smep Microfinance Bank

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER 2019

smepBank

52 WEEK SAVING CHALLENGE

CULTIVATE A SAVING CULTURE

POWERED BY SMEP

Grow your savings weekly and earn interests of 7%p.a

This is a saving challenge that aims at cultivating a saving culture among Kenyans through your SMEP savings account with an aim of reaching achieveble targets.

The aim is reaching achievable amounts of:

Ksh. 34,450
Ksh. 68,900
Ksh. 137,800 or MORE

by spreading it throughout the year.

For Enquiries call: 0711-606900

Regulated by CBK and Member, KDIC

CONTENTS

DIRECTORS

Dr. Nelson C. Kuria
Chairperson

Mrs. Violet Awori
Vice Chairperson

Mr. Symon Kamore
Managing Director

Canon Peter Karanja
Non Executive Director

Mr. Sam Awuor
Company Secretary

Ms. Jane Ngugi
Non Executive Director

Mr. Jenard Nyaga
Non Executive Director

Mr. Allan Ngugi*
Honorary Treasurer

* Deceased December 2019

CORPORATE INFORMATON

DIRECTORS

Dr. Nelson Kuria	Chairperson
Mrs. Violet Awori	Vice Chairperson
Mr. Allan Ngugi*	Honorary Treasurer
Mr. Symon Kamore	Managing Director
Rev. Canon Peter Karanja	
Mr. Sam Awuor	
Ms. Jane Wangari Ngugi	
Mr. Jenard Mwaniki Nyaga	

CREDIT COMMITTEE

Mrs. Violet Awori	Chairperson
Rev. Canon Peter Karanja	
Ms. Jane Wangari Ngugi	

AUDIT AND RISK COMMITTEE

Mr. Allan Ngugi*	Chairperson
Mr. Sam Awuor	
Rev. Canon Peter Karanja	

FINANCE AND STRATEGY COMMITTEE

Rev. Canon Peter Karanja	Chairperson
Dr. Nelson Kuria	
Mr. Allan Ngugi*	
Mrs. Violet Awori	
Ms. Jane Wangari Ngugi	
Mr. Jenard Mwaniki Nyaga	
Mr. Symon Kamore	

HUMAN RESOURCE AND GOVERNANCE COMMITTEE

Mr. Jenard Mwaniki Nyaga	Chairperson
Rev. Canon Peter Karanja	
Mr. Sam Awuor	
Mrs. Violet Awori	
Mr. Symon Kamore	

* Deceased December 2019

REGISTERED OFFICE

Kirichwa Road
LR No.2/187
P O Box 64063-00620
Nairobi

COMPANY SECRETARY

CS. Sam D. Awuor
P.O. Box 64063 - 00620
Nairobi.

PRINCIPAL BANKERS

The Co-operative Bank of Kenya Limited
China Centre, Ngong Road,
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KCB Bank Kenya Limited
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P O Box 30081-00100
Nairobi

Jamii Bora Bank Limited
Koinange Street Branch
P O Box 22741-00400
Nairobi

AUDITORS

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CHAIRMAN'S STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER 2019

Dear Esteemed Shareholders

It is with great pleasure that I present to you the Financial Statements and Annual Report for the period ended 31st December 2019. God has really seen us through yet another challenging year and our hard work and investments are now paying off. We significantly increased our profits before tax from a loss of Kshs 16 million in the year 2018 to a profit of Kshs 19.5 million in the year 2019. This shows that, amidst the tough economic environment, SMEP MF Bank's performance has continued to improve while at the same time making great inroads into the market.

An Extremely Tough Economic and Operating Environment in Year 2020

We began year 2020 with optimistic prospects of continued performance due to the projected growth in the national economy. Real GDP was projected to grow significantly in 2020 and in 2021. Equally, macroeconomic stability was expected to continue.

However, by the middle of March this year when the first case of corona virus was reported in our country, things took an extremely disruptive and totally unexpected turn occasioned by the emergence of the global COVID 19 pandemic. Since then, the pandemic has created a highly unstable operating environment and has continued to ravage national economies and all types of organizations. The Bank is trying to remain sustainable in a landscape characterized by a high level of uncertainty where both demand and supply chains have been greatly disrupted. The bright Prospects for this year have now completely waned amid the debilitating impact of the Covid-19 pandemic. By the end of March 2020, the government imposed a curfew nationally and closed non-essential social spaces to contain the spread of the virus which has hurt the domestic economy greatly. Starting from early April, growth reduced significantly, a situation that was further compounded by the advent of locust swarms threatening agricultural production. Depressed demand from Europe, Kenya's largest export market has sharply reduced the level of exports, while global lockdowns are crippling remittance inflows and tourism receipts. To cushion the economy from the impact of the blow, the government announced a fiscal stimulus package worth about 2.0% of GDP, including tax reliefs for consumers and businesses; cash transfers and food assistance; and increased healthcare spending. This will widen the fiscal deficit and pressure on government revenues, heightening the governments financing needs.

Growth is projected to reduce markedly this year as the full impact of the Covid-19 pandemic takes its toll on the economy. Global confinement measures will cripple the tourism sector and exports. Meanwhile, the threat of a second wave of locust swarms poses a further downside risk to agricultural production, which accounts for about a third of GDP.

On the flip side, and like they say, "Every cloud has a silver lining", as a matter of necessity and survival, microfinance institutions including our Bank, have been forced by circumstances to radically increase the pace of digital transformation. This will improve efficiency in service delivery and competitiveness. The financial institutions which will not embrace technology will perish. I am happy to inform our shareholders and our customers that we are among the leading microfinance institutions in embracing technological change.

Year 2021-2025 Strategic Plan

Our Strategic Plan for the period 2016-2020 is coming to an end at the end of this year. Despite the fact that the major transformation envisaged in the plan was not achieved due to the inability to raise the expected significant amount of capital, it is never the less heartening to note that the performance of the bank improved reasonably well within the plan period. The Bank has grown in terms of credibility and is now a more recognizable brand to potential customers and competitors. We are working on the next Strategic Plan for the period 2021-2025, which will further raise the Bank's profile to an even higher level.

In the financial sector, we are going to be the "next big thing."

Celebrating 10 years Milestone since becoming a Microfinance Bank

SMEP MF Bank is celebrating ten years since we got the license from the CBK to engage in deposit taking. This was a great milestone for us and notably, this license has seen us grow our market share to 5%, and as a result, we are now classified by the CBK as a Tier 1 Microfinance Bank, i.e., a Large Microfinance Bank. This is indeed a great achievement and it has substantially raised our profile in the marketplace. We have grown both our loan book and deposits in endeavor to increase our income. We have also grown phenomenally from a five (5) bank branch to a forty (40) bank branch. Our customer base has increased significantly as well as our staff numbers.

Regulatory Changes

The Central Bank of Kenya will now start vetting shareholders in microfinance banks owning at least a 10 percent stake, if proposed regulations seeking to boost governance are adopted. The regulator says in the draft Microfinance Bill, 2019 that people holding at least 10 percent stake will be regarded as significant shareholders. This is the first time the regulator has defined a significant owner of microfinance banks, and an upgrade of the current law that only limits individual ownership at 25 percent.

The Board is still looking for a strategic shareholder to enable the Bank increase its core capital, expand our outreach through expansion of branch network and digitization. The capital will also enable us to have more funds to increase our level of lending. We have received a number of offers, but we are careful in our choice of a strategic shareholder who understands the DNA of SMEP as opposed to others who would like to change who we really are. We have said, "Slow but sure."

	2016	2017	2018	2019
Total Income	569M	562M	653M	837M
Total Assets	2.65B	2.73B	2.94B	3.3B
Customer Deposits	1.45B	1.6B	1.9B	2.14B
Loans to Customers (net)	1.67B	1.67B	1.65B	1.68B
Net Profit before Taxes	(134.4M)	(31.9M)	(15.97M)	19.49M

"On the flip side, and like they say, "Every cloud has a silver lining", as a matter of necessity and survival, microfinance institutions including our Bank, have been forced by circumstances to radically increase the pace of digital transformation."

CHAIRMAN'S STATEMENT

The Board of Directors recommends that no dividend is paid for the year. Although we are increasing our profits gradually, we still need to invest more for bigger and better profits in the coming years. Furthermore, as you are also no doubt aware, the devastating effect of COVID 19 has reversed the gains in terms of profit in one blow.

CONCLUSION

Although our business is up against a number of challenges owing to the ongoing uncertainties brought about by the COVID 19 pandemic, we are confident in our ability to manage these risks, ensure recovery and continued growth, guided by our able MD Mr. Symon Kamore and his team of senior managers. The board under the leadership of the Chairman, Dr Nelson Kuria, will be on hand to offer the necessary advice and stewardship. These are extra-ordinary times that call for the very best in terms of teamwork and unity of purpose among all of us in SMEP MF BANK.

Looking ahead, we will continue to reinvent our business, invest in new areas of growth and realign our priorities to position SMEP MF BANK as a business that is fit for the future.

I'm always grateful to all shareholders for the faith you have in me as your Chair. I wish to thank all the board members; without their support, we couldn't have been here. It is important for me also to thank all our staff particularly for their commitment and tenacity during the prevailing very difficult period of COVID 19.

The journey of success is long and challenging, but I am confident that we shall make it.
Aluta continua!

Dr. Nelson C. Kuria, OGW, MBS, FmIoD

GENERAL SECRETARY'S STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER 2019

Greetings in the name of our Lord Jesus Christ. We do not take it for granted that all of us availed ourselves for this year's AGM. We appreciate your commitment and sacrifice. On behalf of NCCK, thank you very much.

God has been gracious to us that we are here celebrating another milestone for SMEP. We, once again recorded an improvement for the second year running. This is an indication that the strategies that were put in place are now working and we are now enjoying the fruits of our labour. I'd like specially to appreciate the Board, Management and Staff of SMEP for their hard work and input. However, going forward, we would like to see better profit margins, which will mean dividends for the shareholder. The sky is the limit. With God, all things are possible.

> **"We, once again recorded an improvement for the second year running.**
> **This is an indication that the strategies that were put in place are now working and we are now enjoying the fruits of our labour."**

NCCK has been in the process of shedding off some shares to get to the 25% threshold as directed by the regulator. ACK Diocese of Thika and the African Brotherhood Church are still in the process of acquiring substantial shareholding in SMEP. It is a slow but sure process. I'd like to encourage each and every one of you to continually purchase more shares, as this will substantially increase your bargaining power. Invest now for your future.

SMEP was founded by NCCK and as such, NCCK has an obligation of supporting SMEP. In this regards, we have now resolved to open and operate current accounts for all our businesses with SMEP. These include Jumuia Hotels, Jumuia Hospitals, Ufungamano Leadership Center and NCCK as a corporate body. We have to lead by example that we cannot expect profits from an organization we do not support. This has also been extended to all our service providers who have been encouraged to open operational accounts with SMEP to facilitate easier payment of goods and services provided.

SMEP has continuously come up with very innovative products that are geared towards supporting the Church as well as individual customers. You, the shareholders, have supported us greatly. However, it is my desire that all of us will support SMEP by operating at least one account. To our customers, your support is priceless. To the staff, we are banking on you big. We believe you can deliver. To the Church, we thank you for the tremendous support.

God bless you all

Rev. Canon Chris Kinyanjui Kamau
General Secretary of the National Council of Churches of Kenya (NCCK)

MD'S STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER 2019

2019 Financial Statements and Annual Report

It is with great pleasure that I present to you the SMEP Microfinance Bank Financial Statements and Annual report for the year ended 31st December 2019.

Dynamic Operating environment

Year 2019 was great for SMEP Microfinance Bank. However, it was not without challenges. Technology continued to disrupt the business of banking and the pressure to stay on top of the digital agenda was keenly felt. In addition, regulatory changes and evolving consumer preferences compelled us to continue understanding our customers' needs, evolve and execute on our strategy faster and with precision.

Impressive Financial Performance

Notwithstanding these pressures, the management team successfully steered the Bank to seize the opportunities that presented themselves in the market. As such, we turned in a strong performance. Total Net operating income grew by 22% and reached a new high of Shs. 609 Million, while Profit Before Tax (PBT) increased by 222%. This is despite an increase in Non-Performing Loans (NPL) coverage to 69% from 62% as we accelerated the recognition of exposures of non-performing assets. Our market share remained robust as we grew to a tier 1 Microfinance Bank and increased our Market share to over 5%. The impressive results for the year are very pleasing and a clear demonstration of our long-term efforts to establish a strong strategic framework and discipline in its execution. We have delivered a 28% growth in total revenue, 37% increase in interest income and a 12% growth in our balance sheet. This is a testament to the effectiveness of a focused management team and commitment to long term business sustainability and growth.

> **"We have delivered a 28% growth in total revenue, 37% increase in interest income and a 12% growth in our balance sheet."**

YEAR	2016	2017	2018	2019	Growth% (2018-2019)
Net Profit Before Taxes(Kshs M)	(146.4)	(120.1)	(15.97)	19.5	222%
Total Income(Kshs M)	569	563	653	837	28%
Customer Deposits (Kshs B)	1.45	1.61	1.90	2.14	13%
Total Assets(Kshs B)	2.66	2.73	2.94	3.30	12%
Loans To Customers (Net)(Kshsb)	1.68	1.68	1.65	1.68	2%

MD'S STATEMENT

In addition to the above impressive financial performance, the Bank complied with the liquidity requirements during the year. Our regulator CBK requires that we maintain a liquidity ratio of 20%. We were able to grow our average liquidity ratio from 22% in year 2018 to 31% in year 2019. Our customers now have more confidence in us.

Increased Visibility

SMEP Eldoret and Ngong branch were officially launched in 2019 and we can now see a significant growth in customer numbers, deposits as well as our loan book in those areas. Maua Branch was also refurbished into a modern branch so as to address the needs of our customers better. This has also solidified our position as a market leader in the greater Mt. Kenya region. Other branches that have been refurbished include Machakos and Thika.

Transforming Lives

We are still pushing for cheap deposits and also innovative ways for our customers to save. As such, the 52week saving challenge is still on course and as such, Kenyans can proudly say they are now able to save consistently as we have slowly cultivated a saving culture among Kenyans. We were able to mobilize over Ksh80m through the challenge in the year 2019.

The Digital Agenda

We successfully upgraded our core banking software to the latest version, T24-R18. This has greatly increased our capacity as a bank and the customer experience is now super. We are still unlocking some of the features within the system and this will greatly enhance our service delivery. The Bank will also roll out Pesa Link and digital lending services within the year.

Conclusion

With the outbreak of COVID 19, we expect a very challenging year 2020. Tens of thousands of consumers are now being placed under quarantine or lockdown. As a result, they might lose their ability to pay for credit. Also, business loans, especially to small and medium enterprises, are now at risk due to the forced shutdown. But entire Market segments such as Churches, travel and hospitality will be hard hit, as they will have no way to make up for the lost revenues in the future. These challenges notwithstanding, we remain committed to our purpose of transforming lives.

Finally let me take this opportunity to thank all our customers, staff, shareholders and stakeholders who have stood with us through thick and thin. My appreciation to the Board of Directors for their wise counsel, leadership and support. Without you all, SMEP MF Bank would not be where it is. God bless!

Thank you.

Symon Kamore, CPA, MBA, B.Ed (Sci), CISA

REPORT OF THE DIRECTORS

The Directors submit their report and the audited financial statements for the period ended 31 December 2019, which show the state of SMEP Microfinance Bank Limited (the "company")

1. INCORPORATION

Company is incorporated in Kenya under the Companies Act. It is a public limited liability company domiciled in Kenya. The address of the registered office is as set out on page 1.

2. PRINCIPAL ACTIVITY

The company's mission is to improve quality of life of our customers through the provision of competitive market driven financial solutions. The principal activity of the company is to provide microfinance services through provision of loans and other financial services to the public.

3. RESULTS FOR THE YEAR	2019 Shs	2018 Shs
Net Profit / (Loss) before taxation	19,491	(15,977)
Taxation credit (Charge)	(13,217)	2,510
Profit / (Loss) for the year transferred to retained earnings	6,274	(13,467)

4. BUSINESS REVIEW

Kenya's Banking Industry

The Kenyan banking sector remained stable and resilient in 2019. The average commercial banks' liquidity and capital adequacy ratios stood at 49.7% and 18.8% respectively in December 2019. The ratio of Gross Non-Performing loans (NPLs) to gross loans declined to 12.0% in December 2019 from 12.3% in October 2019. There were decreases in NPLs in trade, real estate, financial services, manufacturing and personal/household sectors, reflecting repayments date due to enhanced recovery efforts by banks as well as write-offs (Central Bank of Kenya, 2019).

Overall inflation increased to 5.8 percent in December 2019 from 5.6 percent in November but remained within expectations. Continued increase in microlenders have infiltrated the microfinance banks' client base which had caused the core capital to risk-weighted assets ratio decreasing from 20 per cent in June 2017 to 18 per cent in June 2018, which was above the minimum requirement of 10 per cent.

Technological disruptions in the Kenyan market have affected the financial services sector in recent years. As underlined by data from the Central Bank of Kenya (CBK), mobile money is the most significant factor indicating that the value of mobile transactions has grown at a CAGR of 66.3% since inception in 2007, from Kshs 14.8 billion of transaction volume to Kshs 4.0 trillion of transaction volume.

Company Review

SMEP Microfinance Bank Limited has maintained a steady growth over the recent years leading to an increase in market share by 0.6 percent from 3.6% in 2017 to 4.2% in 2018 hence moving from tier II to tier I in the microfinance sector (Central Bank of Kenya, 2019).The overall bank performance improved over the period from December 2018 to December 2019 with total assets and customer deposits increasing by 12% and 13% respectively. Profit before tax also grew by 222% which is a significant improvement.The bank has become steadfast in innovations indicated by the successes in running with the "52 Weeks Savings Challenge", "Chunga Mchungaji" and "Ushirika Fanisi" products during the year. These had contributed significantly to the growth in Key Performance Parameters during the period.

REPORT OF THE DIRECTORS

Future Outlook

As the company continues to position itself as a significant player in the banking sector, it strives to continue partnering with churches as well as integrating digital technology into the banking business both tailored to focus on fundamental continuous improvements in operations and value delivery to its customers. The bank also continues to rely on technology to reduce operational costs and hence drive up efficiency as well as implement cost cutting and monitoring strategies to eliminate operational leakages and waste while converging on improved customer experience.

With resilience on the Kenyan economy indicated from real GDP growth by 5.4% in the first three quarters of 2019, the resultant macroeconomic stability and growth of MSMEs, the company anticipates a stronger growth in 2020. The bank will also continue with the targeted strategy towards increasing non-funded income and interest income through focus on high yielding short term credit facilities.

Business disruptions arising from the effects of Corona Virus have already been experienced in the first quarter of 2020. While the governments the world over are doing their best to manage and arrest the situation, it may be too early to express any opinion as to the disruptions that lie ahead. The shareholders are nevertheless assured that the Board will position itself to address the emerging challenges.

5. DIVIDENDS

The Directors do not recommend the payment of dividends in respect of the year ended 31 December 2019 (2018: Nil)

6. FINANCIAL STATEMENTS

At the date of this report, the directors were not aware of any circumstances which would have rendered the values attributed to the assets in the financial statements misleading.

7. ACCUMULATED LOSSES

The accumulated losses of the company are set out in note 29 to these financial statements.

8. DIRECTORS

The Directors who held office during the year and to the date of this report are listed on page 1.

9. CORPORATE GOVERNANCE STATEMENT

SMEP Microfinance Bank Limited is committed to the standards of world-class corporate governance as set in Microfinance Act 2006, Kenya Companies Act, the Central Bank of Kenya and by itself in conformity to the international Best Practice.

The Board of Directors is responsible for the long-term direction for the profitable growth of the company whilst being accountable to the shareholders for legal compliance and maintenance of the highest corporate governance standards and business ethics.

REPORT OF THE DIRECTORS

9. CORPORATE GOVERNANCE STATEMENT (continued)

Board Committees

The Board is responsible for drawing and implementing strategies for the success of the company, establishing and maintaining the company's system of internal controls so that the objectives of profitability and sustainable growth and shareholders' value growth are fully realized.

The day-to-day running of the business of the company is delegated to the MD but the notices and agenda for all board meetings are circulated on timely basis to all directors together with other relevant reports for discussion.

The Board is made up of 7 non-executive directors and 1 executive director i.e Managing Director.

1. Dr. Nelson Kuria - Chairperson
2. Mrs. Violet Awori - Vice Chairperson
3. Mr. Allan Ngugi * - Honorary Treasurer
4. Rev. Canon P. Karanja
5. Mr. Sam Awuor
6. Ms. Jane Wangare Ngugi
7. Mr. Jenard Mwaniki Nyaga
8. Mr. Symon Kamore - Managing Director

Board Meetings

The Board of Directors meets on quarterly basis to monitor the implementation of the company's planned strategy, review it in conjunction with its financial and budgetary performance and approve issues of strategic nature. Specific reviews are also undertaken on operational issues and future planning. The Board held 4 meetings during the year under review.

Board Committees

The Board has constituted committees which meet regularly namely Audit and Risk Management Committee, Finance and Strategy Committee, Human Resource and Governance Committee and Credit Committee. The terms of reference for each committee are well set by the board and reviewed regularly.

(a) Audit and Risk Committee

The Audit Committee meets on quarterly basis. The Committee comprises 3 non-executive members of the Board who are independent of the day-to-day management of the company's operations.

The following are the members of the committee:

1. Mr. Allan Ngugi * Chairperson
2. Rev. Canon P. Karanja Member
3. Mr. Sam Awuor Member

The Head of Internal Audit is the secretary to the committee. The committee;

a. Reviews and monitors the integrity of the company's annual and interim financial statements.

b. Considers the appropriateness of the company's accounting policies and procedures.

c. Monitors and assesses the role and effectiveness of the internal audit function.

d. Deals with matters relating to appointment, remuneration and resignation or dismissal of external auditors.

e. Ensures implementation of the ERM Framework in a systematic, timely and effective manner.

f. Reviews, monitors, interrogates and reports to the Board on the risk management information, with references to Key Risk Indicator (KRI) information.

The committee held 4 meetings during the year under review.

* Deceased December 2019

CORPORATE GOVERNANCE

(b) Credit Committee

The Committee meets on quarterly basis or as required to review the credit risk profile of the company and recommend for Board approval policies and standards for the credit risk governance and management.

The committee comprises the following directors:

1. Mrs. Violet Awori - Chair person
2. Rev. Canon P. Karanja
3. Ms. Jane Ngugi

The Head of credit is the secretary to the committee.

The committee;

a. Reviews and oversees the overall credit policy.

b. Considers all loan applications above the management lending limits.

c. Handles all matters relating to credit risk management.

The committee held 4 meetings during the year under review.

(c) Finance and Strategy Committee

This Committee meets on a quarterly basis whose mandate is to support the board in driving strategy to ensure achievement of the company's financial and other goals.

The committee is comprised of the following directors:

1. Rev. Canon P. Karanja - Chair person
2. Dr. Nelson Kuria
3. Mrs. Violet Awori
4. Mr. Allan Ngugi *
5. Mr. Symon Kamore
6. Ms. Jane Ngugi
7. Mr. Jenard Nyaga

The mandate of the committee is:

a. To review, oversee the implementation of, and make recommendations to the full board regarding all the aspects of the SMEP Strategic plan.

b. Review the relevance and progress of the current strategy.

c. To monitor and review the performance of the bank against targets.

d. To review transformation proposals for the business.

The committee held 4 meetings during the year under review.

(d) Governance and Human Resource Committee

The Governance and HR committee is constituted to ensure the company's greatest asset (human resource) is well managed and that the company and its directors embrace good corporate governance in all their dealings.

The committee is comprised of the following directors:

1. Mr. Jenard Mwaniki Nyaga - Chairperson
2. Rev. Canon P. Karanja
3. Mr. Sam Awuor
4. Mrs. Violet Awori
5. Mr. Symon Kamore

The mandate of the committee is:

a. To review and monitor the implementation of the human resource policies and strategy in the organization.

b. To review the implementation of the Performance Management Tool.

c. To review and monitor the implementation of staff welfare especially on the Employee Share Ownership Plan.

d. To ensure that the staff pension scheme is properly administered.

The committee held 4 meetings during the year under review.

(a) Monitoring and Evaluation

The directors have a wide range of skills and experience and each contributes independent judgement and knowledge to the Board's discussion. They have developed self-assessments to monitor their roles and effectiveness in leading SMEP Microfinance Bank Limited to maximize performance in light of the future strategy.

(b) Appointment of the Managing Director

The Managing Director is the accounting officer of SMEP Microfinance Bank Limited and is appointed by the Board with prior approval of the Central Bank of Kenya.

(c) Reckless and fraudulent activities

SMEP Microfinance Bank Limited has not allowed a credit facility or guarantees to be outstanding, incurred and liability, entered into any contract or transaction or conducted its business or part thereof in a fraudulent or reckless manner detrimental to the interest of depositors or the general public.

(d) Schemes of arrangement
No scheme of arrangement has been entered with our creditors.

(e) Restrictions on trading investments
SMEP Microfinance Bank Limited has not acquired or held, directly or indirectly, any part of the share capital of:- or have a beneficial interest in any financial, commercial, agricultural, industrial or other undertaking, where the value of SMEP Microfinance Bank Limited's interest exceeds twenty five percent (25%) in the aggregate of her core capital.

(f) Single borrower limit
SMEP Microfinance Bank Limited has extended one loan exceeding 5% of her core capital to a single end-user-borrower. The loan was performing as at the year end.

(g) Insider lending limits
SMEP Microfinance Bank Limited has not extended any advance or credit facility exceeding two percent (2%) of her core capital to significant shareholders and her directors.

(h) Know your customer requirements
The management of SMEP Microfinance Bank Limited has: -
i. Maintained proper identification of customers wishing to open accounts or make transactions or to an engagement directly or indirectly through proxy.
ii. Maintained adequate and accurate records for a minimum of seven years regarding its customers, sources of funds and transactions.

4. BOARD AND BOARD COMMITTEES ATTENDANCE REGISTER

	Board	AGM	Audit and Risk committee	Credit committee	Finance and Strategy	HR and Governance
No. of meetings held						
Dr. Nelson Kuria	8	1	n/a	n/a	4	n/a
Mrs. Violet Awori	8	1	n/a	14	4	4
Rev. Canon Peter Karanja	5	1	3	7	3	4
Mr. Allan Ngugi	7	1	5	n/a	4	n/a
Mr. Jernard M. Nyaga	8	1	n/a	n/a	4	4
Mrs. Jane W. Ngugi	8	1	n/a	14	4	n/a
Mr. Sam Awuor	8	1	5	n/a	n/a	4
Mr. Symon Kamore	n/a	1	n/a	n/a	4	4

Management Committees
Management has constituted the Assets and Liabilities Committee which meets regularly. The terms of reference for each committee are well set by the management.

Assets and Liabilities Committee
The Assets and Liabilities Committee which meets on a quarterly basis. The composition of the ALCO Committee of SMEP Microfinance Bank Limited consist of: -

1. Managing Director
2. Head of Finance and Strategy
3. Head of Business Development
4. Head of Human Resource & Administration
5. Chief Accountant
6. Team Leader Risk & Compliance
7. Head of Credit

CORPORATE GOVERNANCE

The Chief Accountant is the secretary for the committee. The Committee;
a. Reviews local and national economic forecasts.
b. Reviews and assesses the integrity of the internal and risk control systems;
c. Ensure that the risk policies and strategies are effectively managed;
d. Sets out the nature, role, responsibility and authority of the risk management function of SMEP Microfinance Bank Limited.
e. Provide an independent and objective oversight and review of the information raised by the management at different levels.
f. Monitors limits on loans to deposit and loans to capital ratios as well as the percentage on a deposit category as set by the board.
g. Monitors levels of maximum and minimum maturities for all categories of assets and liabilities as set by the board.
h. Monitors limits of the sensitivity of the net interest margin on changes in the market interest rates as set by the board;
i. Monitors maximum percentage imbalance between rates and sensitive assets and liabilities as set by the board.
j. Monitors limits of minimum liquidity provisions to be maintained to sustain operations while longer time adjustments are set by the board;
k. Monitors limits of minimum spread acceptable between costs and yields of liabilities and assets as set by the board;
l. Monitors source of funds;
m. Monitors SMEP Microfinance Bank Limited's policies, procedures and holding portfolios to ensure that it achieves its goals;
n. Generally, implements the funds management policy of SMEP Microfinance Bank Limited; and
o. Review an explanation of any known exceptions to this policy as well as an action plan and timetable to bring SMEP Microfinance Bank Limited into compliance with such policy limits.

10. Statement as to disclosure to the company auditor
Each of the persons, who was a director at the time the report was approved confirms that:
(a) There is, so far as the person is aware, no relevant audit information of which the company's auditor is unaware;
(b) The person has taken all the steps that the person ought to have taken as a director to be aware of any relevant audit information to establish that the company's auditor is aware of that information.

11. Directors' benefits
The company started its operations as a Microfinance Bank in 2015. During the year under review, directors were only paid sitting allowance.

12. Auditor
The company's auditor Mazars Certified Public Accountants (K) were appointed in the year and has indicated willingness to continue in office in accordance with the section 717 of The Companies Act, 2015.

By order of the board

Chairman

27 March 2020
Date

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act and the Microfinance Act requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company as at the end of the financial year and of its operating results for that year. The two Acts of parliament require the directors to ensure that the company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the company. The directors are also responsible for safeguarding the assets of the company.
The directors accept responsibility for the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error. They also accept responsibility for:

i). Designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements;
ii). Selecting and applying appropriate accounting policies; and
iii). making accounting estimates and judgements that are reasonable in the circumstances.

The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the company as at 31 December 2019 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act.
Having assessed the company's ability to continue as a going concern, the directors are not aware of any material uncertainties related to events or conditions that may cast doubt upon the company's ability to continue as a going concern. The directors are therefore of the view that the company will remain a going concern for at least the next twelve months from the date of this statement.

Approved by the Board of Directors on 27 March 2020 and signed on its behalf by:

Board Chairman

Director

INDEPENDENT AUDITORS' REPORT

Opinion

We have audited the accompanying financial statements of SMEP Microfinance Bank Limited, set out on pages 15 to 57, which comprise the statement of financial position as at 31 December 2019, the statements of comprehensive income, changes in equity and cash flows for the year that ended, and notes, including a summary of significant accounting policies.

In our opinion the accompanying financial statements give a true and fair view of the financial position of the company as at 31 December 2019 and of its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015.

Basis for opinion

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

Our audit approach

Overview

Key audit matters in the audit process and professional judgement was excised in determining the materiality, audit scope and sampling. These areas are summarised as below:

Materiality	In determining our materiality, the total assets were considered as the suitable benchmark, as the microfinance bank business line is on issue of Loans and has been in a loss-making position.
Scope	We audited the financial statements of the Bank for the year under review.
Area of Focus	The key areas the audit excise focused on were: . Compliance with IFRS 9 model · IT systems and controls

Key audit matters

1.Impairment of loans to customers.

See Accounting policy Note 1 on Financial Instruments.

Key audit matter

On 1 January 2018, the Company adopted IFRS 9 Financial Instruments, resulting in impairment charges being recognised when losses are expected rather than when they are incurred. Impairment of loans and advances to customers is considered a key audit matter because the directors make complex and subjective judgments over both timing of recognition of impairment and the estimation of the size of any such impairment.

The information regarding the effect of this standard are disclosed in accounting policy notes 1.

The key areas where we identified greater levels of management judgement and therefore increased levels of audit focus in the implementation of IFRS 9 are:

i) Significant Increase in Credit Risk ('SICR') - The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12-month or lifetime expected credit loss is assessed.

ii) Classification and measurement of financial instruments as well as Expected Credit Loss (ECL) modelling - Judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD') and ultimately the Expected Credit Loss (ECL). The PD models used in the different loan portfolios are the key drivers of the Group's ECL results and are therefore most significant judgmental aspect of the Group's ECL modelling approach.

INDEPENDENT AUDITORS' REPORT

ii) Relevance and reliability of data used for ECL measurement - Judgement was applied in assessing the persuasiveness and reliability of the data in contributing assurance over the accuracy and completeness of the loans.

How the matter was addressed

Reviewing management's judgment around the classification and measurement of financial assets and significant increase in credit risk.

Reviewing the ECL model for compliance with the principles of IFRS 9 as well as ensuring consistency with the prior year application.

Evaluating key data inputs and assumptions impacting ECL calculations to assess the reasonableness of and PD assumptions applied.

Selecting a sample of facilities from the Group's loan book and performing tests to establish whether significant facilities are correctly staged/classified.

Assessing whether the disclosures appropriately disclose the key judgements and assumptions used in determining the expected credit losses.

Reviewing the data and assumptions made by management in arriving at the provisions and recomputing the trade receivables provision based on the accounting policy

IT systems and environment

We identified the IT system and controls over financial reporting as an area of focus as the microfinance's financial accounting. Financial reporting system is heavily dependent on a system (Temenos - T24 R18) which was upgraded in the year from (Temenos - T24 R08). We did not have access to the core banking system, our interactions with the management though indicated that procedures were automated and effectively designed. However, we noted that deletion of active users from the system was not timely done to leavers and change management procedures were not available and also a cyber-security attack happened in the year. Additionally the system upgrade had unsolved reconciliations of 19 million which had not been addressed by the audit date.

Other information

The directors are responsible for other information. Other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report thereon.

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

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

Directors' responsibility for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

INDEPENDENT AUDITORS' REPORT

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

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

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

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

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

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

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

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

Report on other legal requirements

As required by the Kenyan Companies Act, we report to you, based on our audit, that:

i) We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;

ii) In our opinion, proper books of account have been kept by the company, so far as appears from our examination of those books; and

iii) The company's statement of financial position and statement of comprehensive income are in agreement with the books of account.

The engagement partner responsible for the audit resulting in this independent auditor's report was CPA Evanson Ngang'a, P/No. 2146.

MAZARS

MAZARS Certified Public Accountants

Nairobi, Kenya.

27 March 2020.

smep Bank Microfinance

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	2019 Ksh '000	2018 Ksh '000
Interest income	5	705,120	514,501
Interest expense	6	(228,649)	(152,665)
Net interest income		**476,471**	**361,836**
Fee income	7	56,188	56,420
Other operating income	8	75,866	82,913
Foreign exchange losses - net		550	(164)
Operating income		**609,075**	**501,005**
Expenses			
Administration and operating expenses	9	504,773	(512,067)
Impairment losses on financial assets at amortised costs	15	72,480	(4,915)
Finance Cost	20	12,331	-
		589,584	**516,982**
Profit/(loss) before tax		19,491	(15,977)
Taxation	11	(13,217)	2,510
Profit/(loss) after tax		**6,274**	**(13,467)**
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss			
Gain on revaluation of property		-	30,000
Deferred tax attributable to gain on revaluation of property		-	(9,000)
Other comprehensive income for the year, net of tax		-	21,000
Total comprehensive income/(loss) for the year		**6,274**	**7,533**

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2019

	Note	2019 Ksh '000	2018 Ksh '000
ASSETS			
Cash and bank balances		287,467	211,936
Deposits with banks	12	352,893	346,293
Loans to customers	13	1,682,315	1,647,359
Cash balances with Central Bank of Kenya	15	117,648	100,709
Tax recoverable	11(c)	24,145	27,319
Other assets	16	225,352	86,806
Intangible assets	17	44,144	29,490
Property and equipment	18	432,895	430,161
Right of use asset	20	98,730	-
Deferred taxation	19	48,361	61,578
TOTAL ASSETS		**3,313,950**	**2,941,651**
LIABILITIES			
Customer deposits	22	2,143,119	1,895,977
Borrowings	23	480,845	486,689
Lease Liability	20	116,564	-
Other liabilities	25	69,360	45,701
		2,809,888	**2,428,367**
EQUITY			
Share capital	26	542,976	541,392
Share premium	26	2,354	2,354
Funds awaiting allotment	27	28,625	29,272
Accumulated losses		(224,143)	(213,984)
Revaluation surplus		154,250	154,250
Shareholders' equity		**504,062**	**513,284**
TOTAL LIABILITY AND EQUITY		**3,313,950**	**2,941,651**

The financial statements on pages 13 to 66 were approved and authorised for issue by the board of directors on 27 March 2020 and were signed on its behalf by:

Board Chairman..... Director..... Managing Director.....

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2019

	Share capital Shs'000	Share premium Shs'000	Funds awaiting allotment Sh'000	Revenue Reserves Shs'000	Revaluation surplus Shs'000	Statutory reserve Shs'000	Total Shs'000
Balance at 1 January 2019	541,412	2,354	29,252	(213,984)	154,250	-	513,284
Transition Adjustment	-	-	-	(16,433)	-	-	(16,433)
Issued Shares	1,564	-	(1,564)	-	-	-	-
Share Premium Adjustment	-	-	-	-	-	-	-
Unalloted Members contribution	-	-	937	-	-	-	937
Profit for the year	-	-	-	6,274	-	-	6,274
Transfer from statutory reserve	-	-	-	-	-	-	-
	542,976	**2,354**	**28,625**	**224,143**	**154,250**	**-**	**504,062**
Share subscriptions received	-	-	461	-	-	-	461
Balance at 31 December 2018	**540,859**	**2,354**	**22,161**	**(217,189)**	**133,250**	**19,471**	**501,366**
Balance at 1 January 2018	540,859	2,354	22,621	(217,189)	133,250	19,471	501,366
Transition adjustment (note 1)	-	-	-	(2,799)	-	-	(2,799)
Loss for the year	-	-	-	(13,467)	-	-	(13,467)
Other comprehensive income for the year	-	-	-	-	21,000	-	21,000
Allotted shares	553	-	(553)	-	-	-	-
Share subscriptions received	-	-	7,184	-	-	-	7,184
Transfer from statutory reserve	-	-	-	19,471	-	(19,471)	-
Balance at 31 December 2018	**541,392**	**2,354**	**29,252**	**(213,984)**	**154,250**	**-**	**513,284**

The statutory reserve related to the excess provisions for impairment of loans and advances as computed per the Kenyan Microfinance Act, 2006 over the loans and advances impairment provisions as computed in accordance with IFRS 9 on financial instruments. The statutory reserve is not distributable.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2019

	2019 Kshs '000'	2018 Kshs '000'
Profit/(loss) after tax	**19,491**	**(15,977)**
Adjustment for:		
Depreciation - Property and equipment	26,960	26,607
Depreciation - ROU	35,248	-
Amortisation of computer software	22,171	14,407
Loss/(gain) on disposal of property and equipment	-	(531)
Revolving fund written back	-	(13,600)
Impairment losses on financial assets at amortized costs	(7,621)	7,751
Working capital changes:		
Decrease in loans to customers	(34,956)	29,421
(increase)/Decrease in other assets	(138,546)	5,261
Increase in customer deposits	247,142	288,844
Increase/(decrease) in other liabilities	23,659	(540)
(Increase)/decrease in cash reserve ratio – CBK	(16,939)	(19,810)
Day adjustment - impact of IFRS 9	(16,433)	(2,799)
Cash generated from operations	**160,176**	**319,034**
Taxation paid	(377)	-
Net cash generated from operating activities	**159,798**	**319,034**
Cash flows from investing activities		
Proceeds from disposal of asset	-	533
Payments for right-of-use assets	(43,623)	-
Purchase of intangible assets	(34,783)	(9,796)
Purchase of property and equipment	(30,413)	(41,045)
Net cash used in investing activities	**(108,819)**	**(50,308)**
Cash flows from financing activities		
Loans received	-	139,897
Loans repaid	(51,238)	(174,933)
Payments of principal portion of the lease liability	-	-
Interest paid on lease liabilities	12,331	-
Funds awaiting allotment	937	7,184
Net cash generated from financing activities	**4,907**	**27,852**
At start of year	**565,980**	**325,106**
At end of year	**578,989**	**565,980**

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of these financial statements are set out below.

a) Basis of preparation

The financial statements are prepared on a going concern basis in compliance with International Financial Reporting Standards (IFRS). They are presented in Kenya Shillings (Kshs), which is also the functional currency, rounded to the nearest shilling. The measurement basis used is the historical cost basis except where otherwise stated in the accounting policies below;

The financial statements comprise a profit and loss account (income statement), statement of comprehensive income, balance sheet (statement of financial position), statement of changes in equity, statement of cash flows, and notes to the financial statements. Income and expenses, excluding the components of other comprehensive income, are recognised in the profit and loss account. Other comprehensive income is recognised in the statement of comprehensive income and comprises items of income and expense (including reclassification adjustments) that are not recognised in the profit and loss account as required or permitted by IFRS. Reclassification adjustments are amounts reclassified to the profit and loss account in the current period that were recognised in other comprehensive income in the current or previous periods. Transactions with the owners of the company in their capacity as owners are recognised in the statement of changes in equity.

New standards, amendments and interpretations adopted by the company

International Financial Reporting Standard 16 (IFRS 16): Leases

From 1 January 2019, to comply with IFRS 16, Leases, which replaced IAS 17, the company now recognises lease liabilities relating to leases under which the company is the leases that had previously been classified as operating leases (other than leases with less than 12 months to run from 1 January 2019 and leases of low value items). Such liabilities have been measured at 1 January 2019 at the present value of the remaining lease payments discounted using the group's incremental borrowing rate as at 1 January 2019. Corresponding right-of-use assets have been recognised, measured as if the company's new accounting policy (see Note 1(q)) had been applied since the commencement of each lease but discounted using the company's incremental borrowing rate as at 1 January 2019. The difference between the lease liabilities and right-of-use assets at 1 January 2019 has been recognised as an adjustment to retained earnings at that date.

As permitted by the transition provisions in the new standard, comparative amounts have not been restated. The company's accounting policy for leases under which the company was lessee was, up to 31 December 2018, as follows:

Leases of property, plant and equipment including hire purchase contracts where the company assumes substantially all the risks and rewards incidental to ownership are classified as finance leases. Finance leases are recognised as a liability at the inception of the lease at the lower of the fair value of the leased assets and the present value of the minimum lease payments. The interest rate implicit in the lease is used as the discount factor in determining the present value. Each lease Property, plant and equipment acquired under finance leases are capitalised and depreciated over the estimated useful life of the asset.

Leases of assets where a significant proportion 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 profit or loss on a straight-line basis over the lease period. Prepaid operating lease rentals are recognised as assets and are subsequently amortised over the lease period.

The measurement of assets and liabilities that were recognised as finance leases under the previous accounting policy has continued unchanged, but the assets have been reclassified from Property, plant and equipment to Right-of-use assets (see Notes 18 and 19). Right-of-use assets and lease liabilities in respect of operating leases (excluding leases with a term, on commencement, of 12 months or less and leases for which the underlying asset is of low value) in force at 1 January 2019 have been recognised in accordance with the transition requirements of IFRS 16, as described above.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

The resulting adjustment passed at 1 January 2019 as a result of applying IFRS 16, was as follows:

	Kshs '000'
Lease liabilities	117,387
Right-of-use assets	133,820
Net adjustment to retained earnings at 1 January 2019	**(16,433)**

(b) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

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

(c) Application of new and revised IFRSs

(i) New and amended IFRS Standards that are effective for the current year ended 31 December 2018.

Impact of initial application of IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

As permitted by IFRS 9, the company has elected to continue to apply the hedge accounting requirements of IAS 39.

As a result of the adoption of IFRS 9, the company has adopted consequential amendments to IAS 1 Presentation of Financial Statements, which require separate presentation in the statement of profit or loss and OCI of interest revenue calculated using the effective interest method. Previously, the Company disclosed this amount in the notes to the financial statements.

Additionally, 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 company'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 2.

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.

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.

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.

Impact of initial application of IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some

contracts to buy or sell non-financial items. This standard replaces IAS 39 Financial Instruments: Recognition and Measurement. The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

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The key changes to the company'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 2.

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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.

a) Recognition and Initial Measurement
The company initially recognises loans and advances, deposits and subordinated liabilities on the date on which they are originated. All other financial instruments are recognised on the trade date, which is the date on which the company becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue

b) Classification
Financial assets – Policy applicable from 1 January 2018
On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.
A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are Solely Payments of Principal and Interest (SPPI).

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

Business model assessment

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

The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;

- How the performance of the portfolio is evaluated and reported to the Bank's management;

- The risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;
-
- How managers of the business are compensated (e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected); and

- The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

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

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

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

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

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse loans);
- Features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Bank holds a portfolio of long-term fixed-rate loans for which the Bank has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Bank has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Non-recourse loans

In some cases, loans made by the Bank that are secured by collateral of the borrower limit the Bank's claim to cash flows of the underlying collateral (non-recourse loans). The Bank applies judgment in assessing whether the non-recourse loans meet the SPPI criterion. The Bank typically considers the following information when making this judgement:

- Whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- The fair value of the collateral relative to the amount of the secured financial asset;
- The ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- Whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- The Bank's risk of loss on the asset relative to a full-recourse loan;

- The extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- Whether the Bank will benefit from any upside from the underlying assets.

Contractually linked instruments

The Bank has some investments in securitisations that are considered contractually linked instruments. Contractually linked instruments each have a specified subordination ranking that determines the order in which any cash flows generated by the pool of underlying investments are allocated to the instruments. Such an instrument meets the SPPI criterion only if all of the following conditions are met:

- The contractual terms of the instrument itself give rise to cash flows that are SPPI without looking through to the underlying pool of financial instruments;
- The underlying pool of financial instruments (i) contains one or more instruments that give rise to cash flows that are SPPI; and (ii) may also contain instruments, such as derivatives, that reduce the cash flow variability of the instruments under (i) and the combined cash flows (of the instruments under (i) and (ii)) give rise to cash flows that are SPPI; or align the cash flows of the contractually linked instruments with the cash flows of the pool of underlying instruments under (i) arising as a result of differences in whether interest rates are fixed or floating or the currency or timing of cash flows; and
- The exposure to credit risk inherent in the contractually linked instruments is equal to or less than the exposure to credit risk of the underlying pool of financial instruments.

Reclassifications

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

Impact of application of IFRS 15 Revenue from Contracts with Customers

In the current year, the company has applied IFRS 15 Revenue from Contracts with Customers (as amended in April 2016) which is effective for an annual period that begins on or after 1 January 2018. IFRS 15 introduced a 5-step approach to revenue recognition. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Details of the new requirements as well as their impact on the company's financial statements are described below.

The company has applied IFRS 15 in accordance with the fully retrospective transitional approach without using the practical expedients for completed contracts in IFRS 15:C5(a), and (b), or for modified contracts in IFRS 15:C5(c) but using the expedient in IFRS 15:C5(d) allowing both non-disclosure of the amount of the transaction price allocated to the remaining performance obligations, and an explanation of when it expects to recognise that amount as revenue for all reporting periods presented before the date of initial application, i.e. 1 January 2018.

IFRS 15 uses the terms 'contract asset' and 'contract liability' to describe what might more commonly be known as 'accrued revenue' and 'deferred revenue', however the Standard does not prohibit an entity from using alternative descriptions in the statement of financial position. The company has adopted the terminology used in IFRS 15 to describe such balances.

The company's accounting policies for its revenue streams are disclosed in detail below. Apart from providing more extensive disclosures for the company's revenue transactions, the application of IFRS 15 has not had a significant impact on the financial position and/or financial performance of the company.

ii) New and revised IFRS Standards in issue but not yet effective

At the date of authorisation of these financial statements, the company has not applied the following new and revised IFRS Standards that have been issued but are not yet effective and in some cases had not yet been adopted by the:

New standards and Amendments to standards	Effective on or after
Amendments to IAS 19 Employee Benefits	1 January 2019
IFRIC 23 Uncertainty over income tax	1 January 2019
Annual Improvements to IFRS Standards 2015–2017	1 January 2019

At the date of authorisation of these financial statements, the company has not applied the following new and revised IFRS Standards that have been issued but are not yet effective:

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

IFRS 16 Leases
General impact of application of IFRS 16 Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related Interpretations when it becomes effective for accounting periods beginning on or after 1 January 2019. The date of initial application of IFRS 16 for the company will be 1 January 2019.

Leases and the related Interpretations when it becomes effective for accounting periods beginning on or after 1 January 2019.

January 2019. The date of initial application of IFRS 16 for the company will be 1 January 2019.

The company has chosen the modified retrospective application of IFRS 16 in accordance with IFRS 16:C5 (b). Consequently, the company will restate the comparative information. In contrast to lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.

Impact of the new definition of a lease

The change in definition of a lease mainly relates to the concept of control. IFRS 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has:

- The right to obtain substantially all of the economic benefits from the use of an identified asset; and
- The right to direct the use of that asset.

The company will apply the definition of a lease and related guidance set out in IFRS 16 to all lease contracts entered into or modified on or after 1 January 2019 (whether it is a lessor or a lessee in the lease contract). In preparation for the first-time application of IFRS 16, the company is in the process of carrying out an implementation project. The directors of the company anticipate IFRS 16 will be adopted in the company's financial statements for the annual period beginning 1 January 2019. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until a detailed review has been completed.

Impact on Lessee Accounting
Operating leases
IFRS 16 will change how the company accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

On initial application of IFRS 16, for all leases (except as noted below), the company will:

a) Recognise right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments;

b) Recognise depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss

c) Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated cash flow statement.

Lease incentives (e.g. rent-free period) will be recognised as part of the measurement of the right-of-use assets and lease liabilities whereas under IAS 17 they resulted in the recognition of a lease liability incentive, amortised as a reduction of rental expenses on a straight-line basis.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets. This will replace the previous requirement to recognise a provision for onerous lease contracts.

This will replace the previous requirement to recognise a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets (such as personal computers and office furniture), the company will opt to recognise a lease expense on a straight-line basis as permitted by IFRS 16. Under IAS 17, all lease payments on operating leases are presented as part of cash flows from operating activities.

Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment

(or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.

Amendments to IAS 19 Employee Benefits Plan Amendment, Curtailment or Settlement

The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability (asset)).

The amendments are applied prospectively. They apply only to plan amendments, curtailments or settlements that occur on or after the beginning of the annual period in which the amendments to IAS 19 are first applied. The amendments to IAS 19 must be applied to annual periods beginning on or after 1 January 2019 but they can be applied earlier if an entity elects to do so.

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

IFRIC 23 Uncertainty over Income Tax Treatments

IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires an entity to:

i) Determine whether uncertain tax positions are assessed separately or as a company; and

ii) Assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:

- If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
- If no, the entity should reflect the effect of uncertainty in determining its accounting tax position.

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Entities can apply the Interpretation with either full retrospective application or modified retrospective application without restatement of comparatives retrospectively or prospectively.

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

Annual improvements to IFRS Standards 2015 – 2017 Cycle

The Annual Improvements to IFRS Standards 2015-2018 cycle makes amendments to the following standards:

• IAS 12 Income Taxes - The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

• IAS 23 Borrowing Costs - The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

• IFRS 11 Joint Arrangements - The amendments to IFRS 11 clarify that when a party that participates in but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the joint operation. All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

All the amendments are effective for annual periods beginning on or after 1 January 2019 and generally require prospective application. Earlier application is permitted.

The directors of the company do not anticipate that the application of the amendments in the future will have an impact on the consolidated and company financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

(iv) Early adoption of standards
The company did not early-adopt any new or amended standards in 2019.

The principal accounting policies applied in the preparation of the financial statements are set out below. These policies have been applied consistently.

d) Basis of preparation
The financial statements are prepared under the historical cost basis of accounting except for property that is measured at revalued amounts. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

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, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

The principal accounting policies adopted in the preparation of these financial statements remain unchanged from the previous year and are set out below:

e) Interest income and expense
Interest income and interest expense for all interest bearing financial instruments are accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income and expense on all trading assets and liabilities are considered to be incidental to the bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income. Fair value changes on other financial assets and liabilities carried at fair value through profit or loss, are also presented in net trading income included in the profit or loss.

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

Interest income includes interest on loans and receivables, placements with other banks and investments in government securities, and is recognised in the year in which it is earned.

f) Fees and commission income
In the normal course of business, the bank earns fees and commission income from a diverse range of services to its customers. Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, placement fees and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period. Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

g) Net trading income
Net trading income arises from the margins which are achieved through market marking and customer business and from changes in market caused by movements in interest and exchange rates, prices and other market variables. It comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes.

h) Equipment
Equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight line basis at annual rates estimated to write off the cost of equipment over their expected useful lives using the following rates:

Computers and office equipment	20.0%
Motor vehicles	25.0%
Furniture, fittings and office renovations	12.5%

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

i) Intangible assets-computer software costs

Generally, costs associated with developing computer software programmes are recognised as an expense incurred. However, a cost that is clearly associated with an identifiable and unique product which will be controlled by the bank and has a probable benefit exceeding the cost beyond one year, are recognised as an intangible asset.

Expenditure which enhances and extends computer software programmes beyond their original specifications and lives is recognised as a capital improvement and added to the original costs of the software. Computer software development costs recognised as assets are stated at cost less amortisation. Amortisation is calculated on a straight line basis over the estimated useful lives not exceeding a period of 5 years.

j) Impairment of non-financial assets

At the end of each reporting period, the bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. 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 for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.
Where an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

k) Taxation

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

(i) Current taxation

The corporate tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

(ii) Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in associates, except where the bank is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.
Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

(iii) Current and deferred tax for the year
Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognised in other comprehensive income or directly in the equity respectively.

Foreign currencies
Transactions in foreign currencies during the year are translated at the rates ruling at the time of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Kenya Shillings at the rates of exchange ruling at the end of each reporting date. Non-monetary items that are measured in terms of historical costs in a foreign currency are not retranslated. Gains and losses on exchange of monetary items are dealt with in the profit or loss in the period in which it arises.

Provisions
Provisions are recognised when the bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations and a reliable estimate of the amount of the obligation can be made.

Statutory reserve
IAS 39 requires the bank to recognise an impairment loss when there is objective evidence that loans and receivables are impaired. However, Central Bank of Kenya prudential guidelines require the bank to set aside amounts for impairment losses on loans and advances in addition to those losses that have been recognised under IAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. These amounts are dealt with in the statutory reserve.

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

p) Cash and cash equivalents
Cash and cash equivalents include notes and coins on hand, unrestricted balances held with Central Bank of Kenya (CBK), items in the course of collection from other banks, deposits held at call with banks and treasury bills with original maturities of less than three months. Such assets are generally subject to insignificant risk of changes in their fair value, and are used by the bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

q) Leases
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Rentals payable under operating leases are charged to profit or loss for the year on a straight-line basis over the term of the relevant lease.

r) Contingent liabilities
Letters of credit, acceptances, guarantees and performance bonds are generally written by the bank to support performance by a customer to third parties. The bank will only be required to meet these obligations in the event of the customer's default. These obligations are accounted for as off financial position transactions and disclosed as contingent liabilities.

s) Fiduciary activities
Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from these financial statements where the bank acts in a fiduciary capacity such as nominee, trustee or agent.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

t) Employee benefit costs

i) Bank's defined contribution retirement benefit scheme

The bank operates a defined contribution retirement benefit scheme for its permanent employees. The assets of the scheme are held and administered independently of the bank's assets by an insurance company. The scheme is funded by contributions from both the bank and employees.

ii) Statutory defined benefit obligation pension scheme

The bank contributes to the National Social Security Fund (NSSF). This is a defined contribution scheme registered under the National Social Security Act. Contributions are determined by local statute. The bank's contributions to the statutory retirement benefit scheme are charged to the profit or loss for the year to which they relate.

iii) Other employee entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made f or the liability for annual leave outstanding at the financial position date.

u) Comparatives

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

2 Critical accounting estimates and judgements in applying the entity's accounting policies

In the process of applying the entity's accounting policies, management has made estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial period. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These are dealt with below:

Critical accounting judgements in applying the company's policies

Impairment losses on loans and receivables

The entity reviews its loan portfolios to assess impairment regularly. In determining whether an impairment loss should be recorded in the profit or loss, the company makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before a decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a company, or national or local economic conditions that correlate with defaults on assets in the entity. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Key sources of estimation uncertainty

Property and equipment

Critical estimates are made by the directors in determining depreciation rates for property and equipment.

3. Going concern

The company reported a net profit before tax of Ksh.19.49 million and net loss of Ksh.15.97 million (2018) during the year and had borrowings of Ksh.480.85 million (2018 – Ksh.486.69 million) as at 31 December 2019. These conditions do not indicate existence of a material uncertainty that may cast doubt about the company's ability to continue as a going concern. The directors are of the opinion that with continued diversification of their loan products and seeking for additional funding, the company will continue to operate profitably and be in a position to fund operating expenses and capital expenditure requirements over the coming years, as well as to meet payment obligations. The directors are confident of the success of these measures and have therefore deemed it appropriate to prepare the financial statements on a going concern basis.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

4. Financial risk review

This note presents information about the company's exposure to financial risks and the company's management of capital.

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

- Credit risk
- Liquidity risk
- Market risks

a) Credit risk

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

The following aspects of credit risks have been considered:

- Credit quality analysis
- Collateral held and other credit enhancements
- Amounts arising from ECL
- Impaired financial assets – Comparative information under IAS 39 v.
- Concentrations of credit risk
- Offsetting financial assets and financial liabilities

(i) Credit quality analysis

An analysis of the company's credit risk exposure per class of financial asset, internal rating and "stage" without taking into account the effects of any collateral or other credit enhancements is provided in the following tables. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts. For loan commitments and financial guarantee contracts, the amounts in the table represent the amounts committed or guaranteed, respectively. Explanation of the terms 'Stage 1', 'Stage 2' and 'Stage 3'.

Type of credit exposure
Loans and advances to customers at amortised Cost: ksh '000'

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	Year ended 2018 Total
	Kshs	Kshs	Kshs	Kshs	Kshs
Grade 1: Normal	1,369,920	-	-	1,369,920	1,464,585
Grade 2: Watch	164,673	-	-	164,673	64,830
Grade 3: Substandard	-	6,917	-	6,917	6,033
Grade 4: Doubtful		24,218	-	24,218	6,005
Grade 5: Loss	-	-	391,863	391,863	314,114
Gross carrying amount	1,534,593	31,135	391,863	1,957,591	1,855,567
Loss allowance	109,809	2,291	163,175	275,275	202,666
Carrying amount	1,424,784	28,844	228,688	1,682,316	1,652,901

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

a) Credit risk (continued)

Loans and advances to customers at amortised Cost : ksh '000'

In thousands 'Kenya shilling'	2019				2018 Total ksh
	Stage 1	Stage 2	Stage 3	Total	
Current	1,369,920	-	-	1,369,920	1,465,585
Overdue < 30 days	164,673	-	-	164,673	64,830
Overdue > 30 days	-	31,135	391,863	422,998	326,152
Total	**1,534,593**	**31,135**	**391,863**	**1,957,591**	**1,856,567**

Cash and cash equivalents

The company held cash and cash equivalents of Shs.360 million at 31 December 2019 (2018: Shs. 354 Million). The cash and cash equivalents are held with financial institution counterparties that are rated at least B, based on Global Corporate Default Study ratings.

(ii) Collateral held and other credit enhancements

The company holds collateral and other credit enhancements against certain of its credit exposures. The following table sets out the principal types of collateral held against different types of financial assets.

Type of credit exposure

Percentage of exposure that is subject to collateral requirements

In thousands Kenya shillings		31-Dec	31-Dec	Principal type of collateral held
	Note	2019	2018	
Loans To Customers	14	1,975,591	1,855,567	property & equipment & cash

The following tables stratify credit exposures from customer loans and advances by ranges of loan-to- value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan – or the amount committed for loan commitments – to the value of the collateral. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. For credit-impaired loans the value of collateral is based on the most recent appraisals.

In Thousands Kenya Shillings	Note	31-DEC 2019	2018
Ltv Ratio			
Less Than 50%		1,489,955	957,942
51–70%		104,011	32,236
71–90%		77,973	-
91–100%		22,302	-
More Than 100%		263,350	865,389
Total		**1,957,591**	**1,855,567**
Credit-Impaired Loans			
Less Than 50%		372,932	67,609
51-70%		100,342	54,046
More Than 70%		88,735	694,336
Total		**562,009**	**815,991**

Financial risk review (continued)
a) Credit risk (continued)
Loans and advances to corporate customers

The general creditworthiness of a corporate customer tends to be the most relevant indicator of credit quality of a loan extended to it (see Note 3(B)). However, collateral provides additional security and the company generally requests that corporate borrowers provide it. The company may take collateral in the form of a first charge over real estate, floating charges over assets and other liens and guarantees.

Because of the Company's focus on customers' creditworthiness, the company does not routinely update the valuation of collateral held against all loans to customers. Valuation of collateral is updated when the loan is put on a watch list and the loan is monitored more closely. For credit-impaired loans, the company obtains appraisals of collateral because it provides input into determining the management credit risk actions.

Loans and advances to customers designated as at FVTPL

At 31 December 2019, the maximum exposure to credit risk of loans and advances to customers designated as at FVTPL was their carrying amount of Ksh 275 million (2018: Ksh.203 million). The company has mitigated the credit risk exposure of some but not all of these loans and advances by developing an effective system of internal control, to consistently determine adequate allowances in accordance with the company's stated policies and procedures, IFRSs and relevant supervisory guidance. Focus is also in developing and maintaining the company's risk processes for measuring Expected Credit Loss including monitoring of credit risk, incorporating forward looking information and the method used to measure ECL.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. ACCOUNTING POLICIES.....cont

(iii) Amounts arising from ECL

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

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

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- The remaining lifetime probability of default (PD) as at the reporting date; with
- The remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The ECL model contains a three-stage approach that is based on the change in the credit quality of assets since initial recognition.

Stage 1 - If, at the reporting date, the credit risk of non-impaired financial instruments has not increased significantly since initial recognition, these financial instruments are classified in Stage 1, and a loss allowance that is measured, at each reporting date, at an amount equal to 12-month expected credit losses is recorded.

Stage 2 - When there is a significant increase in credit risk since initial recognition, these non-impaired financial instruments are migrated to Stage 2, and a loss allowance that is measured, at each reporting date, at an amount equal to lifetime expected credit losses is recorded. In subsequent reporting periods, if the credit risk of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the ECL model requires reverting to recognition of 12-month expected credit losses.

Stage 3 - When one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred, the financial asset is considered credit-impaired and is migrated to Stage 3, and an allowance equal to lifetime expected losses continues to be recorded or the financial asset is written off.

Credit risk grades

The company allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. The credit risk grades within company are based on a probability of default. The company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to the nature and type of loans.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

The company grades its loans into five categories on the basis of the following criteria Performing loans, being loans which are well documented and performing according to contractual terms. Such loans are considered under stage 1 - no significant increase in credit risk for purposes of the ECL calculation;

Watch loans, being loans whose principal or interest have remained un-paid for one day to thirty days or where one instalment is outstanding for less than 30 days. Such loans are also classified as stage 1 for purposes of the ECL calculation;

Substandard loan, being loans not adequately protected by the current repayment capacity and the principal or interest have remained un-paid between thirty-one to one eighty days or where two to six instalments have remained outstanding. Under this category, loans past due between 31 - 90 days (or 2-3

pending instalments) are classified within in stage 2 – significant increase in credit risk for purposes of the ECL calculation. Loans aged beyond 90 days are classified as stage 3 - credit impaired;

Doubtful loans, being loans not adequately protected by the current repayment capacity and the principal or interest have remained un-paid between one hundred and eighty-one to three hundred and sixty days or where seven to twelve instalments have remained outstanding. Such loans are classified as stage 3 for purposes of the ECL calculation; and

Loss loans, being loans which are considered uncollectible or of such little value that their continued recognition as receivable assets is not warranted, not adequately protected and have remained un-paid for more than three hundred and sixty days or where more than twelve instalments have remained outstanding. Such loans are also classified as stage 3 for purposes if the ECL calculation.

The table below provides an indicative mapping of how the company's internal credit risk grades relate to PD.

Grading	12-month weighted-average PD	
	2019	2018
Grades 1: Low–fair risk	28.4%	30%
Grades 2: Higher risk	28.4%	89%
Grades 3-5: Substandard, doubtful, loss	100.0%	100%

The company monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and advances, loan commitments, financial guarantees and investment

Credit risk grades are a primary input into the determination of the term structure of PD for exposures. The Company collects performance and default information about its credit risk exposures analysed by historical product and borrower performance as well as by credit risk grading.

The Company employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Determining whether credit risk has increased significantly

The Company assesses whether credit risk has increased significantly since initial recognition at each reporting date. Determining whether an increase in credit risk is significant depends on the characteristics of the financial instrument and the borrower, and the geographical region. What is considered significant differs for different types of lending, in particular between wholesale and retail.

Accounts which are more than 30 days overdue have been determined as having a SICR. For accounts with a SICR PD and LGD has been assessed under the life time credit losses basis.

Discounting used in the ECL calculation

The average contractual interest rates for each credit risk category was taken as the discounting rate for the respective category.

Collateral information

Collateral available for the various buckets determined for IFRS 9 modelling has been considered at the Loss Give Default formulation.

Loss Give Default formulation.

Collateral amounts considered for modelling purposes has been based on the forced sale values, this information was extracted from the bank's core banking system. These values were discounted by one year with the average interest rates per bucket used as the discount rate.

Discounting was done for one year since information available on collateral realization shows that the bank is able to dispose collateral with 12 months from date of seizure and the amounts realized based on historical data provided. Proceeds on sale of collateral

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

1. ACCOUNTING POLICIES.....cont

based on historical data have always exceeded the forced sale values hence no further haircuts have been considered.

For the groups bucket only group savings have been applied as collateral for modelling purposes, these have been proportionately apportioned to members with outstanding loan balances per bucket based on the total group outstanding loan balance. No discounting has been done on the group savings.

Cash recoveries

Subsequent cash recovery factor has been incorporated under the Loss Given Default formulation. These are recoveries received after an account has dropped to the non-performing classes. These amounts have been discounted based on the year the cash was received to present value.

Stage 3 Expected Credit Losses (ECL)

Stage 3 ECL applies to accounts which are credit impaired i.e. over 90 days overdue. For stage 3 ECL is/ has been computed after considering the present value for security and the recoveries history.

Deposits and bank balances Expected Credit Losses

An expected credit loss model for deposits and call balances placed with banks will be based on the default rate assigned by global credit rating bodies S&P and GCR.

The S&P ranking has assigned a risk/default rate of 0.00% for financial institutions rated AAA, 0.02% for AA rated, 0.07% A rated, 0.29% for BBB rated, 0.76% for BB rated, 2.93% for B rated and 15.79% for CCC/C rated financial institutions (Source 2017 Annual Global Corporate Default Study, Standard & Poor). GCR has carried out a credit rating of Kenyan banks but has not assigned risk/default rates for the various ratings given. On the other hand, S&P has not done a rating specific to Kenyan financial institutions but has risk rates assigned to various ratings as documented above whose description we have reviewed and came up with the risk rates applicable to Kenyan banks.

In the GCR rating of Kenyan financial institutions such as KCB Bank, Equity Bank and Commercial Bank of Africa are described as consistently having a stable outlook which is what is similar to the S&P description of financial institutions rated BB. Hence a default rate of 0.76% has been considered for deposits held with Tier one banks. Tier two banks such as Diamond Trust Bank are described as having a stable or positive outlook in the GCR rating which can be equated to the S&P rating of B with a default rate of 2.93%. Whilst Tier three banks such as stable or positive or watch outlook by GCR which bear similar descriptions as the CCC/C rating by S&P with a risk/default rate of 15.79%.

Definition of default

The Company considers loans that have been outstanding for more than 30 days as defaulted loans. Loans that are more than 90 days past due are considered to be credit impaired. The Company considers a financial asset as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of a financial asset have occurred or when contractual payments are 90 days past due. The company's write-off policy under IAS 39 is not expected to be materially different under IFRS 9.

For the purposes of IFRS 9 and based on the company's loan book and risk profile, the bank has considered product type as most appropriate for aggregating its loan book. The following product buckets have been determined:

Asset Finance – this category comprises of loan products issued by the bank secured by motor vehicles and by a charge on title deeds.

Groups – category includes loan products issued to organised groups and members of organised groups. Loans in this category are secured by the log books, a charge on title deeds and group savings held by the bank.

Church – category comprises of loan products issued to churches and affiliates for development purposes and secured by a charge on title deeds.

Agriculture – comprises loan products to customers engaged in the Agri business.
Consumer and Household – this category comprises loan products issued to individuals, staff and other salary based products. The loans are secured by log books and by a charge on title deeds.

SME – this category comprises loan products to SME sector and Staff Development loans. Loans are secured by vehicle log books and by a charge on title deeds.

Insurance – comprises of IPF loan products.

Incorporation of forward-looking information
IFRS 9 requires the ECL models to consider forward looking information and not simply relying on past experience.

The relevant forward looking information will impact PD in terms of the changes to the likelihood of a loss event occurring compared to history and LGD in terms of impact on actual loss were a default event to take place.

The relevant forward looking information will impact PD in terms of the changes to the likelihood of a loss event occurring compared to history and LGD in terms of impact on actual loss were a default event to take place.
The company considers the following forward looking factors to be relevant to the business:

- Inflation
- Interest rates
- GDP growth
- Employment levels

However the Company did not apply macro-economic adjustments to the PD because the Company is focused on short term lending.

As an equal probability would be assigned to each of these outcomes, the forward looking factors are not expected to have a material impact on the ECL.
The company also considers interest rates, inflation and employment to be the relevant factors influencing PD. It has been noted that economic factors do not have any significant impact on PD, all the economic factors having a correlation of less than one.

Modified financial assets
A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and/or timing of the contractual cash flows either immediately or at a future date. In addition, the introduction or adjustment of existing covenants of an existing loan would constitute a modification even if these new or adjusted covenants do not yet affect the cash flows immediately but may affect the cash flows depending on whether the covenant is or is not met (e.g. a change to the increase in the interest rate that arises when covenants are breached).

The company renegotiates loans to customers in financial difficulty to maximise collection and minimise the risk of default. A loan forbearance is granted in cases where although the borrower made all reasonable efforts to pay under the original contractual terms, there is a high risk of default or default has already happened and the borrower is expected to be able to meet the revised terms. The revised terms in most of the cases include an extension of the maturity of the loan, changes to the timing of the cash flows of the loan (principal and interest repayment), reduction in the amount of cash flows due (principal and interest forgiveness) and amendments to covenants. The company has an established forbearance policy which applies for corporate and retail lending.

When a financial asset is modified, the company assesses whether this modification results in derecognition. In accordance with the company's policy a modification results in derecognition when it gives rise to substantially different terms.
To determine if the modified terms are substantially different from the original contractual terms the company considers the following:

- Qualitative factors, such as contractual cash flows after modification are no longer SPPI, change in currency or change of counterparty, the extent of change in interest rates, maturity, covenants.

If these do not clearly indicate a substantial modification, then;

- A quantitative assessment is performed to compare the present value of the remaining contractual cash flows under the original terms with the contractual cash flows under the revised terms, both amounts discounted at the original effective interest.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD)
- Loss given default (LGD); and
- Exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD. Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

ECL is calculated by multiplying the lifetime PD by LGD and EAD.

LGD is the magnitude of the likely loss if there is a default. The Company estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, and recovery costs of any collateral that is integral to the financial asset.

EAD represents the expected exposure in the event of a default. The Company derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For financial guarantees, the EAD represents the amount of the guaranteed exposure when the financial guarantee becomes payable. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Company measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Company considers a longer period. The maximum contractual period extends to the date at which the Company has the right to require repayment of an advance or terminate a loan commitment or guarantee.

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

- instrument type
- credit risk grading;
- type
- LTV ratio;
- date of initial recognition;
- remaining term to maturity;
- industry; and
- geographic location of the borrower.

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the company has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

Loss allowance

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

a) Credit risk (continued)

Loans and advances to customers at: ksh '000'

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total	Year ended 2018 Total
	ECL	Kshs	Kshs	Kshs	Kshs
Loss as at 01.01.19	69,687	867	132,112	202,666	205,502
Change in loss allowance				-	-
Transfer to stage 1	12,188	(476)	(11,712)	-	-
Transfer to stage 2	-	(203)	(203)	-	-
Transfer to stage 3	(21)	(139,522)	139,543	-	-
New financial assets originated or purchased	89,043	1,814	11,738	102,595	173,504
Derecognized financial asset	61,088	(139,811)	108,709	29,986	(193,323)
Loss allowance as at 31.12.19	**109,809**	**2,291**	**163,175**	**275,275**	**206,666**

Loans and advances to customers at: ksh '000'

	As at 31 December 2019		
	Gross carrying/nominal amount	Allowance for ECL	ECL charge to profit and loss
Summary of financial instruments to which impairment requirements in IFRS 9 are applied	1,957,591	275,275	72,480
	As at 31 December 2018		
	Gross carrying/nominal amount	Allowance for ECL	ECL charge to profit and loss
Summary of financial instruments to which impairment requirements in IFRS 9 are applied	1,855,567	202,666	2,836

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

a) Credit risk (continued)

More information about the significant changes in the gross carrying amount of financial assets during the period that contributed to changes in the loss allowance, is provided at the table below:

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	Kshs	Kshs	Kshs	Kshs
Gross carrying amount as at 01.01.19	1,529,415	6,033	320,119	1,855,567
Change in loss allowance				
Transfer to stage 1	54,047	(8,468)	(45,579)	-
Transfer to stage 2	(1,465)	2,863	(1,398)	-
Transfer to stage 3	(13)	(878)	891	-
New financial assets originated or purchased	986,052	21,789	21,693	1,029,534
Derecognized financial asset	(1,033,443)	9,796	96,137	(927,510)
Gross carrying amount as at 31.12.19	1,534,593	31,135	391,863	1,957,591

	Stage 1 12-month	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	Kshs	Kshs	Kshs	Kshs
Gross carrying amount as at 01.01.18	1,558,158	13,093	301,254	1,872,505
Change in loss allowance				-
Transfer to stage 1	1,518	(923)	(595)	-
Transfer to stage 2	(603)	603	-	-
Transfer to stage 3	(29,793)	(8,637)	38,430	-
New financial assets originated or purchased	84,104	3,878	45,498	133,479
Derecognized financial asset	(88,066)	(9,085)	(53,267)	(150,418)
Gross carrying amount as at 31.12.18	1,525,318	(1,072)	331,320	1,855,566

securities is shown below.

Loans to customers - net:

	2019 Shs '000	%	2018 Shs '000	%
Agriculture	33,486	2%	26,916	2%
Business services	1,115,385	66%	908,441	55%
Consumer	533,444	32%	717,544	43%
	1,682,315		1,652,901	

Concentration by location for loans and advances, loan commitments and financial guarantees is based on the customer's country of domicile. Concentration by location for investment securities is based on the country of domicile of the issuer of the security.

Offsetting financial assets and financial liabilities

There were no financial assets and financial liabilities that were offset in the Bank's statement of financial position and none are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments.

b) Liquidity risk

The company is exposed to the risk that it will encounter difficulty in raising funds to meet commitments associated with customer requirements. Liquidity risk is addressed through the following measures:

(i) Management of liquidity risk

The company'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 company's reputation. The Audit and Risk Committee, is tasked with the responsibility of ensuring that all foreseeable funding commitments and deposits withdrawals can be met when due and that no difficulties meeting financial liabilities as they fall due is encountered.

A portfolio of short-term liquid assets largely made up of short-term liquid investment securities and bank facilities ensure that sufficient liquidity is maintained within the company as a whole.

(ii) Source of funding

The company has an aggressive strategy aimed at increasing the customer base and maintains a diversified and stable base of customers. The company also borrows from the banks for short term liquidity requirements.

(iii) Exposure to liquidity risk

The key measure used by the company for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment in securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. The company regulators require that the company maintains a liquidity ratio of 20%. The company complied with the liquidity requirements during the year. The average liquidity ratio for the year was 31% (2018 – 22%).

4. Financial risk review (continued)

The table below represents the cash flows payable by the company under non- derivative financial liabilities by remaining contractual maturities at the end of the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows. The company manages the inherent liquidity risk based on expected undiscounted cash inflows.

As at 31 December 2019	LESS THAN 1 MONTH Kshs. '000'	BETWEEN 1-3 MONTHS Kshs. '000'	BETWEEN 4-12 MONTHS Kshs. '000'	1 YEAR LESS THAN YEAR 3 Kshs. '000'	OVER 3 YEARS Kshs. '000'	TOTAL Kshs. '000'
Liquidity risk						
Financial Liabilities						
Customer deposits	(1,862,605)	(27,397)	(129,482)	(109,636)	(13,998)	(2,143,118)
Related party	-	(2,069)	-	-	-	(2,069)
Borrowings	(5,167)	(29,550)	(115,781)	(330,348)	-	(480,846)
Total liabilities Contractual (maturity dates)	(1,867,772)	(59,016)	(245,263)	(439,984)	(13,998)	(2,626,033)
Financial Assets						
Cash and bank balances	287,467	-	-	-	-	287,467
Short term deposits with banks	-	360,513	-	-	-	360,513
Loan to customers (net)	-	-	-	-	117,648	117,648
Loan to customers (net)	210,938	34,652	327,205	867,224	242,295	1,682,314
Total assets (expected maturity dates)	498,405	395,165	327,205	867,224	359,943	2,447,942
NET LIQUIDITY GAP	(1,369,367)	336,149	81,942	427,240	345,945	(178,091)
As at 31 December 2018						
Total liabilities Contractual (maturity dates)	(1,730,575)	(48,458)	(370,786)	(234,107)	(810)	(2,384,736)
Total assets (expected maturity dates)	429,334	380,102	315,325	727,054	454,482	2,306,297
NET LIQUIDITY GAP	(1,301,241)	331,644	(55,461)	492,947	453,672	(78,439)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

4. Financial risk review (continued)

c) Market Risk

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads will affect the company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

Overall authority for market risk is vested in the Risk Committee which is responsible for the development of detailed risk management policies. The policies are subject to review and approval by the board.

Exposure to interest rate risk

The company is exposed to various risks associated with the effects of fluctuation in the prevailing levels of market interest rates on financial position and cash flows. The risk committee closely monitors the interest rates trends to minimize the potential adverse impact of interest rate changes. The table overleaf summarizes the exposure of interest rate risk at the reporting date. The company maintains an appropriate mix of fixed and floating rates deposit base. Interest rates on advances to customers and other risk assets are either pegged to the company's lending rate The Company's rates are adjusted from time to time to reflect the cost of deposits.

Interest rates on cash collateral held are determined by the company with the company retaining the discretion to adjust the rates in line with changes in market trends. The interest rates, therefore, may fluctuate depending on the movement in the market interest rates. The company also invests in fixed interest rate instruments issued by the Government of Kenya through the Central Bank of Kenya.

Included in the table overleaf are financial assets and liabilities at carrying amounts categorized by the earlier of contractual repricing or maturity dates.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

As at 31 December 2019	LESS THAN 1 MONTH Kshs. '000'	BETWEEN 1-3 MONTHS Kshs. '000'	BETWEEN 4-12 MONTHS Kshs. '000'	1 YEAR LESS THAN YEAR 3 Kshs. '000'	OVER 3 YEARS Kshs. '000'	NON-INTEREST BEARING Kshs. '000'	TOTAL Kshs. '000'
b) Liquidity risk							
Financial Liabilities							
Customer deposits	(241,043)	(232,978)	(618,920)	(109,636)	(13,998)	(926,543)	(2,143,118)
Related party	-	-	-	-	-	(2,069)	(2,069)
Borrowings	(5,167)	(29,550)	(115,781)	(260,978)	-	(69,370)	(480,846)
	(246,210)	(262,528)	(734,701)	(370,614)	(13,998)	(997,982)	(2,626,033)
Financial Assets							
Cash and bank balances	-	-	-	-	-	287,467	287,467
Short term deposits with banks	-	360,513	-	-	-	-	360,513
Cash reserve ratio - CBK	-	-	-	-	-	117,648	117,648
Loan to customers (net)	210,939	34,652	327,205	867,224	242,295	-	1,682,315
	210,939	395,165	327,205	867,224	242,295	405,115	2,447,943
On statement of financial position interest sensitivity gap	(35,271)	132,637	(407,496)	496,610	228,297	(592,867)	(178,090)
As at 31 December 2018							
Total liabilities	(848,158)	(31,229)	(309,449)	(131,949)	(393)	(1,063,557)	(2,384,735)
Contractual (maturity dates)							
Total assets (expected maturity dates)	217,398	380,102	315,325	727,054	353,773	312,645	2,306,297
On statement of financial position interest sensitivity gap	(630,760)	348,873	5,876	595,105	353,380	(750,912)	(78,438)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

4. Financial risk review (continued)
c) Market risks (continued)

Interest rate risk stress test

The impact that an immediate hypothetical increase or decrease in interest rates of 10% applied at the beginning of the year would have on the profit for the year assuming a growing balance sheet and current interest rate risk profile would be as follows:

	2019 sh '000'		2018 sh '000'	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
10% increase in interest rates	47,647	38,118	36,184	25,329
10% decrease in interest rate	(47,647)	(38,118)	(36,184)	(25,329)

The model does not take into account any corrective action in response to interest rate movements, particularly in adverse situations.

Currency risk
The company operates wholly within Kenya and its assets and liabilities are reported in the local currency.

The company's currency position is as follows:-

	KES	USD	EURO	TOTAL
Assets	Sh'000	Sh'000	Sh'000	Sh'000
Cash and bank balances	283,464	3,997	6	287,467
Short term deposits with banks	360,513	-	-	360,513
Cash reserve ratio- CBK	117,648	-	-	117,648
Loans to customers (net)	1,682,315	-	-	1,682,315
Total financial assets	2,443,940	3,997	6	2,447,943
Liabilities				
Balances due to banking institutions				
Customer deposits	(2,143,118)	-	-	(2,143,118)
Related party	(2,069)	-	-	(2,069)
Borrowings	(480,846)	-	-	(480,846)
Total financial liabilities	(2,626,033)	-	-	(2,626,033)
Net balance sheet position	(182,093)	3,997	6	(178,090)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

4. Financial risk review (continued)
c) Currency risk

Net balance sheet position as at 31 December 2018

	KES	USD	EURO	TOTAL
	Sh'000	Sh'000	Sh'000	Sh'000
Total financial assets	2,298,281	3,997	6	2,302,284
Total financial liabilities	(2,384,735)	-	-	(2,384,735)
Net balance sheet position	(86,454)	3,997	6	(82,451)

The table below summarizes the estimated impact of a 10% appreciation/depreciation of the Kenya shilling against the two major currencies traded by the company i.e. the US Dollar and the Euro.

Shilling against the two major currencies traded by the company i.e. the US Dollar and the Euro.

	2019 sh '000'		2018 sh '000'	
	Effect on profit	Effect on equity	Effect on profit	Effect on equity
+10% KES movement	400	280	802	561
+10% KES movement	400	280	802	561

The Central Bank of Kenya sets and monitors capital requirements for Microfinance Bank Institutions as a whole.
The Microfinance Bank regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premium, perpetual bonds (which are classified as innovative Tier 1 securities), retained earnings after deductions for intangible assets, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances Tier 2 capital, which includes qualifying subordinated liabilities, collective impairment allowances and the element of the fair value reserve relating to unrealised gains on equity instruments classified as available-for-sale.

Various limits are applied to elements of the capital base. Qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying term subordinated loan capital may not exceed 50 % of tier 1 capital. There also are restrictions on the amount of collective impairment allowances that may be included as part of tier 2 capital. Other deductions from capital include the carrying amounts of investments in subsidiaries that are not included in the regulatory consolidation, investments in the capital of Microfinance Bank and certain other regulatory items.

Risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-statement of financial position exposures.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

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

In implementing current capital requirements, the Central Bank of Kenya requires each Microfinance Bank to maintain;

• A minimum level of regulatory capital of Shs 60 million.

• A ratio of core capital to the risk–weighted assets plus risk-weighted off-statement of financial position assets at or above the required minimum of 8%.

• Core capital of not less than 8% of total deposit liabilities.

• Supplementary capital of not less than 12% of risk-weighted assets plus risk-weighted off-statement of financial position items.

The Microfinance Bank has complied with all externally imposed capital requirements throughout the year.

	2019 Ksh '000'	2018 Ksh '000'
Tier 1 capital		
Share capital	542,976	541,392
Share premium	2,354	2,354
Retained earnings	(224,143)	(213,984)
Net after tax profits	6,274	7,533
	327,461	337,295
Tier 2 capital		
Statutory reserves	-	-
Regulatory capital	327,461	337,295
Total risk-weighted assets	2,249,323	1,951,470
Capital ratios		
Total regulatory capital expressed as a percentage of total risk-weighted assets (CBK minimum - 12%)	15%	17%
Total tier 1 capital expressed as a percentage of total risk-weighted assets (CBK minimum - 8%)	15%	17%

Capital allocation

The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Risk and Compliance and Credit, and is subject to review by the Board Credit Committee or ALCO as appropriate.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

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

		2019	2018
5	Interest income	Kshs '000'	Kshs '000'
	Loans to customers	653,472	502,028
	Deposits with banks	51,648	12,473
		705,120	514,501

6	Interest expenses		
	Borrowings	63,460	58,012
	Customer deposits	165,189	94,653
		228,649	152,665

7	Fees income		
	Loan disbursement	12,767	31,786
	Loan application fee	42,949	23,461
	Membership	208	631
	Other fees	264	542
		56,188	56,420

8	Other operating income		
	Front office income	8,817	9,346
	Other income and charges	67,049	59,967
	Write back of revolving loan fund (note 24)	-	13,600
		75,866	82,913

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
9	Administration and operating expenses	Kshs '000'	Kshs '000'
	Staff costs (note 10)	229,094	233,756
	Office rent and service charge	59,746	79,508
	Computer expenses	17,707	27,405
	Depreciation (note 19)	26,960	26,607
	Communication	24,478	26,002
	Travel and transport	13,134	15,447
	Amortization of computer software (note 18)	22,171	14,407
	Legal expenses	13,049	13,708
	Programme expenses	12,999	13,040
	General Insurances	16,035	12,250
	Directors fee	10,208	10,648
	Advertising expenses	9,575	8,924
	Office expenses	7,826	8,807
	Bank charges	6,840	7,017
	Office equipment maintenance	10,334	6,980
	Printing and stationery	3,401	3,113
	AGM expenses	2,072	2,170
	Withholding tax	7,622	1,506
	Audit fee	2,325	1,433
	Subscriptions and donations	1,270	1,233
	Clients training	47	6
	Provision expense	3,130	-
	Professional fees	4,750	-
	Capital raising costs - over provision	-	(1,900)
		504,773	512,067

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
10	Personnel costs	Kshs '000'	Kshs '000'
	Salaries and wages	185,868	192,583
	Medical expenses	24,853	21,682
	Pension fund expenses	10,459	9,830
	Other payroll expenses	6,745	8,129
	Staff recruitment training and exposure costs	540	905
	Statutory pension contributions (NSSF)	629	627
		229,094	233,756

11	Taxation		
(A)	Tax credit/(expense)		
	Current tax at 30% (2018: 30%)	-	-
	Deferred tax (note 21)	13,217	(4,986)
	Prior year overprovision of deferred tax	-	2,476
		13,217	(2,510)

(B)	Reconciliation of expected tax based on accounting loss to tax credit		
	Accounting loss before tax	19,491	(15,977)
	Tax applicable rate of 30% (2018: 30%)	5,847	(4,793)
	Tax effect of:		
	Tax effect of IFRS Day 1 adjustments	-	(840)
	Expense not deductible	-	647
	Prior year overprovision of deferred tax	-	2,476
		-	(2,510)

(C)	Tax recoverable		
	At 1 January	27,319	27,319
	Prior year adjustment	(3,551)	-
	Withholding tax paid	377	-
	At 31 DecembeR	24,145	27,319

12	Cash and bank balances		
	Cash and bank balances	287,467	211,936

For the purpose of the cash flow statement, cash and cash equivalents comprise cash in hand and deposits held with banks, net of bank overdrafts.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
13	Deposits with banks maturing within 1 year	Kshs '000'	Kshs '000'
	Co-operative Bank of Kenya Limited	129,400	120,853
	Jamii Bora Bank Limited	230,997	111,827
	UBA Bank Limited	117	121,364
		360,514	354,044
	Less impairment provision for low credit risk assets	(7,621)	(7,751)
		352,893	346,293

The effective average interest rate on deposits with banks as at 31 december 2019 was 11.5% (31 December 2018: 10.4%).

14	Loans to customers		
	Loans to customers	1,911,454	1,796,259
	Loans to staff	46,137	53,766
	Accumulated impairment losses (note 15)	(275,276)	(202,666)
		1,682,315	1,647,359

The Effective Interest Rate On Loans To Customers At 31 December 2019 Was 27.1% (2018 - 25.6%)- 25.6%).

15	Changes in expected credit losses and other credit impairment charges		
	a) Impairment losses on loans and advanceS		
	At 1 January	202,666	202,703
	IFRS 9 Day 1 adjustment	-	2,799
		202,666	205,502
	CBK inspection recommended additional provisions	37,091	-
	Impairment losses recognised/(reversed) on loans in the year	35,519	(2,836)
	At 31 December	275,276	202,666

	b) Impairment losses on financial assets		
	At 1 January	7,751	-
	IFRS 9 Day 1 adjustment	-	(7,751)
	Impairment loss in the year	(130)	-
		7,621	7,751

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
	Impairment losses recognised/(reversed) on loans in the year	Kshs '000'	Kshs '000'
	At 31 December		
	CBK inspection recommended additional provisions	37,091	-
	Impairment losses on loans and advances (Note 15(a))	35,519	(2,836)
	Impairment losses on financial assets at amortised costs (Note 15(b))	(130)	7,751
		72,480	4,915
16	Cash balances with Central Bank of Kenya		
	Cash ratio requirement	117,648	100,709

The cash ratio requirement is maintained based on the customer deposits with the company as adjusted by the Central Bank of Kenya requirements. As as 31 December 2019, the cash reserve ratio requirement was 5.25% for all customer deposits (2018: 5.25%)

17	Other assets		
	Deposits and prepayments	23,289	20,194
	Other receivables	196,928	61,696
	Stationery inventory	5,135	4,916
		225,352	86,806
18	Intangible assets		
	Cost		
	As at 1 January	118,746	108,950
	Additions during the year	34,783	9,796
	As at 31 December	153,529	118,746
	Amortization		
	As at 1 January	89,256	74,849
	Amortization	20,129	14,407
	As at 31 December	109,385	89,256
	Net book value		
	As at 31 December	44,144	29,490

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

19 Property and equipment

	Freehold land and buildings	Motor Vehicles	Equipment Furniture and fittings	Total
Cost	Kshs '000'	Kshs '000'	Kshs '000'	Kshs '000'
At 1 January 2019	330,437	18,363	268,230	617,030
Additions	-	-	30,413	30,413
Prior year elimination on revaluation	909	(2)	(4)	903
Disposal	-	(75)	(15)	(90)
At 31 December 2019	331,346	18,311	298,623	648,280
At 1 January 2018	300,000	20,371	228,564	548,935
Additions	1,346	-	39,699	41,045
Disposal	-	(2,008)	(33)	(2,041)
Revaluation adjustments	29,091	-	-	29,091
At 31 December 2018	330,437	18,363	268,230	617,030
Depreciation				
At 1 January 2019	-	18,307	168,562	186,869
Prior year elimination on revaluation	909	-	(4)	905
Charge for the year	325	54	27,323	27,703
Disposal	-	(75)	(15)	(90)
At 31 December 2019	1,234	18,286	195,865	215,385
At 1 January 2018	584	19,240	143,386	163,210
Charge for the year	325	1,075	25,207	26,607
Elimination on disposal	-	(2,008)	(31)	(2,039)
Elimination on revaluation	(909)	-	-	(909)
At 31 December 2018	-	18,307	168,562	186,869
Net book value				
At 31 December 2019	330,112	25	102,758	432,895
At 31 December 2018	330,437	56	99,668	430,161

19 Property and equipment (cont)

Net book value - Cost basis
Had the company's freehold land and buildings been measured on historical cost basis, the carrying amounts would have been as follows;

	Freehold land and buildings	Motor Vehicles	Equipment Furniture and fittings	Total
Net book value - Cost basis	Kshs '000'	Kshs '000'	Kshs '000'	Kshs '000'
At 31 December 2019	102,793	25	102,758	205,576
At 31 December 2018	103,118	56	99,668	202,842

Fair value measurements of the company's freehold land and buildings:

The table below shows an analysis of freehold land and buildings at fair value by level of the fair value hierarchy. Freehold land and buildings are grouped into levels 1 to 3 based on the degree to which the fair value is observable.

i) Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets and liabilities.

ii) Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as a price) or indirectly (i.e. derived from prices); and

iii) Level 3 fair value measurements are those derived from valuation technical techniques that include inputs for the asset or liability that are not based on observable market dat (unobservable inputs)

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
	KSH '000'	KSH '000'	KSH '000'	KSH '000'
AT 31 DECEMBER 2019				
FREEHOLD LAND AND BUILDINGS	-	330,000	-	330,000
AT 31 DECEMBER 2018				
FREEHOLD LAND AND BUILDINGS	-	330,000	-	330,000

The company's freehold land and buildings are stated at their revaluation amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value measurements of the company's freehold land and buildings were performed as at 31 December 2018 by Tysons Limited, independent valuers.

The fair value of the freehold land and buildings was determined based on market comparable approach that reflects recent transactions prices for similar properties. The resultant surplus was credit to the revaluation reserves in the shareholders equity.

There were no transfers between level 1, 2 and 3 during the years ended 31 December 2019 and 31 December 2018.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
20	Right of use asset	Kshs '000'	Kshs '000'
	Balance as at 1 January 2019	-	-
	Day 1 adjustment	133,978	-
	Additions in the year	-	-
	Depreciation charge	(35,248)	-
	Balance as at 31 December 2019	98,730	-
	Lease liabilities		
	Maturity analysis		
	Less that one year	31,876	-
	One to five years	84,688	-
	More than five years	-	-
	Total undiscounted lease liabilities as at 31 December	116,564	-
	Current	31,876	-
	Non-current	84,688	-
	Total	116,564	-
	Amount recognized in profit and loss		
	Interest on lease liabilities	12,331	-
	Depreciation charge	35,248	-
	Amount recognized in the statements of cash flows		
	Total cash outflow of the lease	(43,623)	-
21	Deferred tax		
	The net deferred tax asset is attributable to the following items:		
	Assets		
	Provision for leave pay	954	691
	Provision for bad debts	84,869	59,148
	Other provisions		3,789
	Unrealized exchange losses	-	49
	Tax losses carried forward	27,622	63,596
		113,445	127,273

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
21	Deferred tax (cont)	Kshs '000'	Kshs '000'
	Liabilities		
	Unrealized exchange gain	(165)	-
	Excess depreciation over capital allowance	(6,497)	(3,061)
	Revaluation surplus	(62,634)	(62,634)
		(69,296)	(65,695)
	Net deferred tax	44,149	61,578
	The movement in the deferred tax account during the year were as follows:		
	At 1 January	61,578	68,068
	Deferred tax credit for the year (note 11(a))	(13,217)	4,986
	Prior year (over) provision (note 11(a))	-	(2,476)
	Charge to the other comprehensive income	-	(9,000)
		48,361	61,578
22	Borrowings		
	Loans - at amortized cost		
	Christian Aid	7,900	7,900
	Rabobank loan account	25,194	-
	Jitegemee Trust Limited	-	20,856
	Anglican Relief & Dev. Fund	5,164	6,164
	Cooperative Bank Limited	262,929	253,679
	BNP - Profit Programme	41,227	60,986
	KIVA Microfunds	54,924	63,278
	Lilian Fonds	1,296	1,296
	NCCK Advocacy Programme	160	160
	OIKO Credit	31,567	67,280
	Plan International	5,090	5,090
		435,451	486,689
	Bank overdraft		
	Bank overdrafts	45,394	-

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

23 Borrowings (cont)	2019 Kshs '000'	2018 Kshs '000'
Maturity of the borrowing		
Due within one year	122,481	88,437
Due after one year	313,971	398,252
	436,452	486,689

Movement in loan balance		
At 1 January	486,689	521,725
Loans received	135,080	139,897
Loans repaid	(186,317)	(174,933)
	435,452	486,689

i) Summary of borrowing arrangements

a) The company has a term loan facility of up to sh.300 Million with The Co-operative Bank of Kenya Limited. The term loan attracts interest at a rate of 11% p.a and is repayable within 60 months on a monthly basis. The loan is secured by a general lien over all the company's collection accounts held with The Co-operative Bank of Kenya Limited and a floating debenture over all assets of the company, with a valuation of ksh.120 Million to be up-stamped to ksh.269 Million.

b) Jitegemee Trust Limited loan is repayable in 4 years and is secured by an unlimited irrevocable guarantee by the NCCK, a debenture on all the assets of the company and a lien over all cash inflows being funded by the loan granted. The effective interest rate as at 31 December 2019 was 10% (2018: 10%).

c) Plan International loan is interest free and is unsecured.

d) The loan from NCCK Advocacy Programme is interest free and unsecured with no fixed repayment period.

e) The loan from Liliane Foundation is a fund running indefinately to support persons with disabilities. This attracts no interest.

f) KIVA operates a web based business that allows website users to connect with lenders that provide small loans to individuals or groups in developing countries. The company entered into an agreement with KIVA in May 2017 and have since been receiving loans at no interest rates.

g) The CMS Africa is a fund established to finance viable enterprises and to provide entrepreneurial training for qualified small scale entrepreneurs, CMS Africa offered an amount of ksh.2 Million in 2017. The fund and any agreed interest accruing to the fund remains the property of CMS Africa. The loan is interest free.

h) OIKO credit loan is repayable in twelve quarterly instalments with 6 months moratorium on principle from disbursement date which was in March 2017. Interest is payable at 13.97% and subsequently reviewed semi-annually paid quarterly at 182 day T-bill + 4.5% (Min 10% p.a)

i) BNP - Profit Program loan is a fund established by the National Treasury for the purpose of availing credit to participating Microfinance Bank institutions to support rural and agriclutural access to credit on a six year program effective from December 2010. SMEP Microfinance Bank Limited joined the program in December 2012. The loan tenure is 10 years with a four year grace period all inclusive. The loan shall be repaid in twelve equal consecutive semi-annual installments at the rate of 5% p.a. on a reducing balance.

j) Rabobank Foundation provided a term loan facility of ksh.30 Million at an interest rate of 9% p.a repayable within 72 months on a semi-annual basis. The loan is secured by a joint and several liability agreement between the National Council of Churches of Kenya and Smep.

24	Revolving loan fund	2019 Kshs '000'	2018 Kshs '000'
	At 1 January	-	13,600
	Write back to profit and loss (note 8)	-	(13,600)
	At 31 December	-	-

In October 2005, the holding company entered into an agreement with the Ministry of Labour and Manpower Development, Micro Enterprise Development Project (MEDP) supported by DANIDA for a revolving loan fund to aid farming activities in Taita Taveta district. The project was to run for a period of five years to year 2017. However, no communication on required repayment has been received threfore written back.

25	Other liabilities	2019 Kshs '000'	2018 Kshs '000'
	Leave pay provision (note 25(a))	3,179	2,302
	Sundry payables	64,112	41,330
	Due to related party note (note 26(b))	2,069	2,069
		69,360	45,701

A	Movement in leave provision is as follows:		
	At start of year	2,302	3,971
	(Charge)/credit for the year	877	(1,669)
	At the year end	3,179	2,302

26. Related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over all the other party in making financial or operational decisions.

All transactions with related parties are at arm's length in the normal course of business, and on terms conditions similar to those applicable to other customers.

SMEP Microfinance Bank Limited is a subsidiary of Small and Micro Enterprise Program Limited, a company limited by guarantee.

Small and Micro Enterprise Program Limited, a company limited by guarantee is owned by National Council of Churches of Kenya (NCCK)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

A	Transactions	2019 Kshs '000'	2018 Kshs '000'
THE REMUNERATION OF MEMBERS OF KEY MANAGEMENT DURING THE YEAR WAS AS FOLLOWS:-			
	Salaries and other benefits	36,869	40,406
	Due after one year	5,699	2,877
B	Balances		
	Due (to) related parties		
	Small and Micro Enterprise Programme	(2,069)	(2,069)
	National Council of Churches of Kenya (Fixed deposit)	(7,200)	(2,885)
	Due from related parties		
	National Council of Churches of Kenya (loan)	5,087	5,661
	Loans to staff	16,506	24,615
	Loans to directors	5,768	10,600
		18,092	35,922

27. Share capital and share premium

As at 31 December 2019 the authorised share capital of the company comprised of 480,000,000 (2018: 480,000,000) ordinary shares with a par value of Shs 5. The issued shares as at 31 December 2019 are 108,595,344 (2018: 108,282,514) and are fully paid. Issued and fully paid ordinary shares have a par value of Shs 5, carry one vote per share and a right to dividend.

28	Funds awaiting allotment	2019 Kshs '000'	2018 Kshs '000'
	At 1 January	29,252	22,621
	Additional subscriptions	937	7,184
	Allotted shares (Note 27)	(1,564)	(553)
	At 31 December	28,625	29,252

29	Revenue reserves	2019 Kshs '000'	2018 Kshs '000'
	At 1 January 2019	-213,984	-217,189
	Transition adjustment (note 1)	-16,433	-2,799
	Profit for the year	6,274	-13,467
	Transfer to statutory reserve	-	19,47
		(224,143)	(213,984)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

		2019	2018
30	Contingent liabilities	Kshs '000'	Kshs '000'
	Contingent liabilities	58,736	58,736

In 2015, Kenya Revenue Authority ("KRA") carried out a tax audit on Pay as You Earn, Value Added Tax and Withholding Tax for the years 2011 to 2015 and issued a preliminary assessment Shs 75,496,248. The amount disclosed as a contingent liability represents management's estimate of the tax liability whose prospects of waiver by the Kenya Revenue Authority are considered good.

Other contingent liabilities represent legal cases in the ordinary course of business. The directors have determined that the probability of occurrence of a liability are remote.

		2019	2018
31	Capital commitments	Kshs '000'	Kshs '000'
	Authorised but not contracted for	86,990	74,210

Capital commitments comprise of funds committed for acquiring ICT hardware infrastructure and branch renovations. 2019 was for upgrading T24 system.

32. Subsequent events

None as at the year end.

33. Incorporation

The company is domiciled and incorporated in Kenya under the Kenyan Companies Act.

34. Comparatives

These financial statements are presented in Kenya Shillings rounded to the nearest thousands (Sh'000), which is also the functional currency.

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

35. Ultimate holding company

The immediate holding company is Small and Microenterprise Programme (a company limited by guarantee). The ultimate holding entity is the National Council of Churches of Kenya.

NOTICE IS HEREBY GIVEN that the 9th **ANNUAL GENERAL MEETING** of **SMEP MICROFINANCE BANK LIMITED** will be held via electronic communication, on the **29th** of June **2020** at 2:30 p.m. to conduct the following business:-

1. To read the notice convening the Meeting and determine if a quorum is present

2. To receive, consider and if approved, adopt the Company's audited financial statements for the year ended 31 December 2019, together with the reports of the Chairman, Directors and Auditors thereon.

3. To note that the Directors do not recommend the payment of a dividend for the Financial Year under review

4. To elect Directors:
   In accordance with Article 111 of the Company's Articles of Association, the following Directors retire by rotation and being eligible, offer themselves for re-election.
   a) Dr. Nelson C. Kuria
   b) Mr. Sam Awuor
   c) Rev Canon Peter Karanja

5. To note that auditors Mazaar will continue in office in accordance with the provisions of Section 721(2) of the Companies Act, 2015 and to authorize the Directors to fix their remuneration for the ensuing financial year.

6. To approve the remuneration of Directors.

Dated at Nairobi this **8th** day of **June** 2020

By order of the Board

Sam Awuor
Company Secretary

PROXY FORM

……..

The Company Secretary,
SMEP Microfinance Bank Limited
P. O. Box 64063 - 00620
Nairobi, Kenya

I/WE_____

Of_____

Being a shareholder of **SMEP Microfinance Bank Limited** hereby appoint the Chairman of the Meeting or (see notes 3 and 5) _____ (Name of proxy) in respect of my _____ (Number of shares).

Please indicate here if you are appointing more than one proxy _____ (see note 5) as my/our proxy to attend, represent and vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held electronically on 26th June, 2020at 10:00 a.m. and at any adjournment thereof.

Signed this _____ day of _____2020

Signature(s)

_____

_____

I/WE direct my/our proxy to vote on the following resolutions as I/WE have indicated by marking the appropriate box with an 'X'. If no indication is given,my/ourproxywillvoteorwithholdhisorhervoteathisorherdiscretionandI/WE authorize my/our proxy to vote (or withhold his or her vote) as he or she thinks fit in relation to any other matter which is properly put before the Meeting.

Please clearly mark the box below to instruct your proxy how to vote

RESOLUTION	FOR	AGAINST	WITHHELD
Approval of the Report and Financial Statements for the Year ended 31 December, 2019			
Re-election of Dr. Nelson C. Kuria			
Re-election of Mr. Sam Awuor			
Re-election of Rev. Canon Peter Karanja			
Approve the **Directors' Remuneration Report** and to authorize the Board to fix the remuneration of Directors.			
Auditors: In accordance with the provisions of Sections 721 and 724 of the Companies Act 2015, to note that Mazars will continue in office and to authorize Directors to fix their remuneration.			
Special Business: Approve by way of special resolution Articles 58 and 61 of the Articles of Association of the Company be and are hereby amended to provide for holding of Annual General Meetings and Extraordinary General Meetings virtually and for voting to be carried by electronic means.			

ELECTRONIC COMMUNICATIONS CONSENT FORM

Please complete in BLOCK CAPITALS

Full name of Proxy(s):_____

_____

_____

Address: _____

_____

Mobile Number

Date: _____

Signature: _____

Please tick **ONE** of the boxes below and return to Image Registrars at P.O. Box 9287-00100 Nairobi,5th floor, Absa Towers (formerly Barclays Plaza), Loita Street:

Approval of Registration

I/WE approve to register to participate in the virtual Annual General Meeting to be held on 18th June, 2020.

Consent for use of the Mobile Number provided

I/WE would give my/our consent for the use of the mobile number provided for purposes of voting at the AGM.

Notes:

1. If a member is unable to attend personally, this Proxy Form should be completed and returned to reach the Company's share registrar, **Image Registrars Limited**, 5th Floor, Barclays Plaza, Loita Street, P.O. Box 9287, GPO 00100, Nairobi, or via email to info@image.co.ke to arrive not later than **11:00 a.m.** on**24th June, 2020** i.e. 48 hours before the meeting or any adjournment thereof.

2. In case of a member being a corporate body, the Proxy Form must be under its common seal or under the hand of an officer or duly authorized attorney of such corporate body.

3. As a shareholder you are entitled to appoint one or more proxies to exercise all or any of your shareholder rights to attend and to speak and vote on your behalf at the meeting. The appointment of the Chairman of the meeting as proxy has been included for convenience. To appoint as a proxy any other person, delete the words "the Chairman of the Meeting or" and insert the full name of your proxy in the space provided. A proxy need not to be a shareholder of the Company.

4. Completion and submission of the form of proxy will not prevent you from attending the meeting and voting at the meeting in person, in which case any votes cast by your proxy will be excluded.

5. To be valid the form of proxy should be completed, signed and delivered (together with a power of attorney or other authority (if any) under which it is assigned or a notarized certified copy of such power or authority) to Image Registrars, Barclays Plaza, 5th Floor, Loita Street and address P. O. Box 9287-00100 Nairobi not later than 11.00 am on 16thJune 2020 or, in the case of a poll taken subsequent to the date of the meeting, or any adjourned meeting, not less than 24 hours before the time appointed for the taking of the poll which is taken more than 48 hours after the day of the meeting or adjourned meeting.

6. In the case of a company being a shareholder then this proxy form must be executed under its common seal or signed on its behalf by an officer of that company or an authorized attorney for that company.

7. A "vote withheld" option has been included on the form of proxy. The legal effect of choosing this option on any resolution is that you will be treated as not having voted on the relevant resolution. The number of votes in respect of which votes are withheld will, however, be counted and recorded, but disregarded in calculating the number of votes for or against each resolution.

CONTACT US

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