losses required to comply with the requirements of Central Bank of Kenya Prudential Guidelines. The amount is not available for distribution. The reserve balance as at 31 December 2021 was KShs 319,421,000 (2020 – KShs 169,604,000).

## 30. EVENTS AFTER THE REPORTING DATE

The ongoing COVID - 19 pandemic is causing major disruptions to community health and economic activity with wide-ranging impacts across many business sectors globally. Additionally, many of the Bank's customers have been impacted by the COVID - 19 pandemic. The Bank is continuing to work with customers impacted by COVID - 19 to restructure loans. Regulators and governments have implemented a broad range of measures to promote financial stability in response to COVID - 19. Those measures implemented by governments and regulators in Kenya include tax relief on both businesses and individual, liquidity and funding initiatives to strengthen the banking system. The ongoing COVID - 19 pandemic has also increased the estimation uncertainty in the preparation of the financial statements. The Bank has made various accounting estimates for future events in the financial statements based on forecasts of economic conditions which reflect expectations and assumptions as at 31 December 2021 and that the Bank believes are reasonable under the circumstances. There is a considerable degree of judgement involved in preparing these estimates. The underlying assumptions are also subject to uncertainties which are often outside the control of the entity. Accordingly, actual economic conditions are likely to be different from those forecast since anticipated events frequently do not occur as expected, and the effect of those differences may significantly impact accounting estimates included in the financial statements.

While pervasive across the financial statements, the estimation uncertainty is predominantly related to expected credit losses where the entity recognised a credit impairment charge of KShs. 44,055,000 (pre-tax) in the year ended 31 December 2021 (2020: KShs 65,950,000). For further details of these estimation uncertainties refer to the detailed notes in the financial statements. The ramifications of COVID - 19 continue to be uncertain and it remains difficult to predict the impact or duration of the pandemic.