CITIBANK N.A.
(KENYA BRANCHES)

QUARTERLY FINANCIAL STATEMENTS AND OTHER DISCLOSURES
FOR THE PERIOD ENDED 30 SEPTEMBER 2019
3. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Revenue recognition

Revenue is derived substantially from banking business and related activities and comprises net interest income and non-interest income. Income is recognised on an accrual basis in the period in which it accrues.

(i) Interest income and expense

Interest income and expenses are recognised in the profit or loss for all interest-bearing instruments on an accrual basis using the effective interest method.

Policy applicable after 1 January 2018

Income from loans and advances to customers, placements with other banks and Investments in government securities is recognised in profit or loss using the effective interest rate method. The ‘effective interest rate’ is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

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

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

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

(a) Revenue recognition (continued)

(i) Interest income and expense (continued)

Policy applicable after 1 January 2018

Amortised cost and gross carrying amount

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

Calculation of interest income

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

For financial assets that were credit-impaired on initial recognition, purchased originated credit impaired (POCI) assets, interest income is calculated by applying the credit-adjusted effective interest rate to the 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.

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.

Policy applicable before 1 January 2018

Interest income and expense

Interest income and expense were recognised in profit or loss using the effective interest method. The effective interest rate was the rate that exactly discounted the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the bank estimated future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate included transaction costs and fees and points paid or received that were an integral part of the effective interest rate. Transaction costs included incremental costs that were directly attributable to the acquisition or issue of a financial asset or financial liability.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Revenue recognition (continued)

(i) Interest income and expense – continued

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

— interest on financial assets and financial liabilities measured at amortised cost;
— interest on debt instruments measured at FVOCI;

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

— financial liabilities measured at amortised cost; and

(ii) Fees and commission income

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

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 expensed as the services are received.

(iii) Rental income

Rental income in respect of operating leases is accounted for on a straight-line basis over the lease terms on ongoing leases.

(iv) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities and includes all realised and unrealised fair value changes, interest and foreign exchange differences.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Revenue recognition (continued)

(v) Net income from other financial instruments at fair value

Net income from other financial instruments at fair value relates to derivatives held for risk management purposes and includes all realised and unrealised fair value changes and foreign exchange differences.

(b) Financial instruments

Policy applicable after 1 January 2018

(i) Classification and Measurement

Financial Assets – Derivatives and Equity Instruments

Under IFRS 9, derivatives and in-scope equity instruments are measured at fair value, with changes reflected through the profit and loss account (FVTPL). Exceptions can only apply if the derivative is part of a hedge accounting programme.

The Bank measures all equity instruments in scope of IFRS 9 at FVTPL.

Financial Assets – Debt Instruments

Under IFRS 9, the following primary classification and measurement categories exist for financial assets-debt instruments:

— Amortized cost;
— Fair value through other comprehensive income (FVOCI); and
— Fair value though profit or loss (FVTPL)

In addition, IFRS 9 provides special designation options for financial assets-debt instruments that are either measured at ‘amortized cost’ or ‘FVOCI’. An entity has an option to designate such instruments at FVTPL only where this designation eliminates or significantly reduces an accounting mismatch.

The following paragraphs explain the classification criteria for the 3 categories in more detail.

Amortised cost

A financial asset-debt instrument shall be classified and subsequently measured at amortized cost (unless designated under FVO) only if both of the following conditions are met:

(i) Business Model test: the financial asset-debt instrument is held in a business which has a business model whose objective is to hold assets in order to collect contractual cash flows; and
(ii) SPPI test: the contractual terms of the financial asset-debt instrument give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI).
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Financial Assets – Debt Instruments - continued

FVOCI

A financial asset shall be classified and measured at FVOCI (unless designated FVO) if both of the following conditions are met:

(i) Business Model test: the financial asset is held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets: and

(ii) SPPI test: 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 (SPPI).

FVTPL

Any financial instrument that does not fall into either of the above categories shall be classified and measured at fair value through profit and loss. For example, where the asset is not held within a business model whose objective is to hold to collect the contractual cash flows or within a business model whose objective is to both collect the cash flows and to sell the assets, then the asset will be classified as FVTPL.

Moreover, any instrument for which the contractual cash flow characteristics do not comprise solely payments of principal and interest (that is, they fail the SPPI test) must be classified in the FVTPL category.

Business Model Assessment

The Bank’s business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The Bank’s business model does not depend on management’s intentions for an individual instrument (i.e., it is not an instrument-by-instrument assessment). This assessment is performed at a higher level of aggregation. The level of aggregation is at a level which is reviewed by key management personnel, enabling them to make strategic decisions for the business. The Bank has more than one business model for managing its financial instruments. The assessment of the business model requires judgment based on facts and circumstances, considering quantitative factors and qualitative factors.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Financial Assets – Debt Instruments - continued

Business Model Assessment - continued

The Bank considers all relevant evidence that is available at the date of the assessment. Such relevant evidence includes, but is not limited to:

(i) How the performance of the business model and the financial assets held within that business model are evaluated and reported to the Group’s/Company’s key management personnel;
(ii) The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way in which those risks are managed; and
(iii) How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected); and
(iv) The frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity.

Assessment of whether the contractual cash flows are solely payments of principal and interest.

If an instrument is held in either a hold to collect or a or hold to collect and sell business model, then an assessment to determine whether contractual cash flows are solely payments of principal and interest on the principal outstanding (SPPI) is required to determine classification. For SPPI, interest is defined as consideration for the time value of money and the credit risk associated with the principal amount outstanding during a period of time. It can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time and a profit margin that is consistent with a basic lending arrangement. Other contractual features that result in cash flows that are not payments of principal and interest result in the instrument being measured at FVTPL.

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

The contractual cash flow test must be performed at initial recognition of the financial asset and, if applicable, as at the date of any subsequent changes to the contractual provisions of the instrument.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Financial liabilities

For financial liabilities there are two measurement categories: amortized cost and fair value through profit and loss (including a fair value option category). The Bank separates derivatives embedded in financial liabilities where they are not closely related to the host contract.

The Bank designates financial liabilities at fair value through profit or loss if one of the following exist:

— The liability is managed and performance evaluated on a fair value basis;
— Electing fair value will eliminate or reduce an accounting mismatch; or
— The contract contains one or more embedded derivatives

For financial liabilities designated at fair value through profit or loss, fair value changes are presented as follows:

— The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability must be recorded in OCI, and
— The remaining amount of the change in the fair value of the liability is recorded in P&L.

Upon early extinguishment (e.g., liability is repurchased before maturity), changes in own credit previously recorded in OCI will not be recycled to P&L. The OCI balance is reclassified directly to retained earnings.

Reclassifications

Financial asset classification is determined at initial recognition and reclassifications are expected to be extremely rare. A financial asset can only be reclassified if the business model for managing the financial asset changes. Reclassification of financial liabilities is not permitted. Reclassification of financial instruments designated under FVO or FVOCI is also not permitted.

Modifications

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.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Financial assets - continued

When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with IFRS 9, the Bank shall recalculate the gross carrying amount of the financial asset and shall recognize a modification gain or loss in profit or loss.

As the Bank classifies a financial asset at initial recognition on the basis of the contractual terms over the life of the instrument, reclassification on the basis of a financial asset’s contractual cash flows is not permitted, unless the asset is sufficiently modified that it is derecognized.

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.

Impairment

The IFRS 9 impairment standard applies to any debt instruments measured at amortised cost or at fair value through other comprehensive income and also to off balance sheet loan commitments and financial guarantees.

Expected credit loss impairment model

Credit loss allowances will be measured on each reporting date according to a three-Stage expected credit loss impairment model under which each financial asset is classified in one of the stages below:

— Stage 1 – From initial recognition of a financial asset to the date on which the asset has experienced a significant increase in credit risk relative to its initial recognition, a loss allowance is recognized equal to the credit losses expected to result from defaults expected over the next 12 months. Interest is calculated based on the gross carrying amount of the asset.

— Stage 2 – Following a significant increase in credit risk relative to the risk at initial recognition of the financial asset, a loss allowance is recognized equal to the full credit losses expected over the remaining life of the asset. Interest is calculated based on the gross carrying amount of the asset.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(v) Classification and Measurement - continued

Expected credit loss impairment model - continued

The credit losses for financial assets in Stage 1 and Stage 2 are measured 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 Group expects to receive).

Stage 3 – When a financial asset is considered to be credit-impaired, a loss allowance equal to the full lifetime expected credit losses will be recognized. Credit losses are measured as the difference between the gross carrying amount and the present value of estimated future cash flows. Interest revenue is calculated based on the carrying amount of the asset, net of the loss allowance, rather than on its gross carrying amount.

Evidence that a financial asset is impaired includes observable data that comes to the attention of the Company such as:

— Significant financial difficulty of the issuer or obligor;
— A breach of contract, such as a default or delinquency in interest or principal payments;
— It becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
— The disappearance of an active market for that financial asset because of financial difficulties; or
— Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:

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

Loans are written off when there is no realistic probability of recovery. The estimation of an expected credit loss (ECL) is required to be unbiased and probability weighted, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. The estimate also considers the time value of money.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(v) Classification and Measurement - continued

Expected credit loss impairment model - continued

The measurement of an ECL is primarily determined by an assessment of the financial asset’s probability of default (PD), loss given default (LGD) and exposure at default (EAD) where the cash shortfalls are discounted to the reporting date. For a financial asset in Stage 1, the Bank will utilise a 12-month PD, whereas a financial asset within Stage 2 and Stage 3 will utilise a lifetime PD in order to estimate an impairment allowance.

Wholesale Classifiably Managed Exposures

An impairment allowance will be estimated for Corporate loans utilising sophisticated models depending on the relative size, quality and complexity of the portfolios.

Staging

Financial assets can move in both directions through the Stages of the IFRS 9 impairment model depending on whether the assessment of whether there is a significant increase of credit risk since initial recognition or whether the asset is credit impaired subsequently changes.

In order to determine the ECL reporting stage for an obligation, the Bank will check whether the asset is already impaired (Stage 3) or not (Stage 1 and 2).

Stage 2 will be determined by the existence of a significant credit deterioration (or credit improvement) compared with the credit rating at initial recognition. Stage 1 assets do not have significant credit deterioration compared with that at initial recognition. All newly acquired or originated financial assets that are not purchased or originated credit impaired (POCI) are recognised in Stage 1 initially. The existence of a (statistically) significant deterioration/improvement is combined with the materiality of the probability of default to determine whether a transfer in stages is required. Further, the Bank will not rebut the presumption that exposures 30 days past due are deemed to have incurred a significant increase in credit risk. Additional qualitative reviews are also be performed to assess the staging results and make adjustments, as necessary, to better reflect the positions which have significantly increased in risk.

Changes in the required credit loss allowance, including the impact of movements between Stage 1 (12-month expected credit losses) and Stage 2 (lifetime expected credit losses), are recorded in profit or loss as an adjustment of the provision for credit losses.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

*Expected credit loss impairment model - continued*

*Expected life*

When measuring ECL, the Group/Company must consider the maximum contractual period over which the Bank is exposed to credit risk, including possible drawdowns and the expected maturity of the financial asset. For certain revolving credit facilities that do not have a fixed maturity, the expected life is estimated based on the period over which the Bank is exposed to credit risk and where the credit losses would not be mitigated by management actions.

*Stage 3 definition of default*

As mentioned above, to determine whether an instrument should move to a lifetime ECL, the change in the risk of a default occurring over the expected life of Bank applies a default definition that is consistent with that used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. The definition of default used for this purpose is applied consistently to all financial instruments unless information becomes available that demonstrates another default definition is more appropriate for a particular financial instrument.

*Forward Looking Information and multiple economic scenarios*

Estimates must consider information about past events, current conditions and reasonable and supportable forecasts around future events and economic conditions. The application of forward looking information (FLI) requires significant judgment. The Bank has developed models that include multiple economic scenarios that consider the variability and uncertainty in expected losses including factors such as GDP growth rates and unemployment rates, provided by the economists in Citi’s Global Country Risk Management (GCRM). These estimates are based on portfolio data that reflect the current risk attributes of obligors and debt instruments combined with loss projections derived from the rating migration, PD and loss models built for estimating stress credit losses for wholesale portfolios. As mentioned above, these models have incorporated specifically developed components to make the estimates compliant with IFRS 9. The PD, LGD and Credit Conversion Factor (CCF) models are calibrated to the observed historical patterns of defaults and losses over several years and linked to economic drivers. The model reflects different loss likelihood and loss severity as a function of different economic forecasts. The Bank does not use the best case or worst case scenario, but assesses a representative number of scenarios (at least 3 when applying a sophisticated approach and where multiple scenarios are deemed to have a material non-linear impact) and probability weights these scenarios to determine the ECL.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Delinquency Managed Exposures

In particular, for Corporate portfolios, where the Bank does not have access to detailed historical information and/or loss experience, the Bank will adopt a simplified approach using backstops and other qualitative information specific to each portfolio.

Other Financial Assets Simplified Approaches

For other financial assets, being short term and simple in nature, the Bank will apply a simplified measurement approach that may differ from what is described above. This approach leverages existing models currently used globally for stress-testing and regulatory capital reporting purposes, but incorporates specifically developed components to make the estimates compliant with IFRS 9.

Presentation of the allowance of 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 asset
— Loan commitments and financial guarantee contracts: as a provision
— Debt instruments measured at FVOCI: as the carrying amount of these financial assets is at fair value, no loss allowance is recognised in the statement of financial position, however, the loss allowance is disclosed in note 4(a) and is recognised in the fair value reserve.

Derecognition

The bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or 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 transferred. Any interest in transferred financial assets that is created or retained by the bank is recognised as a separate asset or liability.

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. 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.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Derecognition - continued

The bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either 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 derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

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

Fair value measurement principles

‘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 bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable after 1 January 2018 (continued)

(i) Classification and Measurement - continued

Fair value measurement principles - continued

If an asset or a liability measured at fair value has a bid price and an ask price, then the bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

Statutory credit risk reserve

Where impairment losses required by regulations exceed those computed under IFRS, the excess is recognised as a statutory credit risk reserve and is accounted for as an appropriation of retained earnings. The statutory credit risk reserve is non-distributable.

Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported on the statement of financial position when there is a legally enforceable right to set-off the recognised amount and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial instruments (continued)

Policy applicable before 1 January 2018

(i) Recognition

The Bank initially recognizes 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 and 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 except where the Bank designates liabilities at fair value through profit and loss.

(ii) Classification and measurement

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

<table>
<thead>
<tr>
<th>Category (as defined by IAS 39)</th>
<th>Class (as determined by the Bank)</th>
<th>Subclasses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>Financial assets at fair value through profit or loss</td>
<td>Debt Securities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equity Securities</td>
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<tr>
<td></td>
<td></td>
<td>Derivatives – non hedging</td>
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<tr>
<td>Financial assets</td>
<td>Financial assets held for trading</td>
<td>Debt Securities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equity Securities</td>
</tr>
<tr>
<td>Financial assets</td>
<td>Financial assets designated at fair value through profit or loss</td>
<td>Debt Securities</td>
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<tr>
<td></td>
<td></td>
<td>Equity Securities</td>
</tr>
<tr>
<td>Financial assets</td>
<td>Loans and receivables</td>
<td>Loans and advances to banks</td>
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<td></td>
<td></td>
<td>Loans to corporates</td>
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<td></td>
<td></td>
<td>Overdrafts</td>
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<td></td>
<td></td>
<td>Credit cards</td>
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<td></td>
<td></td>
<td>Term loans</td>
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<td></td>
<td></td>
<td>Mortgages</td>
</tr>
</tbody>
</table>
3. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(b) **Financial assets and financial liabilities (continued)**

*Policy applicable before 1 January 2018 (continued)*

(ii) **Classification and measurement - continued**

<table>
<thead>
<tr>
<th>Category (as defined by IAS 39)</th>
<th>Class (as determined by the Bank)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>Loans to corporate entities</td>
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<tr>
<td>Loans and receivables</td>
<td>Investment securities – debt instruments</td>
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<tr>
<td>Held to maturity investments</td>
<td>Investment securities – debt securities</td>
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<td>Available for sale financial assets</td>
<td>Investment securities – debt securities</td>
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<td></td>
<td>Investment securities – equity securities</td>
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<tr>
<td>Financial liabilities</td>
<td>Deposits from banks</td>
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<tr>
<td></td>
<td>Customers deposits</td>
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<td></td>
<td>Corporate customers</td>
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<tr>
<td>Off-balance sheet financial instruments</td>
<td>Loan commitments</td>
</tr>
<tr>
<td></td>
<td>Guarantees, acceptances and other financial facilities</td>
</tr>
</tbody>
</table>

(iii) **Financial assets**

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

*Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception.

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

Policy applicable before 1 January 2018 (continued)

(iii) Financial assets - continued

Financial assets at fair value through profit or loss

Investments held for trading are those which were either acquired for generating a profit from short-term fluctuations in price or dealer’s margin, or are securities included in a portfolio in which a pattern of short-term profit-taking exists. Investments held for trading are subsequently re-measured at fair value based on quoted bid prices or dealer price quotations, without any deduction for transaction costs. All related realized and unrealized gains and losses are included in profit or loss. Interest earned whilst holding held for trading investments is reported as interest income.

Foreign exchange forward and spot contracts are classified as held for trading. They are marked to market and are carried at their fair value. Fair values are obtained from discounted cash flow models which are used in the determination of the foreign exchange forward and spot contract rates. Gains and losses on foreign exchange forward and spot contracts are included in foreign exchange income as they arise.

Loans, advances and receivables

Loans and advances to customers and trade receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money directly to a debtor with no intention of trading the receivable. Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortized cost using the effective interest method.

Held to maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank’s management has the positive intention and ability to hold to maturity. A sale or reclassification of more than an insignificant amount of held to maturity investments would result in the reclassification of the entire category as available for sale. Held to maturity investments includes treasury bills and bonds. They are subsequently measured at amortized cost using the effective interest method.

Available for sale

Available for sale financial investments are those non derivative financial assets that are designated as available for sale or are not classified as any other category of financial assets. Available for sale financial assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised in other comprehensive income and presented in the available for sale fair value reserve in equity. When an investment is derecognised, the gain or loss accumulated in equity is re-classified to profit or loss.
3. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(b) **Financial assets and financial liabilities (continued)**

*Policy applicable before 1 January 2018 (continued)*

**(iv) Financial liabilities**

Financial liabilities are recognised when the Bank enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received, net or directly attributable transaction costs incurred. Subsequent measurements of financial liabilities is at amortised cost incurred. Subsequent measurements of financial liabilities is at amortised cost using effective interest rate method. Financial liabilities will include deposits from banks or customers, trade payables from the brokerage and lines of credit for which the fair value option is not applied.

**(v) 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 (carried at amortized cost) 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 Bank, 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.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

Policy applicable before 1 January 2018 (continued)

(v) Identification and measurement of impairment of financial assets - continued

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 as profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

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

Amounts classified as available for sale

Impairment losses on available-for-sale investment 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 and loss is the difference between the acquisition cost, net of any principal repayment and amortization, and the fair value, less any impairment loss recognised previously in profit or loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

If in subsequent period, the fair value of an impaired available for sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through profit or loss; otherwise any increase in fair value is recognised through Other Comprehensive Income (OCI). Any subsequent recovery in the fair value of an impaired available for sale equity security is always recognised in OCI.

(vi) 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 transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

Policy applicable before 1 January 2018 (continued)

(vi) De-recognition - continued

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) cumulative gain or loss that had been recognised in OCI is recognised in profit or loss. 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 in 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 derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include repurchase transactions.

(vii) 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 recognised 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.

(viii) Restructured loans

Restructured troubled loans and advances are loans and advances for which the Bank has granted a concession to the borrower due to a deterioration of the borrower’s financial condition. The restructuring may include:

— A modification of terms, e.g., a reduction in the interest from that originally agreed or a reduction in the principal amount; and
— The transfer from the borrower to the bank of real estate, receivables from third parties, other assets, or equity interest in the borrower in full or partial satisfaction of the loan.

Such restructured loans and advances whose terms have been renegotiated are no longer considered to be past due but are treated as new loans after the minimum number of payments under the new arrangement have been received.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Financial assets and financial liabilities (continued)

*Policy applicable before 1 January 2018 (continued)*

(ix) *Fair value of financial assets and financial liabilities*

Fair value of financial assets and financial liabilities is the price that would be received to sell an asset or paid to transfer a liability respectively in an orderly transaction between market participants at the measurement date.

(x) *Amortized cost measurement*

The amortized cost of a financial asset or financial 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 recognised and the maturity amount, minus any reduction for impairment.

(c) *Cash and cash equivalents*

For the purpose of presentation in the statement of cash flows, the cash and cash equivalents include balances with the Central Bank of Kenya which are available to finance the bank’s day to day operations, net balances from banking institutions, and investments with maturities of three months or less from the date of acquisition.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Cash and cash equivalents are highly liquid assets, subject to insignificant risk of changes in their fair value and are used by the bank in the management of short term commitments.

(d) *Derivative financial instruments*

The bank enters into financial instruments for trading purposes with third parties to hedge their exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions and valuation techniques. The gain or loss on re-measurement to fair value is recognised immediately in the profit and loss. The main derivative financial instruments in use by the bank are as follows:

(i) *Currency forwards*

Foreign exchange forward contracts are agreements to buy and sell a specified quantity of foreign currency, usually on a specified future date at an agreed rate. The fair value of forward exchange contracts is the present value of the mark to market adjustment at the reporting date.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Derivative financial instruments (continued)

(ii) Currency options

A currency option is an agreement between two counter-parties, giving the option buyer (option holder) the right, but not the obligation, either to buy or to sell a quantity of currency at a specified rate, on or before a specified date in the future. All currency options concluded with third parties are immediately offset by an opposite option transacted with another Citibank affiliate under exactly the same parameters (date, notional amount, currency and strike price). The bank receives a premium for the transaction. Thus no fair value of outstanding options is carried on the bank’s statement of financial position.

(e) Transactions in foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction or valuation where items are measured. Foreign currency monetary assets and liabilities are translated at the exchange rate ruling at the reporting date other than the forwards contracts which are carried at prevailing forward rates. Resulting exchange differences are recognised in the profit and loss for the year. Non-monetary assets and liabilities denominated in foreign currency are recorded at the exchange rate ruling at the transaction date.

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

(f) Employee benefits

(i) Retirement benefit schemes

The majority of the bank’s employees are eligible for retirement benefits under a defined contribution plan. Contributions to the defined contribution plan are charged to the profit or loss as incurred.

The employees and the Bank also contribute to the NSSF, a national retirement scheme. Contributions are determined by local statutes and the Bank’s contributions are charged to the profit or loss in the year to which they relate.

(ii) Share based payments

Certain categories of senior management are awarded ordinary shares in Citigroup Inc. (the ultimate holding company) based on their performance. The shares vest over a period of four years. The stock awards are recognised in the profit or loss on the award date at the market value of the shares on the award date. As the awards are categorised as equity-settled, no adjustment is made for fair value changes until the settlement date. The expense is recognised in profit or loss as it vests, with a corresponding entry to the equity compensation reserve.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Employee benefits (continued)

(iii) Short term benefits

Short term employee benefits obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expensed to be paid under short term cash bonus.

(iv) Termination benefits

Termination benefits are recognised as an expense when the bank is demonstrably committed, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the bank has made an offer encouraging voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

(g) Taxation

Income tax expense comprises current tax and change in deferred tax. Current tax is the expected tax payable or receivable on the taxable income or loss for the year using tax rates enacted at the reporting date, and any adjustment to tax payable or recoverable in respect of the previous year.

The amount of current tax payable or recoverable is the best estimate of the tax amount that reflects uncertainty related to income taxes if any.

Deferred tax is recognised on all temporary differences between the carrying amounts 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.

Deferred tax is calculated on the basis of the tax rates currently enacted. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred 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.

(h) Property and equipment

Items of buildings, equipment, furniture and fittings and motor vehicles are stated at cost, less accumulated depreciation and impairment losses. Depreciation is charged on the assets on a straight line basis to allocate the cost to their residual values over useful lives estimated as follows:

— Buildings  
Over the period of the lease
— Computer equipment and computer software  
20% to 33⅓% per annum.
— Furniture and equipment  
10% to 20% per annum.
— Motor vehicles  
25% to 29% per annum.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Property and equipment (continued)

The residual values of the assets are reviewed, and adjusted if appropriate, at each reporting date. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are recognised in the profit or loss in the year in which they arise.

(i) Intangible assets

The costs incurred to acquire and bring to use specific computer software licences are capitalised. The costs are amortised on a straight line basis over the expected useful lives, from the date it is available for use, not exceeding three years.

Computer development costs that are directly associated with the production of identifiable and unique software products that will probably generate economic benefits in excess of its costs are capitalised. The costs are amortised on a straight line basis over the expected useful lives, from the date that it is available for use, not exceeding three years.

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

(j) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income on a straight-line basis over the period of the lease. Prepaid operating lease rentals in respect of leasehold land is recognised as an asset and amortised over the lease period.

(k) Contingent liabilities

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

(l) Related parties

In the normal course of business the Bank has entered into transactions with related parties. The related party transactions are at arm’s length.

(m) Provisions

A provision is recognised in the statement of financial position when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation and the amount can be estimated reliably.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Impairment for non-financial assets

The carrying amounts of the Bank’s 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 assets’ 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.

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.

(o) Comparative information

Where necessary, comparative figures have been restated to conform with changes in presentation in the current year.

(p) New standards, amendments and interpretations

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

The Company has adopted the following new standards and amendments during the year ended 31 December 2018, including consequential amendments to other standards with the date of initial application by the Company being 1 January 2018. The nature and effects of the changes are as explained here in.

<table>
<thead>
<tr>
<th>New standard or amendments</th>
<th>Effective for annual periods beginning on or after</th>
</tr>
</thead>
<tbody>
<tr>
<td>— IFRS 15 Revenue from Contracts with Customers</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— IFRS 9 Financial Instruments (2014)</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— IFRIC 22 Foreign Currency Transactions and Advance Consideration</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— IAS 40 Transfers of Investment Property</td>
<td>1 January 2018</td>
</tr>
<tr>
<td>— Annual improvements cycle (2014-2016)</td>
<td>1 January 2018</td>
</tr>
</tbody>
</table>
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

**IFRS 15 Revenue from Contracts with Customers**

This standard replaces IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfer of Assets from Customers and SIC-31 Revenue – Barter of Transactions Involving Advertising Services.

The standard contains a single model that applies to contracts with customers and two approaches to recognising revenue: at a point in time or over time. The standard specifies how and when the Company will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures.

The Company applied IFRS 15 on 1 January 2018 using the modified retrospective approach in which the cumulative effect of initially applying this Standard is recognised at the date of initial application as an adjustment to the opening balance of retained earnings as at 1 January 2018 without restating comparative periods.

There was no material impact of application of IFRS 15 and no adjustment to retained earnings was required.


On 24 July 2014 the IASB issued the final IFRS 9 Financial Instruments Standard, which replaces earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 Financial Instruments: Recognition and Measurement.

The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As a result of the adoption of IFRS 9, the Company has adopted consequential amendments to IFRS 7 Financial Instruments: Disclosures that are applied to disclosures about 2018, but have not been applied to the comparative information.

The key changes to the Bank’s accounting policies resulting from its adoption of IFRS 9 are summarised below. The full impact of adopting the standard is set out in Note 4(a).
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

IFRS 9: Financial Instruments (2014) - continued

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL).

IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows.

The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification. For an explanation of how the Bank classifies financial assets under IFRS 9.

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

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

For an explanation of how the Bank classifies financial liabilities under IFRS 9, see Note 3(c).

Impairment of financial assets

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with an ‘expected credit loss’ model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognised earlier than under IAS 39. For an explanation of how the Bank applies the impairment requirements of IFRS 9, see Note 3(c).
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

IFRS 9: Financial Instruments (2014) - continued

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

Comparative periods generally have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9. The Company used the exemption not to restate comparative periods.

The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.

— The determination of the business model within which a financial asset is held.
— Determination of factors to consider in determining whether there has been a significant increase in credit risk.
— If a debt security had low credit risk at the date of initial application of IFRS 9, then the Company has assumed that credit risk on the asset had not increased significantly since its initial recognition.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

IFRS 9: Financial Instruments (2014) - continued

Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 - continued

The following table summarizes the impact of transition to IFRS 9 on the opening balance on the retained earnings and fair value reserve. There is no impact on other components of equity.

<table>
<thead>
<tr>
<th>2018</th>
<th>Assigned capital KShs'000</th>
<th>Retained earnings KShs'000</th>
<th>Fair value reserve KShs'000</th>
<th>Statutory credit risk reserve KShs'000</th>
<th>Equity compensation reserve KShs'000</th>
<th>Total KShs'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>As at January 2018</td>
<td>4,582,975</td>
<td>14,747,302</td>
<td>27,951</td>
<td>726,020</td>
<td>93,063</td>
<td>20,177,311</td>
</tr>
<tr>
<td>IFRS 9 Initial application adjustments - FVOCI Instruments</td>
<td>-</td>
<td>(58,026)</td>
<td>58,026</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>IFRS 9 Initial application adjustments - amortised cost</td>
<td>(248,171)</td>
<td></td>
<td></td>
<td>(248,171)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IFRS 9 Initial application adjustments - deferred tax</td>
<td>-</td>
<td>93,064</td>
<td>(21,760)</td>
<td>-</td>
<td>-</td>
<td>71,304</td>
</tr>
<tr>
<td>Restated balance as at 1 January 2018</td>
<td>4,582,975</td>
<td>14,534,169</td>
<td>64,217</td>
<td>726,020</td>
<td>93,063</td>
<td>20,000,444</td>
</tr>
</tbody>
</table>
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

The following clarifications and amendments are contained in the pronouncement:

--- Accounting for cash-settled share-based payment transactions that include a performance condition

Up until this point, IFRS 2 contained no guidance on how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. IASB has now added guidance that introduces accounting requirements for cash-settled share-based payments that follows the same approach as used for equity-settled share-based payments.

--- Classification of share-based payment transactions with net settlement features

IASB has introduced an exception into IFRS 2 so that a share-based payment where the entity settles the share-based payment arrangement net is classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled had it not included the net settlement feature.

--- Accounting for modifications of share-based payment transactions from cash-settled to equity-settled

Up until this point, IFRS 2 did not specifically address situations where a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions. The IASB has introduced the following clarifications:

- On such modifications, the original liability recognised in respect of the cash-settled share-based payment is derecognised and the equity-settled share-based payment is recognised at the modification date fair value to the extent services have been rendered up to the modification date.
- Any difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date would be recognised in profit and loss immediately.

The amendments were effective for annual periods beginning on or after 1 January 2018. Earlier application was permitted. The amendments were to be applied prospectively. However, retrospective application was allowed if possible without the use of hindsight. If an entity applies the amendments retrospectively, it must do so for all of the amendments described above.

The adoption of this standard did not have a material impact on the Company’s financial statements.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)

The amendments in Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts' (Amendments to IFRS 4) provide two options for entities that issue insurance contracts within the scope of IFRS 4:

— an option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets; this is the so-called overlay approach;

— an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4; this is the so-called deferral approach.

The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.

An entity applies the overlay approach retrospectively to qualifying financial assets when it first applies IFRS 9. Application of the overlay approach requires disclosure of sufficient information to enable users of financial statements to understand how the amount reclassified in the reporting period is calculated and the effect of that reclassification on the financial statements.

An entity applies the deferral approach for annual periods beginning on or after 1 January 2018. Predominance is assessed at the reporting entity level at the annual reporting date that immediately precedes 1 April 2016. Application of the deferral approach needs to be disclosed together with information that enables users of financial statements to understand how the insurer qualified for the temporary exemption and to compare insurers applying the temporary exemption with entities applying IFRS 9. The deferral can only be made use of for the three years following 1 January 2018. Predominance is only reassessed if there is a change in the entity’s activities.

The adoption of this standard did not have a material impact on the Company’s financial statements.

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

This Interpretation applies to a foreign currency transaction (or part of it) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income (or part of it).
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

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

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration - continued

This Interpretation stipulates that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

This Interpretation does not apply to income taxes, insurance contracts and circumstances when an entity measures the related asset, expense or income on initial recognition:

IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration

(a) at fair value; or
(b) at the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying IFRS 3 Business Combinations).

The amendments apply retrospectively for annual periods beginning on or after 1 January 2018, with early application permitted.

The adoption of this standard did not have a material impact on the Company’s financial statements.

Transfers of Investment property (Amendments to IAS 40)

The IASB has amended the requirements in IAS 40 Investment property on when a Company should transfer a property asset to, or from, investment property.

The adoption of this standard did not have a material impact on the amounts and disclosures of the Company’s financial statements.

Annual improvement cycle (2014 – 2016) – various standards

<table>
<thead>
<tr>
<th>Standards</th>
<th>Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 1 First-time Adoption of IFRS</td>
<td>Outdated exemptions for first-time adopters of IFRS are removed. The amendments apply prospectively for annual periods beginning on or after 1 January 2018.</td>
</tr>
</tbody>
</table>
(p) New standards, amendments and interpretations (continued)

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

Annual improvement cycle (2014 – 2016) – various standards - continued

<table>
<thead>
<tr>
<th>Standards</th>
<th>Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 28 Investments in Associates and Joint Ventures</td>
<td>A venture capital organisation, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss. This election can be made on an investment-by-investment basis. A non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture. The amendments apply retrospectively for annual periods beginning on or after 1 January 2018; early application is permitted.</td>
</tr>
</tbody>
</table>

The adoption of these standards did not have a material impact on the amounts and disclosures of the Company’s financial statements.

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2018, and have not been applied in preparing these financial statements. The Company does not plan to adopt these standards early. These are summarised below:

| — IFRS 16 Leases | 1 January 2019 |
| — IFRIC 23 Uncertainty over income tax treatments | 1 January 2019 |
| — IFRS 9 Prepayment Features with Negative Compensation | 1 January 2019 |
| — IAS 28 Long-term Interests in Associates and Joint Ventures | 1 January 2019 |
| — Annual improvements cycle (2015-2017) | 1 January 2019 |
| — IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19) | 1 January 2019 |
| — IFRS 3 Definition of a Business | 1 January 2020 |
| — Amendments to references to the Conceptual Framework in IFRS Standards | 1 January 2020 |
| — Amendments to IAS 1 and IAS 8 Definition of Material | 1 January 2020 |
| — IFRS 17 Insurance contracts | 1 January 2022 |
| — Sale or Contribution of Assets between an Investor and its Associate or Company (Amendments to IFRS 10 and IAS 28). | To be determined |
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

   (p) New standards, amendments and interpretations (continued)

      (ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

            All standards and interpretations will be adopted at their effective date (except for those standards and interpretations that are not applicable to the entity).

            IFRS 16: Leases

            On 13 January 2016 the IASB issued IFRS 16 Leases, completing the IASB’s project to improve the financial reporting of leases. IFRS 16 replaces the previous leases standard, IAS 17 Leases, and related interpretations.

            IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer (‘lessee’) and the supplier (‘lessor’). The standard defines a lease as a contract that conveys to the customer (‘lessee’) the right to use an asset for a period of time in exchange for consideration.

            A Company assesses whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

            The standard eliminates the classification of leases as either operating leases or finance leases for a lessee and introduces a single lessee accounting model. All leases are treated in a similar way to finance leases.

            Applying that model significantly affects the accounting and presentation of leases and consequently, the lessee is required to recognise:

            Assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A Company recognises the present value of the unavoidable lease payments and shows them either as lease assets (right-of-use assets) or together with property, plant and equipment. If lease payments are made over time, a Company also recognises a financial liability representing its obligation to make future lease payments.

            (i) depreciation of lease assets and interest on lease liabilities in profit or loss over the lease term; and

            (ii) separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (typically presented within either operating or financing activities) in the statement of cash flows

            IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. However, compared to IAS 17, IFRS 16 requires a lessor to disclose additional information about how it manages the risks related to its residual interest in assets subject to leases.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

IFRS 16: Leases - continued

The standard does not require a Company to recognise assets and liabilities for:
(a) short-term leases (i.e. leases of 12 months or less) and;
(b) leases of low-value assets

The new standard is effective for annual periods beginning on or after 1 January 2019. Early application is permitted insofar as the recently issued revenue Standard, IFRS 15 Revenue from Contracts with Customers is also applied.

The Company is still assessing the potential impact on the amounts and disclosures of the Company’s financial statements.

IFRIC 23 Clarification on accounting for Income tax exposures

IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency.

IFRIC 23 explains how to recognise and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority.

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made. Uncertainty is reflected in the overall measurement of tax and separate provision is not allowed.

The entity is required to measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty (that is, the entity should use either the most likely amount method or the expected value method when measuring an uncertainty).

The entity will also need to provide disclosures, under existing disclosure requirements, about

(a) judgments made;
(b) assumptions and other estimates used; and
(c) potential impact of uncertainties not reflected.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

IFRIC 23 Clarification on accounting for Income tax exposures - continued

The new Standard is effective for annual periods beginning on or after 1 January 2019.

The Company is assessing the potential impact on its financial statements resulting from the application of IFRIC 23.

Prepayment Features with Negative Compensation (Amendments to IFRS 9)

The amendments clarify that financial assets containing prepayment features with negative compensation can now be measured at amortised cost or at fair value through other comprehensive income (FVOCI) if they meet the other relevant requirements of IFRS 9.

The amendments apply for annual periods beginning on or after 1 January 2019 with retrospective application, early adoption is permitted.

The adoption of these amendments will not have an impact on the financial statements of the Group and Company.

Long-term Interests in Associates and Joint Ventures (Amendment to IAS 28)

The amendments clarify that an entity applies IFRS 9 to long-term interests in an associate and joint venture that form part of the net investment in the associate or joint venture but to which the equity method is not applied.

The amendments apply for annual periods beginning on or after 1 January 2019. Early adoption is permitted.

The adoption of these standards will not have an impact on the financial statements of the Company.

Annual improvement cycle (2015 – 2017) – various standards

<table>
<thead>
<tr>
<th>Standards</th>
<th>Amendments</th>
</tr>
</thead>
</table>
| IFRS 3 Business Combinations and IFRS 11 Joint Arrangements | Clarifies how a Company accounts for increasing its interest in a joint operation that meets the definition of a business:  
  — If a party maintains (or obtains) joint control, then the previously held interest is not remeasured.  
  — If a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value. |
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

Annual improvement cycle (2015 – 2017) – various standards - continued

<table>
<thead>
<tr>
<th>Standards</th>
<th>Amendments</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 12 Income taxes</td>
<td>Clarifies that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.</td>
</tr>
<tr>
<td>IAS 23 Borrowing costs</td>
<td>Clarifies that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets – are included in that general pool. As the costs of retrospective application might outweigh the benefits, the changes are applied prospectively to borrowing costs incurred on or after the date an entity adopts the amendments.</td>
</tr>
</tbody>
</table>

The amendments are effective for annual reporting periods beginning on or after 1 January 2019 with earlier application permitted. The adoption of these amendments is not expected to affect the amounts and disclosures of the Company’s financial statements.

The Company did not early adopt new or amended standards in the year ended 31 December 2018.

IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)

The amendments clarify that:

— on amendment, curtailment or settlement of a defined benefit plan, a Company now uses updated actuarial assumptions to determine its current service cost and net interest for the period; and
— the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income (OCI).

Consistent with the calculation of a gain or loss on a plan amendment, entities will now use updated actuarial assumptions to determine the current service cost and net interest for the period. Previously, entities would not have updated the calculation of these costs until the year-end.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

**IAS 19 Plan Amendment, Curtailment or Settlement (Amendments to IAS 19) - continued**

Further, if a defined benefit plan is settled, any asset ceiling would be disregarded when determining the plan assets as part of the calculation of gain or loss on settlement.

The amendments apply for plan amendments, curtailments or settlements that occur on or after 1 January 2019, or the date on which the amendments are first applied. Earlier application is permitted.

The adoption of this standard will not have an impact on the financial statements of the Company.

**IFRS 3 Definition of a Business**

With a broad business definition, determining whether a transaction results in an asset or a business acquisition has long been a challenging but important area of judgement. These amendments to IFRS 3 Business Combinations seek to clarify this matter as below however complexities still remain.

— Optional concentration test
  The amendments include an election to use a concentration test. This is a simplified assessment that results in an asset acquisition if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets.

— Substantive process
  If an entity chooses not to apply the concentration test, or the test is failed, then the assessment focuses on the existence of a substantive process.
  The definition of a business is now narrower and could result in fewer business combinations being recognised.

The amendment applies to businesses acquired in annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted. The adoption of this standard will not have an impact on the financial statements of the Company.

**Amendments to References to the Conceptual Framework in IFRS Standards**

This amendment sets out amendments to IFRS Standards (Standards), their accompanying documents and IFRS practice statements to reflect the issue of the International Accounting Standards Board (IASB) revised Conceptual Framework for Financial Reporting in 2018 (2018 Conceptual Framework).
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

   (p) New standards, amendments and interpretations (continued)

   (ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

   Amendments to References to the Conceptual Framework in IFRS Standards - continued

   Some Standards, their accompanying documents and IFRS practice statements contain references to, or quotations from, the IASC’s Framework for the Preparation and Presentation of Financial Statements adopted by the IASB in 2001 (Framework) or the Conceptual Framework for Financial Reporting issued in 2010. Amendments to References to the Conceptual Framework in IFRS Standards updates some of those references and quotations so that they refer to the 2018 Conceptual Framework, and makes other amendments to clarify which version of the Conceptual Framework is referred to in particular documents.

   These amendments are based on proposals in the Exposure Draft Updating References to the Conceptual Framework, published in 2015, and amend Standards, their accompanying documents and IFRS practice statements that will be effective for annual reporting periods beginning on or after 1 January 2020.

   The adoption of these changes will not affect the amounts and disclosures of the Company’s financial statements.

   IAS 1 and IAS 8 Definition of Material

   The amendment refines the definition of Material to make it easier to understand and aligning the definition across IFRS Standards and the Conceptual Framework.

   The amendment includes the concept of ‘obscuring’ to the definition, alongside the existing references to ‘omitting’ and ‘misstating’. Additionally, the amendments also adds the increased threshold of ‘could influence’ to ‘could reasonably be expected to influence’ as below.

   “Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.”

   However, the amendment has also removed the definition of material omissions or misstatements from IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

   The amendments are effective from 1 January 2020 but may be applied earlier.

   The Company is assessing the potential impact on its financial statements resulting from the application of the refined definition of materiality.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

   (p) New standards, amendments and interpretations (continued)

      (ii) New and amended standards and interpretations in issue but not yet effective
           for the year ended 31 December 2018 - continued

   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:

   (a) insurance contracts, including reinsurance contracts, it issues;
   (b) reinsurance contracts it holds; and
   (c) 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:

   (a) 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
   (b) 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. 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:

   (a) 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
   (b) 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.
3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) New standards, amendments and interpretations (continued)

(ii) New and amended standards and interpretations in issue but not yet effective for the year ended 31 December 2018 - continued

IFRS 17 Insurance Contracts - continued

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 affect the amounts and disclosures of the Company’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 require the full gain to be recognised when assets transferred between an investor and its associate or Company meet the definition of a ‘business’ under IFRS 3 Business Combinations. Where the assets transferred do not meet the definition of a business, a partial gain to the extent of unrelated investors’ interests in the associate or Company is recognised. The definition of a business is key to determining the extent of the gain to be recognised.

The effective date for these changes has now been postponed until the completion of a broader review.

The adoption of these changes will not affect the amounts and disclosures of the Company’s financial statements.

4. FINANCIAL RISK MANAGEMENT DISCLOSURES

This section provides details of the bank’s exposure to risk and describes the methods used by management to control risk in respect of financial instruments. The most important types of financial risk to which the bank is exposed to are credit risk, liquidity risk, operational risk and market risk. Market risk includes interest rate risk and currency risk.

Being a branch, the bank does not have a board of directors but a Management Committee which has overall responsibility for the establishment and oversight of the Bank’s risk management framework.

Through its risk management structure, the bank seeks to manage efficiently the core risks; credit, liquidity and market risk, which arise directly through the bank’s commercial activities. In addition compliance, regulatory risk and operational risk are normal consequences of any business undertaking.
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

The Management Committee has established the Asset and Liability Committee (ALCO), Credit Committee (CC), Business Credit Committee (BCC) and the Business Risk and Controls Committee (BRCC), which are responsible for developing and monitoring the bank’s 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.

(a) Credit risk

Credit risk management

Credit risk is the risk to earnings or capital arising from an obligor’s failure to meet the terms of any contract or to otherwise fail to perform as agreed.

The bank has well documented policies and procedures for managing credit risk. The policies are based on the principles of:

— Management responsibility
— Defined credit approval authorities
— Set standards for risk measurement
— Consistent approach to origination of credit, documentation and problem recognition
— Portfolio management strategies.

The risk that counterparties might default on their obligations is monitored on an ongoing basis.

To manage the level of credit risk, the bank deals with counterparties of good credit standing and for which in its assessment the transactions are appropriate and risks understood by the counterparty.

Credit risk management

The bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments.

Significant increase of credit risk (SICR)

ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. Instead management, in assessing whether the credit risk of an asset has significantly increased the Bank takes into account qualitative and quantitative reasonable and supportable forward-looking information. Refer to note 3(b) (i) for more details.
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Stage 3 definition of default

As mentioned above, to determine whether an instrument should move to a lifetime ECL, the change in the risk of a default occurring over the expected life of the financial instruments must be considered.

The Bank applies a default definition that is consistent with that used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. The definition of default used for this purpose is applied consistently to all financial instruments unless information becomes available that demonstrates another default definition is more appropriate for a particular financial instrument.

Credit quality

The following table sets out information about the credit quality and credit risk exposure of financial assets measured at amortised cost (30 June 2019) and loans and receivables (30 June 2019). Unless specifically indicated the amounts represent gross carrying amounts. For loan commitments, the amounts in the table represent the undrawn portion of amounts committed. Loan commitments are overdraft facilities. Explanations of the terms ‘stage 1’, ‘stage 2’, and ‘stage 3’ is included in this note.
### 4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Credit quality – continued

<table>
<thead>
<tr>
<th>Risk classification</th>
<th>12 month ECL KShs '000</th>
<th>Lifetime ECL not credit impaired KShs '000</th>
<th>Lifetime ECL credit impaired KShs '000</th>
<th>Purchased credit impaired KShs '000</th>
<th>Total 30 Sept 2019 KShs '000</th>
<th>Total December 2018 KShs '000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and advances at amortised cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 1</td>
<td>26,373,668</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>26,373,668</td>
<td>23,398,919</td>
</tr>
<tr>
<td>Stage 2</td>
<td>-</td>
<td>505,778</td>
<td>-</td>
<td>-</td>
<td>505,778</td>
<td>2,875,025</td>
</tr>
<tr>
<td>Stage 3</td>
<td>-</td>
<td>-</td>
<td>943,747</td>
<td>-</td>
<td>943,747</td>
<td>2,249,837</td>
</tr>
<tr>
<td>Gross carrying amount</td>
<td>26,373,668</td>
<td>505,778</td>
<td>943,747</td>
<td>-</td>
<td>27,823,193</td>
<td>28,523,781</td>
</tr>
</tbody>
</table>
4. **FINANCIAL RISK MANAGEMENT DISCLOSURES** (Continued)

(a) **Credit risk (continued)**

Credit quality – continued

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FVOCI Securities KShs ‘000</td>
<td></td>
<td>Cash and balances with Central Bank of Kenya KShs ‘000</td>
<td>Derivative Instruments KShs ‘000</td>
<td>Other assets KShs ‘000</td>
<td>Balances due from foreign banks KShs ‘000</td>
<td>Placement with other banks KShs ‘000</td>
<td>Off balance sheet items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 1</td>
<td>42,320,306</td>
<td>32,488,124</td>
<td>8,953,849</td>
<td>7,365,179</td>
<td>49,815</td>
<td>527,903</td>
<td>16,164,847</td>
<td>4</td>
<td>15,127,973</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>12,731,548</td>
<td>16,164,847</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15,127,973</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>51,028</td>
<td></td>
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</tr>
<tr>
<td>Gross Carrying total</td>
<td>42,320,306</td>
<td>32,488,124</td>
<td>8,953,849</td>
<td>7,365,179</td>
<td>49,815</td>
<td>527,903</td>
<td>16,164,847</td>
<td>4</td>
<td>15,181,001</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2019:
- Stage 1: KShs 42,320,306, KShs 8,953,849, KShs 61,959, KShs 1,664,652, KShs 12,731,548, KShs -
- Stage 2: KShs -
- Stage 3: KShs -
- Gross Carrying total: KShs 42,320,306, KShs 8,953,849, KShs 61,959, KShs 1,664,652, KShs 12,731,548, KShs -

2018:
- Stage 2: KShs -
- Stage 3: KShs -
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

**Allowances for impairment**

The IFRS 9 impairment standard applies to any debt instruments measured at amortised cost or at fair value through other comprehensive income and also to off balance sheet loan commitments and financial guarantees.

**Expected credit loss impairment model**

Credit loss allowances will be measured on each reporting date according to a three-stage expected credit loss impairment model under which each financial asset is classified in one of the stages below:

— Stage 1 – From initial recognition of a financial asset to the date on which the asset has experienced a significant increase in credit risk relative to its initial recognition, a loss allowance is recognized equal to the credit losses expected to result from defaults expected over the next 12 months. Interest is calculated based on the gross carrying amount of the asset.

— Stage 2 – Following a significant increase in credit risk relative to the risk at initial recognition of the financial asset, a loss allowance is recognized equal to the full credit losses expected over the remaining life of the asset. Interest is calculated based on the gross carrying amount of the asset.

The credit losses for financial assets in Stage 1 and Stage 2 are measured 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).

— Stage 3 – When a financial asset is considered to be credit-impaired, a loss allowance equal to the full lifetime expected credit losses will be recognized. Credit losses are measured as the difference between the gross carrying amount and the present value of estimated future cash flows. Interest revenue is calculated based on the carrying amount of the asset, net of the loss allowance, rather than on its gross carrying amount.

Evidence that a financial asset is impaired includes observable data that comes to the attention of the Bank such as:

— Significant financial difficulty of the issuer or obligor;

— A breach of contract, such as a default or delinquency in interest or principal payments;

— It becomes probable that the borrower will enter bankruptcy or other financial reorganisation;

— The disappearance of an active market for that financial asset because of financial difficulties; or

— Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Allowances for impairment - continued

Expected credit loss impairment model - continued

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

Loans are written off when there is no realistic probability of recovery. The estimation of an expected credit loss (ECL) is required to be unbiased and probability weighted, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. The estimate also considers the time value of money.

The measurement of an ECL is primarily determined by an assessment of the financial asset’s probability of default (PD), loss given default (LGD) and exposure at default (EAD) where the cash shortfalls are discounted to the reporting date. For a financial asset in Stage 1, the Bank will utilise a 12-month PD, whereas a financial asset within Stage 2 and Stage 3 will utilise a lifetime PD in order to estimate an impairment allowance.

Wholesale Classifiably Managed Exposures

An impairment allowance will be estimated for Corporate loans utilising sophisticated models depending on the relative size, quality and complexity of the portfolios.

The bank exposure to credit risk is analysed as follows:
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)
   (a) Credit risk (continued)

   **Allowances for impairment – continued**

<table>
<thead>
<tr>
<th>Amounts in KShs</th>
<th>30-Sept-19</th>
<th>31-Dec-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 month ECL (Stage 1) KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lifetime ECL not credit impaired (Stage 2) KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lifetime ECL credit impaired (Stage 3) KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lifetime ECL not credit impaired (Stage 2) KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lifetime ECL credit impaired (Stage 3) KShs '000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total KShs '000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Loss allowance-Loans and advances at amortised cost</th>
<th>30-Sept-19</th>
<th>31-Dec-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss allowance as at 1 January</td>
<td>33,332</td>
<td>549,411</td>
</tr>
<tr>
<td>IFRS 9 transition adjustment</td>
<td></td>
<td>554,289</td>
</tr>
<tr>
<td>Adjusted balance at 1 January</td>
<td>33,332</td>
<td>197,122</td>
</tr>
<tr>
<td>Transfer to 12 months ECL (Stage 1)</td>
<td>5,078</td>
<td>746,533</td>
</tr>
<tr>
<td>Transfer to Lifetime ECL not credit impaired (Stage 2)</td>
<td>364</td>
<td>802,461</td>
</tr>
<tr>
<td>Transfer to Lifetime ECL credit impaired (Stage 3)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- ECL stands for Expected Credit Loss.
- The table details the allowances for impairment as at 1 January, IFRS 9 transition adjustment, and adjustments for various stages of credit impairment.
- The figures are presented in KShs '000.
### 4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Allowances for impairment – continued

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net remeasurement of loss allowance</td>
<td>7430</td>
<td>21,336</td>
<td>97,237</td>
<td>83,331</td>
<td>213,045</td>
<td>188,092</td>
<td>354,742</td>
<td>329,789</td>
<td></td>
</tr>
<tr>
<td>New financial assets originated or purchased</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Changes in models/risk parameters</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Foreign exchange and other movements</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Financial assets derecognised</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Write off</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Recoveries from write off</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>340,146</td>
<td>340,146</td>
<td></td>
</tr>
<tr>
<td><strong>Loss allowance as at 30 Sept</strong></td>
<td>41,125</td>
<td>201,096</td>
<td>858,366</td>
<td>1,100,587</td>
<td>33,332</td>
<td>217,355</td>
<td>761,129</td>
<td>1,011,816</td>
<td></td>
</tr>
</tbody>
</table>
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)
(a) Credit risk (continued)

Allowances for impairment – continued

<table>
<thead>
<tr>
<th></th>
<th>FVOCI Securities KShs ‘000</th>
<th>Cash and balances with Central Bank of Kenya KShs ‘000</th>
<th>Derivative Instruments KShs ‘000</th>
<th>Other assets KShs ‘000</th>
<th>Balances due from foreign banks KShs ‘000</th>
<th>Placement with other banks KShs ‘000</th>
<th>Off balance sheet items KShs ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 1</td>
<td>42,320,306</td>
<td>8,953,849</td>
<td>61,959</td>
<td>1,664,652</td>
<td>12,731,548</td>
<td>-</td>
<td>12,666,039</td>
</tr>
<tr>
<td>Stage 2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>543,991</td>
</tr>
<tr>
<td>Stage 3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>318,142</td>
</tr>
<tr>
<td>Gross Carrying total</td>
<td>42,320,306</td>
<td>8,953,849</td>
<td>61,959</td>
<td>1,664,652</td>
<td>12,731,548</td>
<td>-</td>
<td>13,528,172</td>
</tr>
<tr>
<td>loss allowance</td>
<td>112,662</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>(132,560)</td>
</tr>
<tr>
<td>Net Carrying total</td>
<td>42,432,968</td>
<td>8,953,849</td>
<td>61,959</td>
<td>1,664,652</td>
<td>12,731,548</td>
<td>-</td>
<td>13,395,612</td>
</tr>
</tbody>
</table>
4. **FINANCIAL RISK MANAGEMENT DISCLOSURES** (Continued)

   (a) **Credit risk** (continued)

   *Allowances for impairment – continued*

<table>
<thead>
<tr>
<th>Year</th>
<th>FVOCI Securities KShs ‘000</th>
<th>Cash and balances with Central Bank of Kenya KShs ‘000</th>
<th>Derivative Instruments KShs ‘000</th>
<th>Other assets KShs ‘000</th>
<th>Balances due from foreign banks KShs ‘000</th>
<th>Placement with other banks KShs ‘000</th>
<th>Off balance sheet items KShs ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 1</td>
<td>32,488,124</td>
<td>7,365,179</td>
<td>49,815</td>
<td>527,903</td>
<td>16,164,847</td>
<td>4</td>
<td>15,127,973</td>
</tr>
<tr>
<td>Stage 2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Stage 3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**Gross Carrying total**

<table>
<thead>
<tr>
<th></th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>32,488,124</td>
<td>7,365,179</td>
<td>49,815</td>
<td>527,903</td>
<td>16,164,847</td>
<td>4</td>
<td>15,181,001</td>
</tr>
</tbody>
</table>

**Loss allowance**

<table>
<thead>
<tr>
<th></th>
<th>KShs ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(119,877)</td>
</tr>
</tbody>
</table>

**Net Carrying total**

<table>
<thead>
<tr>
<th></th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
<th>KShs ‘000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>32,368,246</td>
<td>7,365,179</td>
<td>49,815</td>
<td>527,903</td>
<td>16,164,847</td>
<td>4</td>
<td>15,063,237</td>
</tr>
</tbody>
</table>

The bank held Government securities worth KShs 179,150,000 (2018 - KShs 179,150,000) as collateral against some of its loans and advances.
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(a) Credit risk (continued)

Write-off policy

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

Derivatives

The credit risk arising from derivatives is managed as part of the overall lending limits to banks and customers. The amount of credit risk is the current positive fair value of the underlying contract together with potential exposures from future market movements. The Group further limits its exposures to credit losses in the event of default by entering into master netting agreements with certain market counterparties. Exposures are not presented net in the financial statements as in the ordinary course of business they are not intended to be settled net.

Where appropriate, derivatives are used to reduce credit risks in the portfolio. Due to their potential impact on income volatility, derivatives are only used in a controlled manner and within a pre-defined volatility expectation.

(b) Liquidity risk

Liquidity risk is the risk that the bank will encounter difficulty in meeting obligations from its financial liabilities. The bank’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the bank’s reputation.

Liquidity risk arises in the general funding of the bank’s activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate timeframe.

ALCO is responsible for ensuring that the bank manages its liquidity risk and is able to meet all its obligations to make payments as and when they fall due. It also has primary responsibility for compliance with regulations and bank policy and maintaining a liquidity crisis contingency plan.

The bank 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 with daily liquidity positions being monitored.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of liquidity risk.
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)

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

A substantial portion of the bank’s assets are funded by customer deposits made up of current and savings accounts and other deposits. These customer deposits, which are widely diversified by type and maturity, represent a stable source of funds. Lending is normally funded by liabilities in the same currency.

The bank also maintains significant levels of marketable securities either for compliance with statutory requirements or as prudential investments of surplus funds.

A key measure of liquidity risk is the ratio of net liquid assets to deposit liabilities. The Central Bank of Kenya requires banks to maintain a statutory minimum ratio of 20% of liquid assets to all its deposit liabilities.

For this purpose, liquid assets comprises cash and balances with Central Bank of Kenya, net balances with financial institutions, treasury bonds and bills and net balances with banks abroad.

Deposit liabilities comprise deposits from customers, other liabilities that have matured or maturing within 91 days.

The liquidity ratios at the reporting date and during the reporting period (based on month end ratios) were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>At 30 September</td>
<td>75.9%</td>
<td>75.2%</td>
</tr>
<tr>
<td>Average for the period</td>
<td>79.4%</td>
<td>72.6%</td>
</tr>
<tr>
<td>Highest for the period</td>
<td>84.6%</td>
<td>73.1%</td>
</tr>
<tr>
<td>Lowest for the period</td>
<td>72.4%</td>
<td>64.7%</td>
</tr>
</tbody>
</table>
4 FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(b) Liquidity risk (continued)
Residual contractual maturities of financial liabilities

<table>
<thead>
<tr>
<th></th>
<th>On Demand</th>
<th>Due within 3 months</th>
<th>Due between 3 months and 12 months</th>
<th>Due between 1 and 5 years</th>
<th>Due after 5 years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits from banks</td>
<td>2,970,658</td>
<td>-</td>
<td>9,638,185</td>
<td>-</td>
<td>-</td>
<td>12,608,843</td>
</tr>
<tr>
<td>Derivative instruments</td>
<td>10,700</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>10,700</td>
</tr>
<tr>
<td>Due to customers</td>
<td>56,333,008</td>
<td>-</td>
<td>2,091,304</td>
<td>969,134</td>
<td>-</td>
<td>59,393,446</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>1,931,135</td>
<td>960,723</td>
<td></td>
<td></td>
<td></td>
<td>2,891,858</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>61,245,501</td>
<td>960,723</td>
<td>11,729,489</td>
<td>969,134</td>
<td></td>
<td>74,904,847</td>
</tr>
</tbody>
</table>
Customer deposits up to three months represent current and call deposit account balances, which past experience has shown to be stable and of a long term nature.
4. FINANCIAL RISK MANAGEMENT DISCLOSURES (Continued)

(c) Market risk

Market risk is the risk that changes in market prices, such as interest rate and foreign exchange rates 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.

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands.

The Bank is also exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Currency risk is managed principally through limits set on the level of exposure by currency and in total for both overnight and intra-day positions which are monitored daily.

Overall responsibility for market risk is vested in ALCO.

Sensitivity analysis interest rate risk

The sensitivity analysis on the accrual book is measured by the change in DV01 (Dollar value of 01) that measures the change in value of the accrual portfolio due to a 1 basis point parallel move in the interest rates. At 30 September 2019, a 1 basis point parallel increase in the interest rates with all other variables held constant would have resulted to a pre-tax loss movement of KShs 88,906 (2018 – KShs -1,995).

(i) Interest rate risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below summarises the exposure to interest rate risks. Included in the table are the Bank’s assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.
4 FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk (continued)

(ii) Interest rate risk

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The table below summarises the exposure to interest rate risks. Included in the table are the Bank’s assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

<table>
<thead>
<tr>
<th>30-Sept-19</th>
<th>Effective interest rate</th>
<th>Within 3 months</th>
<th>Between 3 and 12 months</th>
<th>Between 1 and 5 years</th>
<th>Non interest bearing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
</tr>
<tr>
<td>Cash and balances with Central Bank</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8,953,849</td>
<td>8,953,849</td>
</tr>
<tr>
<td>Other Assets</td>
<td>1,136,641</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FVOCI Securities</td>
<td>9.21%</td>
<td>5,471,282</td>
<td>34,277,914</td>
<td>2,571,110</td>
<td>-</td>
<td>42,320,306</td>
</tr>
<tr>
<td>Due from foreign branches</td>
<td>12,731,548</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>12,731,548</td>
</tr>
<tr>
<td>Due from other banks</td>
<td>6.75%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Derivative instruments</td>
<td>10,700</td>
<td>61,959</td>
<td></td>
<td>-</td>
<td>61,959</td>
<td>-</td>
</tr>
<tr>
<td>Loans and advances to customers (net)</td>
<td>7.26%</td>
<td>14,713,376</td>
<td>3,696,708</td>
<td>8,312,522</td>
<td>-</td>
<td>26,722,606</td>
</tr>
<tr>
<td>Total financial assets</td>
<td>34,052,847</td>
<td>37,974,622</td>
<td>10,883,632</td>
<td>9,015,808</td>
<td>-</td>
<td>91,926,909</td>
</tr>
</tbody>
</table>

Financial liabilities and equity

| Deposits from banking institutions | 2.44% | 2,970,658 | 9,638,185 | 0 | 0 | 12,608,843 |
| Derivative instruments | - | 10,700 | 10,700 | |
| Customer deposits | 3.22% | 56,333,008 | 2,091,304 | 969,134 | 0 | 59,393,446 |
| Other Liabilities | 1,931,135 | 960,723 | - | - | 2,891,858 |
| Total financial liabilities | 61,234,801 | 12,690,212 | 969,134 | 10,700 | 74,904,847 |

Interest rate sensitivity gap

| (27,181,954) | 25,284,410 | 9,914,498 | 9,005,108 | 17,022,062 |
## FINANCIAL RISK MANAGEMENT (Continued)

### (c) Market risk (continued)

#### (ii) Interest rate risk - continued

<table>
<thead>
<tr>
<th>31-Dec-18</th>
<th>Effective interest rate</th>
<th>Within 3 months</th>
<th>Between 3 and 12 months</th>
<th>Between 1 and 5 years</th>
<th>Non interest bearing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>KShs ‘000</td>
<td>KShs ‘000</td>
<td>KShs ‘000</td>
<td>KShs ‘000</td>
<td>KShs ‘000</td>
</tr>
<tr>
<td>Cash and balances with Central Bank</td>
<td>11.00%</td>
<td>10,916,552</td>
<td>20,557,351</td>
<td>1,014,220</td>
<td>-</td>
<td>32,488,123</td>
</tr>
<tr>
<td>Other Assets</td>
<td>8.40%</td>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>FVOCI Securities</td>
<td>7.19%</td>
<td>49,815</td>
<td>49,815</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and advances to customers (net)</td>
<td>7.19%</td>
<td>20,945,557</td>
<td>2,699,064</td>
<td>3,239,030</td>
<td>-</td>
<td>26,883,651</td>
</tr>
</tbody>
</table>

**Total financial assets**

|                           | 49,102,290 | 23,256,415 | 4,253,250 | 7,414,994 | 84,026,949 |

**Financial liabilities and equity**

| Deposits from banking institutions | 3.40% | 3,342,260 | 5,905,900 | 0 | 0 | 9,248,160 |
| Customer deposits | 5.85% | 53,778,948 | 1,010,054 | 0 | 0 | 54,789,002 |
| Other Liabilities | 1,662,862 | 501,386 | 2,164,248 | | |         |

**Total financial liabilities**

|                           | 58,784,070 | 7,417,340 | 0 | 27,691 | 66,229,101 |

**Interest rate sensitivity gap**

|                           | (9,681,780) | 15,839,075 | 4,253,250 | 7,387,303 | 17,797,848 |
4. FINANCIAL RISK MANAGEMENT (Continued)
   
   (c) Market risk (continued)
      
      (iii) Currency rate risk
      
      The Bank operates wholly within Kenya and its assets and liabilities are carried in the local currency. The various foreign currencies to which the Bank is exposed at 30 September 2019 are summarised below:

<table>
<thead>
<tr>
<th>30-Sept-19</th>
<th>USD</th>
<th>GBP</th>
<th>EURO</th>
<th>JPY</th>
<th>Others</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
<td>KShs '000</td>
</tr>
<tr>
<td>Cash and balances with banks abroad</td>
<td>13,025,052</td>
<td>245,109</td>
<td>634,328</td>
<td>1,096,632</td>
<td>76,318</td>
<td>15,077,439</td>
</tr>
<tr>
<td>Loans and advances</td>
<td>13,357,579</td>
<td>-</td>
<td>1,334,078</td>
<td>225,460</td>
<td>23,840</td>
<td>14,940,957</td>
</tr>
<tr>
<td>Other foreign assets</td>
<td>2,173,876</td>
<td>65</td>
<td>1,221</td>
<td>-</td>
<td>1,553</td>
<td>2,176,715</td>
</tr>
<tr>
<td>Off balance sheet items</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undelivered spot purchases</td>
<td>180,417</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1,743</td>
<td>182,160</td>
</tr>
<tr>
<td>Forward purchases</td>
<td>8,476,165</td>
<td>-</td>
<td>1,706</td>
<td>654,942</td>
<td>64,076</td>
<td>9,196,889</td>
</tr>
<tr>
<td>Total financial foreign assets</td>
<td>37,213,089</td>
<td>245,174</td>
<td>1,971,333</td>
<td>1,977,034</td>
<td>167,530</td>
<td>41,574,159</td>
</tr>
</tbody>
</table>

| Financial liabilities | | | | | | |
| Balance Sheet Items | | | | | | |
| Deposits | 23,944,079 | 228,019 | 1,956,004 | 1,322,555 | 88,412 | 27,539,069 |
| Balances due to banks abroad | - | - | - | - | 2,694 | 2,694 |
| Other Foreign Liabilities | 2,068,961 | 0 | 3,810 | - | 2,083 | 2,074,854 |
| Foreign Loans and Advances | 13,510 | - | - | - | - | 13,510 |
| Inter-Company/Group Balances | 7,270,006 | - | - | - | - | 7,270,006 |
| Off Balance Sheet Items | | | | | | |
| Undelivered Spot Sales | 148,531 | 12,788 | - | - | 1,036 | 162,355 |
| Forward Sales | 3,340,800 | 7,487 | - | 657,319 | 58,625 | 4,064,231 |
| Total Foreign liabilities | 36,785,887 | 248,294 | 1,959,814 | 1,979,874 | 152,850 | 41,126,719 |

| Net Open Position | 427,202 | (3,120) | 11,519 | (2,840) | 14,680 | 447,441 |
| Long/(short)position | 427,202 | (3,120) | 11,519 | (2,840) | 14,680 | 447,441 |
4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk (continued)

(ii) Currency rate risk – continued

<table>
<thead>
<tr>
<th></th>
<th>USD KShs '000</th>
<th>GBP KShs '000</th>
<th>EURO KShs '000</th>
<th>JPY KShs '000</th>
<th>Others KShs '000</th>
<th>TOTAL KShs '000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance sheet items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and balances with banks abroad</td>
<td>16,161,466</td>
<td>377,649</td>
<td>763,709</td>
<td>669,809</td>
<td>140,187</td>
<td>18,112,820</td>
</tr>
<tr>
<td>Loans and advances</td>
<td>9,953,088</td>
<td>-</td>
<td>1,401,517</td>
<td>252,454</td>
<td>0</td>
<td>11,607,059</td>
</tr>
<tr>
<td>Other foreign assets</td>
<td>1,807,129</td>
<td>-</td>
<td>6,345</td>
<td>13</td>
<td>120</td>
<td>1,813,607</td>
</tr>
<tr>
<td><strong>Off balance sheet items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undelivered spot purchases</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Forward purchases</td>
<td>4,155,493</td>
<td>-</td>
<td>583,909</td>
<td>256,126</td>
<td>50,323</td>
<td>5,045,851</td>
</tr>
<tr>
<td><strong>Total financial foreign assets</strong></td>
<td>32,077,176</td>
<td>377,649</td>
<td>2,755,480</td>
<td>1,178,402</td>
<td>190,630</td>
<td>36,579,337</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>USD KShs '000</th>
<th>GBP KShs '000</th>
<th>EURO KShs '000</th>
<th>JPY KShs '000</th>
<th>Others KShs '000</th>
<th>TOTAL KShs '000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Balance Sheet Items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>23,393,997</td>
<td>223,978</td>
<td>1,573,861</td>
<td>921,105</td>
<td>58,398</td>
<td>26,171,339</td>
</tr>
<tr>
<td>Balances due to banks abroad</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>13,595</td>
</tr>
<tr>
<td>Other Foreign Liabilities</td>
<td>1,788,632</td>
<td>0</td>
<td>10,238</td>
<td>-</td>
<td>673</td>
<td>1,799,543</td>
</tr>
<tr>
<td>Foreign Loans and Advances</td>
<td>26,374</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>26,374</td>
</tr>
<tr>
<td>Inter-Company/Group Balances</td>
<td>5,094,111</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5,094,111</td>
</tr>
<tr>
<td><strong>Off Balance Sheet Items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Undelivered Spot Sales</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Forward Sales</td>
<td>1,802,470</td>
<td>158,766</td>
<td>1,176,184</td>
<td>257,946</td>
<td>101,446</td>
<td>3,496,812</td>
</tr>
<tr>
<td><strong>Total Foreign liabilities</strong></td>
<td>32,105,584</td>
<td>382,744</td>
<td>2,760,283</td>
<td>1,179,051</td>
<td>174,112</td>
<td>36,601,774</td>
</tr>
<tr>
<td><strong>Net Open Position</strong></td>
<td>(28,408)</td>
<td>(5,095)</td>
<td>(4,803)</td>
<td>(649)</td>
<td>16,518</td>
<td>(22,437)</td>
</tr>
<tr>
<td><strong>Long/(short)position</strong></td>
<td>(28,408)</td>
<td>(5,095)</td>
<td>(4,803)</td>
<td>(649)</td>
<td>16,518</td>
<td>(22,437)</td>
</tr>
</tbody>
</table>
4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk (continued)

*Sensitivity analysis foreign currency exchange risk*

The bank’s assets and liabilities held in foreign currency are bound to be affected by the fluctuations in the foreign exchange rate. The sensitivity analysis on the foreign currency position is measured by the trading DV01 that measures the change in value of the position as a result of a 1 percentage point shift (appreciation) in exchange rates. The trading DV01 for the USD and the EUR positions that constitute the significant portion of the statement of financial position is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD</td>
<td>42,720</td>
<td>2,841</td>
</tr>
<tr>
<td>EUR</td>
<td>1,152</td>
<td>480</td>
</tr>
<tr>
<td>GBP</td>
<td>312</td>
<td>510</td>
</tr>
<tr>
<td>JPY</td>
<td>284</td>
<td>65</td>
</tr>
</tbody>
</table>

The following significant exchange rates were applied during the year:

<table>
<thead>
<tr>
<th></th>
<th>Closing 2019</th>
<th>Closing 2018</th>
<th>Average 2019</th>
<th>Average 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GBP</td>
<td>127.74</td>
<td>130.10</td>
<td>128.19</td>
<td>130.83</td>
</tr>
<tr>
<td>JPY</td>
<td>96.22</td>
<td>91.96</td>
<td>96.54</td>
<td>91.05</td>
</tr>
<tr>
<td>EUR</td>
<td>113.42</td>
<td>116.68</td>
<td>114.37</td>
<td>116.54</td>
</tr>
<tr>
<td>USD</td>
<td>103.85</td>
<td>101.90</td>
<td>103.76</td>
<td>101.40</td>
</tr>
</tbody>
</table>

(d) Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes reputation and franchise risk associated with the Bank’s business practices or market conduct; and the risk of failing to comply with applicable laws and regulations.

The Bank seeks to ensure that key operational risks are managed in a timely and effective manner through a framework of policies, procedures and tools to identify, assess, monitor, control and report such risks.

Compliance with operational risk policies and procedures is the responsibility of all business managers. The Business Risk and Controls Committee (BRCC) has the overall responsibility for ensuring that an appropriate and robust risk management framework is in place to monitor and manage operational risk.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This is supported by the Manager’s Control Assessment process that assess the effectiveness of controls over the risks identified.
4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Capital management

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
— 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
— 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.

Central Bank of Kenya required the bank to maintain a minimum core capital of Kshs 1 billion as at 31 December 2018. 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.

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.
4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Capital management (continued)

The Bank’s regulatory capital position at 30 September was as follows:

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Core capital (Tier 1)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assigned capital</td>
<td>4,582,975</td>
<td>4,582,975</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>12,540,709</td>
<td>14,382,768</td>
</tr>
<tr>
<td>Less deferred tax asset</td>
<td>(314,349)</td>
<td>(287,927)</td>
</tr>
<tr>
<td><strong>Total capital</strong></td>
<td>16,809,335</td>
<td>18,677,816</td>
</tr>
</tbody>
</table>

**Supplementary capital (Tier 2)**

Statutory reserve

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>26,668</td>
<td>138,904</td>
</tr>
</tbody>
</table>

**Total capital**

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>16,836,003</td>
<td>18,816,720</td>
</tr>
</tbody>
</table>

**Risk weighted assets**

On-balance sheet

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30,897,545</td>
<td>31,763,098</td>
</tr>
</tbody>
</table>

Off-balance sheet

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14,714,580</td>
<td>16,512,633</td>
</tr>
</tbody>
</table>

Market Risk qualifying Assets

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5,289,517</td>
<td>2,806,453</td>
</tr>
</tbody>
</table>

Operational Risk Equivalent Assets

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>17,296,257</td>
<td>17,004,770</td>
</tr>
</tbody>
</table>

**Total risk weighted assets**

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>68,197,899</td>
<td>68,086,953</td>
</tr>
</tbody>
</table>

**Deposits from customers**

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>72,002,290</td>
<td>64,037,162</td>
</tr>
</tbody>
</table>

**Capital ratios**

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core capital/total deposit liabilities (CBK minimum 8%)</td>
<td>23.3%</td>
<td>29.2%</td>
</tr>
<tr>
<td>Core capital /total risk weighted assets (CBK minimum 10.5%)</td>
<td>24.6%</td>
<td>27.4%</td>
</tr>
<tr>
<td>Total capital /total risk weighted assets (CBK minimum 14.5%)</td>
<td>24.7%</td>
<td>27.6%</td>
</tr>
</tbody>
</table>

5. USE OF ESTIMATES AND JUDGEMENTS

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
managements 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.
5. USE OF ESTIMATES AND JUDGEMENTS (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 judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is set out below:

(a) Impairment of financial assets

Judgement is made on classification of financial assets assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial assets are Solely for Payment of Principal and Interest (SPPT) on the principal amount outstanding.

Judgement is made in establishing the criterion for determining whether credit risk on the financial instrument has increased significantly since initial recognition, determining methodology for incorporating forward-looking information into measurement of Expected Credit Losses (ECLs) and selection and approvals of models used to measure ECL.

Assets accounted for at amortised cost and fair value through other comprehensive income are evaluated for impairment on a basis described note 3(b).

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

For credit exposures where there have not been significant increases in credit risk since initial recognition, the Bank provides for 12-month ECLs. These are classified as Stage 1 assets.

For credit exposures where there have been significant increases in credit risk since initial recognition on an individual or collective basis, a loss allowance is required for lifetime ECLs. These are classified as Stage 2 assets.

For credit exposures that are credit impaired and in default, similar to stage 2 assets, a loss allowance is required for lifetime ECLs however the probability of default for these assets is presumed to be 100% less any determined recovery and cure rate.

Business model assessment and assumptions

The following are the critical judgements, apart from those involving estimations (which are dealt with separately above), that the directors have made in the process of applying the Bank’s accounting policies and that have the most significant effect on the amounts recognised in financial statements:
5. USE OF ESTIMATES AND JUDGEMENTS (Continued)

(a) Impairment of financial assets (continued)

Business model assessment

Classification and measurement of financial assets depends on the results of the SPPI and the business model test (refer to note 3(b)). The Bank determines the business model at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. This assessment includes judgement reflecting all relevant evidence including how the performance of the assets is evaluated and their performance is measured, the risks that affect the performance of the assets and how these are managed and how the managers of the assets are compensated. The Bank monitors financial assets measured at amortised cost or fair value through other comprehensive income that are derecognised prior to their maturity to understand the reason for their disposal and whether the reasons are consistent with the objective of the business for which the asset was held. Monitoring is part of the Bank’s continuous assessment of whether the business model for which the remaining financial assets are held continues to be appropriate and if it is not appropriate whether there has been a change in business model and so a prospective change to the classification of those assets.

Significant increase of credit risk (SICR)

ECL are measured as an allowance equal to 12-month ECL for stage 1 assets, or lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. Instead management, in assessing whether the credit risk of an asset has significantly increased the Bank takes into account qualitative and quantitative reasonable and supportable forward-looking information. Refer to note 3(b) for more details.

Establishing groups of assets with similar credit risk characteristics

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. Refer to note 3(b) for details of the characteristics considered in this judgement. The Group monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.
5. USE OF ESTIMATES AND JUDGEMENTS (Continued)

(a) Impairment of financial assets (continued)

Models and assumptions used

The Bank uses various models and assumptions in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk. Refer to note 3 (b) for more details on ECL measurement.

(b) Useful life of assets

Property and equipment

Critical estimates are made by management in determining the useful life of property and equipment.

(c) Fair value of financial instruments

Where the fair values of the financial assets and liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable market data where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

(d) Taxation

Judgment 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.

The Bank recognises the net future tax benefit that relates 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.
5. USE OF ESTIMATES AND JUDGEMENTS (Continued)

(e) Critical accounting judgements in applying the Bank’s accounting policies

Critical accounting judgements made in applying the Branch’s accounting policies include financial asset and liability classification. The Branch’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 held-to-maturity, the Branch has determined that it has both positive intention and ability to hold the assets until their maturity date.
### 6. FINANCIAL ASSETS AND LIABILITIES

#### Accounting classifications and fair values

<table>
<thead>
<tr>
<th>30-Sept-19</th>
<th>Held for trading</th>
<th>FVOCI</th>
<th>Amortised Cost</th>
<th>Others at amortised cost</th>
<th>Fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
</tr>
<tr>
<td><strong>Financial assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and balances with Central Bank of Kenya</td>
<td>-</td>
<td>-</td>
<td>8,953,849</td>
<td>-</td>
<td>8,953,849</td>
</tr>
<tr>
<td>Other assets</td>
<td>-</td>
<td></td>
<td>1,136,641</td>
<td>-</td>
<td>1,136,641</td>
</tr>
<tr>
<td>FVOCI Securities</td>
<td>-</td>
<td>42,320,306</td>
<td>-</td>
<td>-</td>
<td>42,320,306</td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>61,959</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>61,959</td>
</tr>
<tr>
<td>Placements with other banks</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Balances due from foreign branches</td>
<td>-</td>
<td>-</td>
<td>12,731,548</td>
<td>-</td>
<td>12,731,548</td>
</tr>
<tr>
<td>Loans and advances to customers</td>
<td>-</td>
<td>-</td>
<td>26,722,606</td>
<td>-</td>
<td>26,722,606</td>
</tr>
<tr>
<td><strong>Total financial assets</strong></td>
<td>61,959</td>
<td>42,320,306</td>
<td>49,544,644</td>
<td>-</td>
<td>91,926,909</td>
</tr>
</tbody>
</table>

| **Financial liabilities** | | | | | |
| Deposits from banks | - | - | - | 12,608,843 | 12,608,843 |
| Deposits from customers | - | - | - | 59,393,446 | 59,393,446 |
| Derivative financial instruments | 10,700 | - | - | - | 10,700 |
| Other liabilities-items in transit | | | | 2,874,441 | 2,874,441 |
| **Total financial liabilities** | 10,700 | - | - | 74,876,730 | 74,887,430 |
### Accounting classifications and fair values (continued)

<table>
<thead>
<tr>
<th>31-Dec-18</th>
<th>Held for trading</th>
<th>FVOCI</th>
<th>Amortised Cost</th>
<th>Others at amortised cost</th>
<th>Fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
<td>KShs'000</td>
</tr>
<tr>
<td><strong>Financial assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and balances with Central Bank of Kenya</td>
<td>-</td>
<td>-</td>
<td>7,365,179</td>
<td>-</td>
<td>7,365,179</td>
</tr>
<tr>
<td>Other assets</td>
<td>-</td>
<td>1,075,330</td>
<td>-</td>
<td>-</td>
<td>1,075,330</td>
</tr>
<tr>
<td>FVOCI Securities</td>
<td>-</td>
<td>32,488,123</td>
<td>-</td>
<td>-</td>
<td>32,488,123</td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>49,815</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>49,815</td>
</tr>
<tr>
<td>Placements with other banks</td>
<td>-</td>
<td>-</td>
<td>4</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>Balances due from foreign branches</td>
<td>-</td>
<td>-</td>
<td>16,164,847</td>
<td>-</td>
<td>16,164,847</td>
</tr>
<tr>
<td>Loans and advances to customers</td>
<td>-</td>
<td>-</td>
<td>26,883,651</td>
<td>-</td>
<td>26,883,651</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>49,815</td>
<td>32,488,123</td>
<td>51,489,011</td>
<td>0</td>
<td>84,026,949</td>
</tr>
<tr>
<td><strong>Financial liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits from banks</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>9,248,160</td>
</tr>
<tr>
<td>Deposits from customers</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>54,789,002</td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>27,691</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>27,691</td>
</tr>
<tr>
<td>Other liabilities-items in transit</td>
<td>-</td>
<td>-</td>
<td>2,164,248</td>
<td>-</td>
<td>2,164,248</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>27,691</td>
<td>-</td>
<td>66,201,410</td>
<td>66,229,101</td>
<td></td>
</tr>
</tbody>
</table>
6. FINANCIAL ASSETS AND LIABILITIES (Continued)

(a) Accounting classifications and fair values (continued)

The following sets out the branch’s basis of establishing fair value of the financial instruments:

**Derivative financial instruments**

Derivative financial instruments are measured at fair value as set out in Note 15.

**Cash and balances with Central Bank of Kenya**

The fair value of cash and bank balances with the Central Bank of Kenya is their carrying amount.

**Deposits and advances to banks**

The fair value of floating rate placements and overnight deposits is their carrying amounts.

**Loans and advances to customers**

Loans and advances to customers are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of future cash flows expected to be received, including assumptions relating to prepayment rates. Expected cash flows are discounted at current market rates to determine fair value. A substantial proportion of loans and advances reprice within 12 months and hence the carrying amount is a good proxy of the fair value.

**FVOCI Instruments**

FVOCI securities with observable market prices are fair valued using that information. The fair value is determined by discounting the securities using prevailing market rates.

**Deposits from banks and customers**

The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits without quoted market prices is based on discounting cash flows using the prevailing market.

A substantial proportion of deposits are within 6 months and hence the carrying amount is a good proxy of the fair value.
6. FINANCIAL ASSETS AND LIABILITIES (Continued)

(b) Valuation hierarchy

The valuation hierarchy, and types of instruments classified into each level within that hierarchy, is set out below:

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value determined using:</td>
<td>Unadjusted quoted prices in an active market for identical assets and liabilities</td>
<td>Valuation models with directly or indirectly market observable inputs</td>
<td>Valuation models using significant non-market observable inputs</td>
</tr>
</tbody>
</table>

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2019:

<table>
<thead>
<tr>
<th></th>
<th>30-Sept-19</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KShs’000</td>
<td>KShs’000</td>
<td>KShs’000</td>
<td>KShs’000</td>
</tr>
<tr>
<td>Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FVOCI Securities</td>
<td>-</td>
<td>42,320,306</td>
<td>-</td>
<td>42,320,306</td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>-</td>
<td>61,959</td>
<td>-</td>
<td>61,959</td>
</tr>
<tr>
<td>Total assets</td>
<td>-</td>
<td></td>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>42,382,265</td>
<td>42,382,265</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>-</td>
<td>10,700</td>
<td>-</td>
<td>10,700</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>-</td>
<td></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>10,700</td>
<td>-</td>
<td>10,700</td>
</tr>
<tr>
<td>31-Dec-18</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td></td>
<td>32,488,123</td>
<td>-</td>
<td>32,488,123</td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>-</td>
<td>49,815</td>
<td>-</td>
<td>49,815</td>
</tr>
<tr>
<td>Total assets</td>
<td>-</td>
<td>32,537,938</td>
<td>-</td>
<td>32,537,938</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivative financial instruments</td>
<td>-</td>
<td>27,691</td>
<td>-</td>
<td>27,691</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>-</td>
<td></td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
7. RELATED PARTY TRANSACTIONS

(a) Transactions with other Citibank branches and subsidiaries

In the normal course of business, transactions are entered into with other branches and subsidiaries of Citibank N.A, the parent company. During the year, the bank had recoveries/expenses/amounting to KShs 431,879,281 (2018 - KShs 559,845,340) to other Citibank branches and subsidiaries. These transactions were carried out at arm's length.

The balances due from Citibank foreign branches are as disclosed under Note 17.

(b) Key Management personnel Transaction

The Bank has entered into transactions with its employees:

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff loans to Key management</td>
<td>161,160</td>
<td>208,543</td>
</tr>
</tbody>
</table>

Interest earned on loans to key management amounted to KShs 6,735,122 (2018 - KShs 9,710,568).

Interest rates charged on balances outstanding from employees are determined by the Senior Human Resource Committee and are granted at a discounted market interest rate. The mortgages and secured loans granted are secured over property and other assets of the respective borrowers.

No impairment losses have been recorded against balances outstanding during the period with key management personnel, and no specific allowance has been made for impairment losses on balances with key management personnel at the reporting date.

(c) Key management compensation

Compensation of the Bank’s key management personnel includes salaries, bonuses, non-cash benefits and contributions for retirement benefits under a defined contribution plan. Some bank officers also participate in the Group’s share option programme.

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>short-term employee benefits;</td>
<td>182,734</td>
<td>213,273</td>
</tr>
<tr>
<td>other long-term benefits;</td>
<td>16,417</td>
<td>21,321</td>
</tr>
<tr>
<td>share-based payment.</td>
<td>4,943</td>
<td>11,381</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>204,094</strong></td>
<td><strong>245,975</strong></td>
</tr>
</tbody>
</table>
8. PARENT COMPANY

The Bank is a branch of Citibank N.A, a national banking association formed under the laws of the United States of America. The ultimate holding Bank of the parent is Citigroup Inc.

9. EVENT AFTER THE REPORTING PERIOD

There were no significant events after the reporting date.