

**CENTRAL BANK OF KENYA**

**ANNUAL REPORT**

**AND**

**FINANCIAL STATEMENTS**

**30 JUNE 2009**

**ERNST & YOUNG**

**CENTRAL BANK OF KENYA  
ANNUAL REPORT AND FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 30 JUNE 2009**

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**CENTRAL BANK OF KENYA  
BANK INFORMATION  
FOR THE YEAR ENDED 30 JUNE 2009**

**DIRECTORS**

Prof. Njuguna Ndung'u	-	Governor and Chairman
Mrs Jacinta W. Mwatela	-	Deputy Governor and Deputy Chairman-Retired on 8 September, 2008
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman-Appointed on 8 September, 2008
Mr. Joseph K. Kinyua	-	Permanent Secretary-Treasury, Member
Mr. Joseph K. Waiguru	-	Member
Dr. William O. Ogara	-	Member
Mr. Nicholas A. Nesbitt	-	Member
Ms. Agnes Wanjiru	-	Member
Ms. Wanza Kioko	-	Member

**SENIOR MANAGEMENT**

Prof. Njuguna Ndung'u	-	Governor
Mrs Jacinta W. Mwatela	-	Deputy Governor –Retired on 8 September, 2008
Dr. Hezron Nyangito	-	Deputy Governor-Appointed on 8 September, 2008
Mr. Kennedy K. Abuga	-	Director –Governor’s Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director – Finance, Resource Planning and Strategy Management
Mr. Jones M. Nzomo	-	Director – Human Resources and Services Department-Retired on 24 February, 2009
Ms. Rose Detho	-	Director – Banking Supervision Department
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director – Internal Audit & Risk Management
Mr. Charles Koori	-	Director-Research Department-Appointed on 22 October, 2008
Mr. Nicholas N. B. T. Korir	-	Director – Department of Estates, Supplies and Transport
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration-Appointed on 18 September 2008
Mr. Gerald Nyaoma	-	Director – Banking Department
Mr. Jackson M. Kitili	-	Director – Monetary Operations & Debt Management
Mr. Peter K. Rotich	-	Director - Human Resources and Administration-Appointed on 6 May 2009

**REGISTERED OFFICE**

Central Bank of Kenya Building  
Haile Selassie Avenue  
PO Box 60000  
00200 Nairobi, Kenya

**BRANCHES**

**Mombasa**

Central Bank of Kenya Building  
Nkrumah Road  
PO Box 86372  
80100 Mombasa, Kenya

**Kisumu**

Central Bank of Kenya Building  
Jomo Kenyatta Highway  
PO Box 4  
40100 Kisumu, Kenya

**Eldoret**

Kiptagich House  
Uganda Road  
PO Box 2710  
30100 Eldoret, Kenya

**Kenya School of Monetary Studies**

Thika Road  
PO Box 65041  
00200 Nairobi, Kenya

**AUDITORS**

Ernst & Young  
Kenya - Re Towers, Upperhill  
Off Ragati Road  
PO Box 44286  
00100 Nairobi, Kenya

**MAIN LAWYERS**

Oraro and Co Advocates  
ACK Garden House  
1<sup>st</sup> Ngong Avenue  
PO Box 51236  
00200 Nairobi, Kenya

**CENTRAL BANK OF KENYA  
DIRECTORS' REPORT  
FOR THE YEAR ENDED 30 JUNE 2009**

The directors submit their report together with the audited financial statements for the year ended 30 June 2009, which shows the state of affairs of the Bank.

**1. INCORPORATION**

The Bank is incorporated under the Central Bank of Kenya Act Cap 491(the Act).

**2. PRINCIPAL ACTIVITIES**

The Bank is established and administered under the Act with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

**3. RESULTS**

**3.1 Financial Results**

The results for the year as set out on page 10 show that the Bank recorded a profit of KShs 23,229 million against a profit of KShs 8,995 million in 2008. This substantial higher performance over the previous year is due to foreign currency translation gains that amounted to KShs 13,462 million in the year under review compared to only a gain of KShs 54 million in 2008 and proceeds from sale of Grand Regency Hotel amounting to KShs 3,141 million. The Bank held the hotel as a security against a receivable that had been fully provided for. Contributing to this performance also are expenses associated with conduct of monetary policy that were lower than the previous year's by KShs 1,306 million owing to less need for mop-ups due to tight liquidity prevailing in the economy for most part of the year under review. These positive financial performances were tempered by foreign currency earnings that were KShs 3,373 million (32%) lower than in 2008 owing to the ongoing global economic turmoil. Some operating expenses such as currency printing costs, property maintenance and others were higher than previous year's by a total of KShs 1,479 million (29%). Currency printing costs increased due to change in accounting policy on treatment of the printing costs hence the more the new notes were issued into circulation the higher the amortised cost.

**3.2 Financial Position**

The financial position of the Bank is set out in the Balance Sheet on page 11. During the year under review, the assets of the Bank increased by KShs 36,539 million (13%). The increase is mainly due to balances due from international institutions that increased by KShs 23,248 million or 10%, balances in reverse Repo Treasury Bills and Bonds (money injections into the economy) that increased by KShs 7,947 million or 113% and loans and advances (Government overdraft) which stood at KShs 5,124 million at the end of the year compared to a nil balance last year and against the statutory limit of KShs 16 billion. In an effort to maintain the required statutory import cover, the Bank built its foreign currency reserves during the year by a net of KShs 23,248 million in shilling terms through earnings from foreign currency investments, purchases of foreign currency, loan from IMF and revaluation gains. The reverse Repos were necessitated by the need for the Bank to inject liquidity into the economy by lending to commercial banks owing to tight liquidity prevailing in the money market for the better part of the financial year. These main increases were countered by minor decreases and increases in balances of other assets.

Correspondingly, liabilities and equity also increased by KShs 36,539 million (13%) mainly due to increases in currency in circulation by KShs 8,292 million or 9%, loans from IMF by KShs 17,751 million or 86% and equity by KShs 20,751 million or 114%. The increase in currency in circulation mirror demand for cash in the economy while the increase in equity is due mainly to the net profit for the year. The above increase in liabilities were mitigated by decreases of KShs 5,504 million in commercial bank and Government deposits, KShs 1,807 million in Repo transactions and KShs 2, 975 million in other liabilities.

**4. DIVIDEND**

The Board of Directors recommend payment of KShs 7.2 billion dividend for the year ended 30 June 2009 (2008: KShs 4 billion).

**CENTRAL BANK OF KENYA  
DIRECTORS' REPORT  
FOR THE YEAR ENDED 30 JUNE 2009**

**5. DIRECTORS**

The directors who served during the year and up to the date of this report are listed on page 1.

**6. AUDITORS**

The auditors, Ernst & Young, were appointed during the financial year 2006/2007 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and the term expires on conclusion of the audit of the year under review.

By order of the Board

K. K. Abuga  
**BOARD SECRETARY**

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**CENTRAL BANK OF KENYA  
STATEMENT OF DIRECTORS' RESPONSIBILITIES  
ON THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 30 JUNE 2009**

We, the directors, certify that:

1. We are responsible for the preparation of financial statements for each financial year which present a true and fair view of the state of affairs of the Bank and of its operating results for that year. We are also responsible in ensuring that the Bank keeps proper accounting records which disclose with reasonable accuracy, the financial position of the Bank.
2. We accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgement and estimates, in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act.
3. We are responsible for safeguarding the assets of the Bank.
4. We are responsible for establishing and maintaining systems of internal control designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
5. The directors are of the opinion that the financial statements for the year ended 30 June 2009 fairly present the financial position and operating results of the Bank.
6. Nothing has come to the attention of the directors to indicate that the Bank will not remain a going concern for at least twelve months from the date of this statement.

Signed on behalf of the Board of Directors by:-

\_\_\_\_\_  
**Governor**

\_\_\_\_\_  
**Director**

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**CENTRAL BANK OF KENYA**  
**STATEMENT OF CORPORATE GOVERNANCE**

The Central Bank of Kenya is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from CBK Act Cap 491 of the laws of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

**Board of Directors**

Section 11 of the CBK Act Cap 491 provides that the Board of Directors shall constitute the Governor who is also the Chairman, Deputy Governor, who shall also be the Deputy Chairman, the Permanent Secretary to the Treasury, who is a non-voting member and five Non-Executive Directors. Other than the Permanent Secretary to the Treasury who is ex-officio, all the others are appointed by the President of the Republic of Kenya for terms of four years each and are eligible for reappointment provided that no Governor, Deputy Governor or director shall hold office for more than two terms.

Currently there are five Non-Executive Directors namely Messrs Joseph K. Waiguru, Nicholas A. Nesbitt, William O. Ogara, Ms Wanza Kioko and Ms Agnes Wanjiru who are all serving their first term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

**Board Meetings**

The Board meets once every six weeks and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to maintain full and effective control over strategic, financial and operational issues. The Board is not involved in the conduct of day-to-day business as this is a responsibility given to the Governor by the CBK Act Cap 491. It, however, retains responsibility for determining the policy of the Bank.

**Audit Committee**

The Audit Committee is chaired by Dr. William O. Ogara and has three other members who are Non-Executive Directors having experience in Accounting, Auditing, Banking and Financial Management. The committee currently meets on monthly basis and as necessary. Its responsibilities are to:-

- Keep under review the efficiency and effectiveness of internal controls in the Bank;
- Keep under review financial information and improve the quality of financial reporting with particular attention to compliance with legal and reporting requirements;
- Receive and consider the Bank's Annual Budget and recommend to the Board for approval;
- Review the effectiveness of the Internal Audit Function and reports received there from;
- Review the External Auditors' Audit scope timetables and approach; their performance and their findings;
- Recommend on the appointment of the external auditors and their fees;
- Review the Bank's annual financial statements prior to their submission to the Board;
- Review the Bank's Risk Management Policies and Procedures.

**Monetary Policy Committee (MPC)**

Section 4D of the CBK (amendment) Act 2008 establishes the Monetary Policy Committee. The committee is responsible for formulating monetary policy and is required to meet at least once in two months. Members of the committee are appointed by the Minister for Finance for an initial period of three years each and may be reappointed for another final term of three years.

The Committee is currently made up of the following:

- (1) The Governor who is also the Chairman-internal member
- (2) The Deputy Governor who is the Deputy Chairman-internal member
- (3) Permanent Secretary to the Treasury or his representative who shall be non-voting member
- (4) Professor T. C. Ryan-external member appointed by Minister for Finance
- (5) Dr. Rose W. Ngugi-external member appointed by Minister for Finance
  
- (6) Mrs. Sheila S.M.R. M'Mbijewe-external member appointed by Minister for Finance
- (7) Mr. Wycliffe Mukulu-external member appointed by Minister for Finance
- (8) Mr. Charles Koori- internal member appointed by Governor
- (9) Mr. John K. Birech-internal member appointed by Governor

**CENTRAL BANK OF KENYA**  
**STATEMENT OF CORPORATE GOVERNANCE (continued)**

The Board of Directors has two sub committees with specific responsibilities and the chairpersons of these sub-committees submit regular reports to the Board through the Secretariat. The committees and their respective responsibilities are as follows:

**Human Resources Committee**

The Committee is currently chaired by Ms Agnes Wanjiru and membership includes three other Non-Executive Directors with the Governor and the Deputy Governor in attendance. The Committee meets regularly as and when need arises to review human resource policies and make suitable recommendations to the Board.

**Management Structure**

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page 1. The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

There are various other Management Committees, which advise the Governor on specific issues in order to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

**Directors' Emoluments and Loans**

The remuneration paid to the Directors for services rendered during the financial year 2008/2009 is disclosed in note 28 (iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for the staff loans.

**Code of Ethics**

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct apply to the entire Bank's staff under the staff rules and regulations.

**Internal Controls**

The management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2005. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

**Authorizations**

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget, which is approved by the Board before commencement of the financial year. The Board receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.



**CENTRAL BANK OF KENYA**  
**STATEMENT OF CORPORATE GOVERNANCE (continued)**

**Internal Audit**

The internal audit function is performed by Internal Audit and Risk Management department which is also responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit are available to the Audit Committee of the Board.

**Transparency**

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explains current monetary policy and also provides the expected monetary policy stance. In addition, the Bank issues policy briefs to the Treasury on both the monetary and fiscal policies. On an annual basis, the Financial Statements are published in the Kenya Gazette.

**REPORT OF THE INDEPENDENT AUDITORS  
TO THE MEMBERS OF CENTRAL BANK OF KENYA**

***Report on the Financial Statements***

We have audited the accompanying financial statements of the Central Bank of Kenya, as set out on pages 10 to 58 which comprise the balance sheet as at 30 June 2009, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

***Directors' Responsibility for the Financial Statements***

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors, as well as evaluating the overall presentation of the financial statements.

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

***Opinion***

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the Bank as at 30 June 2009 and of the profit and cash flows for the year then ended in accordance with the International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

***Report on other matters***

We also 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 Bank, so far as appears from our examination of those books; and,
- iii) The Bank's income statement and balance sheet are in agreement with the books of account.

Nairobi

..... 2009

**CENTRAL BANK OF KENYA  
INCOME STATEMENT  
FOR THE YEAR ENDED 30 JUNE 2009**

		<b>2009</b>	<b>2008</b>
	<b>Note</b>	<b>KShs million</b>	<b>KShs million</b>
Interest income	2	8,852	12,108
Interest expense	3	<u>(432)</u>	<u>(1,716)</u>
<b>Net interest income</b>		<b>8,420</b>	<b>10,392</b>
Fee and commission income	4	3,005	3,156
Foreign exchange gain	5	13,462	54
Other operating income	6	<u>4,849</u>	<u>421</u>
<b>Operating income</b>		<b>29,736</b>	<b>14,023</b>
Operating expenses	7	<u>(6,507)</u>	<u>(5,028)</u>
<b>Profit for the year</b>		<b><u>23,229</u></b>	<b><u>8,995</u></b>

**CENTRAL BANK OF KENYA  
BALANCE SHEET  
FOR THE YEAR ENDED 30 JUNE 2009**

		<b>2009</b>	<b>2008</b>
<b>ASSETS</b>	<b>Note</b>	<b>KShs million</b>	<b>KShs million</b>
Balances due from banking institutions and gold holdings	8	246,734	223,486
International Monetary Fund	9	914	206
Items in the course of collection	10	1,430	2,885
Advances to Banks	11	15,011	8,542
Loans and advances	12	8,317	3,460
Other assets	13	2,870	1,241
Retirement benefit asset	14	1,425	55
Property and equipment	15	1,034	568
Prepaid operating lease rentals	16	275	278
Intangible assets	17	378	18
Due from Government of Kenya	18	<u>33,329</u>	<u>34,439</u>
<b>TOTAL ASSETS</b>		<b><u>311,717</u></b>	<b><u>275,178</u></b>
<b>LIABILITIES</b>			
Currency in circulation	19	108,042	99,750
Deposits	20	125,637	131,141
International Monetary Fund	9	37,448	19,697
Amounts repayable under repurchase agreements	21	-	1,807
Other liabilities	22	1,488	4,463
Provisions	23	<u>97</u>	<u>66</u>
<b>TOTAL LIABILITIES</b>		<b><u>272,712</u></b>	<b><u>256,924</u></b>
<b>EQUITY AND RESERVES</b>			
Share capital	24	5,000	1,500
General reserve fund	25	26,805	12,754
Proposed dividend	26	<u>7,200</u>	<u>4,000</u>
<b>TOTAL EQUITY AND RESERVES</b>		<b><u>39,005</u></b>	<b><u>18,254</u></b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b><u>311,717</u></b>	<b><u>275,178</u></b>

The financial statements were approved by the Board of Directors for issue on -----2009 and signed on its behalf by:

\_\_\_\_\_  
**Governor**

\_\_\_\_\_  
**Director**

**CENTRAL BANK OF KENYA  
STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 30 JUNE 2009**

	<b>Share capital</b> <b>KShs million</b>	<b>General</b> <b>reserve fund</b> <b>KShs million</b>	<b>Proposed</b> <b>dividend</b> <b>KShs million</b>	<b>Total</b> <b>KShs million</b>
<b>Year ended 30 June 2008</b>				
Balance at start of the year	1,500	7,759	-	9,259
Profit for the year	-	8,995	-	8,995
Proposed dividends	-	(4,000)	4,000	-
<b>Balance at end of the year</b>	<b><u>1,500</u></b>	<b><u>12,754</u></b>	<b><u>4,000</u></b>	<b><u>18,254</u></b>
<b>Year ended 30 June 2009</b>				
Opening balance as previously stated	1,500	12,754	4,000	18,254
Prior year adjustment*	-	<u>1,522</u>	-	<u>1,522</u>
Restated opening balance	1,500	14,276	4,000	19,776
Additional capital paid during the year	3,500	(3,500)	-	-
2008 dividends paid	-	-	(4,000)	(4,000)
Profit for the year	-	23,229	-	23,229
Proposed dividend	-	<u>(7,200)</u>	<u>7,200</u>	-
<b>Balance at end of the year</b>	<b><u>5,000</u></b>	<b><u>26,805</u></b>	<b><u>7,200</u></b>	<b><u>39,005</u></b>

\*The prior year adjustment relates to a change in policy on recognition of bank notes printing expenses as explained in Note 1a (iv).

**CENTRAL BANK OF KENYA  
CASH FLOW STATEMENT  
FOR THE YEAR ENDED 30 JUNE 2009**

	Note	2009 KShs million	2008 KShs million
<b>Operating activities</b>			
Net cash (absorbed)/generated by operating activities	27 (a)	<u>14,161</u>	<u>39,160</u>
<b>Investing activities</b>			
Receipts of government loan		1,110	1,110
Purchase of property and equipment		(697)	(120)
Purchase of intangible assets		(388)	-
Proceeds from disposal of property and equipment		10	81
Proceeds on International Monetary Fund -SDR accounts		<u>(708)</u>	<u>(201)</u>
Net cash (used in)/from investing activities		<u>(673)</u>	<u>870</u>
<b>Financing activities</b>			
Dividends paid		(4,000)	-
Currency in circulation		<u>8,292</u>	<u>9,951</u>
Net cash from financing activities		<u>4,292</u>	<u>9,951</u>
Net increase in cash and cash equivalents		17,780	49,981
Cash and cash equivalents at start of year		225,300	175,265
Exchange rate effects		<u>13,462</u>	<u>54</u>
<b>Cash and cash equivalents at end of year</b>	<b>27 (b)</b>	<b><u>256,542</u></b>	<b><u>225,300</u></b>

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES  
FOR THE YEAR ENDED 30 JUNE 2009**

**1. SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies adopted in the preparation of these financial statements are set out below:

**(a) Basis of preparation**

**i. Preparation**

The financial statements are prepared in accordance with and comply with International Financial Reporting Standards (IFRS). The financial statements are presented in millions of Kenya Shillings (KShs million) and are prepared under the historical cost convention except for measurement at fair value of certain investments.

**ii. Statement of Compliance**

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) and interpretations of those Standards.

**iii. Form of presentation**

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the “lender of last resort” to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. In some cases, confidence can best be sustained if the Bank’s support is disclosed only when the conditions giving rise to potential instability in the economy have improved. Although the financial effects of such operations are included in the financial statements of the Bank, these statements may not explicitly identify such support.

**iv. Changes in accounting policies**

The accounting policies adopted are consistent with those of the previous financial year except as follows:

Bank notes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the income statement from the deferred costs account over the useful period (life span) of each bank note denomination. The deferred amount is recognised as prepayment and represents un-issued bank notes (currency) stock. Previously the costs were expensed upon delivery of currency stock.

**v. Standards, Amendments and Interpretations Effective in 2008**

The following amendments and interpretation standard are mandatory though not relevant to the Bank. The effective date of the amendments was 1 July 2008.

- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments Disclosures - Reclassification of Financial Assets. The amendments allow entities to reclassify certain financial assets out of held-for-trading if they are no longer held for the purpose of being sold or repurchased in the near term.



**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**v. Standards, Amendments and Interpretations Effective in 2008 (continued)**

Financial assets that would be eligible for classification as loans and receivables (i.e. those assets which, apart from not being held with the intent of sale in the near term, have fixed or determinable payments, are not quoted in an active market and contain no features which could cause the holder not to recover substantially all of its initial investment except through credit deterioration) may be transferred from 'Held-for-trading' to 'Loans and receivables', if the entity has the intention and the ability to hold them for the foreseeable future.

Financial assets that are not eligible for classification as loans and receivables may be transferred from 'Held-for-trading' to 'Available-for-sale' or to 'Held-to-maturity', only in rare circumstances. The amendment requires detailed disclosures relating to such reclassifications. The effective date of the amendment was 1 July 2008 and reclassifications before that date are not permitted.

The Bank did not make use of these amendments to reclassify any of its financial instruments between the effective date of these amendments which is 1 July 2008 and 30 June 2009.

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2008 but are not relevant to the Bank's operations:

- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions - This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed.
- IFRIC 13, Customer Loyalty Programmes – The IFRIC issued IFRIC 13 in June 2007. This interpretation requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to award credits.
- IFRIC 14, IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction - IFRIC Interpretation 14 provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 1.
- IFRIC 12, Service Concession Agreements -The IFRIC was issued in November 2006. This interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**vi. Standards, Amendments and Interpretations that have been issued and are not yet effective**

At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective for the Bank's operations and which the Bank has not early adopted:

- IFRS 2, Amendments to IFRS 2, Share-based Payment – Vesting Conditions and Cancellations (effective from 1 January 2009). The Standard restricts the definition of "vesting condition" to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation.
- IFRS 3 Business Combinations and IAS 27, Consolidated and Separate Financial Statements (effective 1 July 2009) - The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. IFRS 3 introduces a number of changes in the accounting for business combinations occurring after this date that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27 requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as an equity transaction. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7, Statement of Cash Flows, IAS 12 Income Taxes, IAS 21, The Effects of Changes in Foreign Exchange Rates, IAS 28 Investment in Associates and IAS 31, Interests in Joint Ventures. The changes by IFRS 3 and IAS 27 will affect future acquisitions or loss of control and transactions with minority interests.
- IFRS 8, Operating Segments. This standard requires disclosure of information about the Bank's operating segments and replaced the requirement to determine primary (business) and secondary (geographical) reporting segments of the Bank. IFRS replaces IAS 14, Segment Reporting (IAS 14) upon effective date.
- IAS 1, (Revised 2007) Presentation of Financial Statements. The standard replaces IAS 1, Presentation of Financial Statements (revised in 2003) as amended in 2005. The revised IAS 1 was issued in September 2007 and is effective for accounting periods beginning on or after 1 January 2009 with early application permitted. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income, which presents income and expense items recognised in profit or loss, together with all other items of recognised income and expense, either in one single statement, or in two linked statements.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

**vi. Standards, Amendments and Interpretations that have been issued and are not yet effective (continued)**

- IAS 23, Borrowing Costs (effective from 1 January 2009)-The IASB issued an amendment to IAS 23 in April 2007. The revised IAS 23 requires capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.
- IAS 32, Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation - These amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for financial years beginning on or after 1 January 2009. The revisions provide a limited scope exception for puttable instruments to be classified as equity if they fulfil a number of specified features.
- IAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items - These amendments to IAS 39 were issued in August 2008 and become effective for financial years beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item.
- IFRIC 15, Agreement for the Construction of Real Estate-IFRIC 15 was issued in July 2008 and becomes effective for financial years beginning on or after 1 January 2009. The interpretation is to be applied retrospectively. It clarifies when and how revenue and related expenses from the sale of a real estate unit should be recognised if an agreement between a developer and a buyer is reached before the construction of the real estate is completed. Furthermore, the interpretation provides guidance on how to determine whether an agreement is within the scope of IAS 11 or IAS 18.
- IFRIC 16, Hedges of a Net Investment in a Foreign Operation - IFRIC 16 was issued in July 2008 and becomes effective for financial years beginning on or after 1 October 2008. The interpretation is to be applied prospectively. IFRIC 16 provides guidance on the accounting for a hedge of a net investment. As such it provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of a net investment, where within the group the hedging instruments can be held in the hedge of a net investment and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.
- IFRIC 17, Distribution of Non-Cash Assets to Owners-effective for periods beginning on or after 1 July 2009-This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends.
- IFRIC 18, Transfers of Assets from Customers effective for periods beginning on or after 1 July 2009-This interpretation provides guidance on how to account for items of property, plant and equipment received from customers, or cash that is received and used to acquire or construct specific assets. This interpretation only applies to such assets that are used to connect the customer to a network or to provide ongoing access to a supply of goods or services or both.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**a) Basis of preparation (continued)**

The directors anticipate that the adoption of these standards will have no material effect on the financial statements of the Bank.

**vii. Improvements to IFRS's**

In May 2008, the International Accounting Standards Board issued its first omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard.

The Bank has not yet adopted the following amendments and anticipates that these changes will have no material effect on the financial statements.

- IFRS 7, Financial Instruments: Disclosures: Removal of the reference to 'total interest income' as a component of finance costs.
- IAS 8, Accounting Policies, Change in Accounting Estimates and Errors: Clarification that only implementation guidance that is an integral part of an IFRS is mandatory when selecting accounting policies.
- IAS 10, Events after the Reporting Period: Clarification that dividends declared after the end of the reporting period are not obligations.
- IAS 16, Property, Plant and Equipment: Items of property, plant and equipment held for rental, are transferred to inventory when the rental ceases and they are held for sale.
- IAS 18, Revenue: Replacement of the term 'direct costs' with 'transaction costs' as defined in IAS 39.
- IAS 19, Employee Benefits: Revised the definition of 'past service costs', 'return on plan assets' and 'short term' and 'other long-term' employee benefits. Amendments to plans that result in a reduction in benefits related to future services are accounted for as curtailment. Deleted the reference to the recognition of contingent liabilities to ensure consistency with IAS 37.
- IAS 20, Accounting for Government Grants and Disclosures of Government Assistance.
- IAS 38, Intangible Assets: Expenditure on advertising and promotional activities is recognised as an expense when the company either has the right to access the goods or has received the service.
- IAS 39, Financial Instruments: Recognition and Measurement: Changes in circumstances relating to derivatives are not reclassifications and therefore may be either removed from, or included in, the 'fair value through profit or loss' classification after initial recognition. Removed the reference in IAS 39 to a 'segment' when determining whether an instrument qualifies as a hedge. Require the use of the revised effective interest rate when remeasuring a debt instrument on the cessation of fair value hedge accounting.

**(b) Significant accounting judgement and estimates**

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the directors' best knowledge of current events and actions, actual results ultimately may differ from those estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(b) Significant accounting judgement and estimates (continued)**

The most significant use of judgement and estimates are as follows:

**(i) Impairment losses on loans and advances**

The Bank reviews its loans and advances at each reporting date to assess whether an allowance for impairment should be recognised in the income statement. In particular, judgement by the directors is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on the assumptions about a number of factors and actual results may differ, resulting in future changes in the allowance.

In addition to specific allowances against individual significant loans and advances, the Bank makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration such factors as any deterioration in industry, technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

**(ii) Pensions**

The actuarial valuation cost of the defined benefit pension plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long nature of these plans, such estimates are subject to significant uncertainty. See note 14 for assumptions used.

**(iii) Property, equipment and intangible assets**

Critical estimates are made by the management in determining depreciation and amortisation rates for property, equipment and intangible assets. The rates used are set out in the accounting policy (g) and (h) below.

**(iv) Useful life of currency**

Useful lives of the various bank notes denominations are currently estimated as follows:

KShs 1,000	2 years
KShs 500	2 years
KShs 200	2 years

The useful life for all other denominations is estimated at 1 year.

**(c) Revenue recognition**

Income is recognised in the period in which it is earned. Income is not accrued if its recoverability is considered doubtful.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(c) Revenue recognition (continued)**

**(i) Interest income and expenses**

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments.

**(ii) Fees and commission income**

Fees and commission income, which arise from financial services provided by the Bank, are recognised when the corresponding services are provided.

**(d) Translation of foreign currencies**

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Assets and liabilities at the balance sheet date which are expressed in foreign currencies are translated into Kenya Shillings at rates ruling at that date. The resulting differences from conversion and translation are dealt with in the income statement in the year in which they arise.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

**(e) Currency printing and minting expenses**

Notes printing and coins minting expenses which include ordering, printing, minting, freight, insurance and handling costs are expensed upon issuance of currency into circulation.

**(f) Employee benefits**

**(i) Retirement benefits**

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund scheme administered by Trustees and funded by the Bank. Kenya School of Monetary Studies (KSMS), Central Bank of Kenya Staff Pension Scheme, Deposit Protection Fund Board, and other related parties, reimburses the Bank the costs of contributions relating to staff seconded to them by the Bank.

The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of government bonds that have terms to maturity approximating to the terms of the related pension liability.

The Bank's net obligation in respect to the plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(f) Employee benefits (continued)**

value and the fair value of any plan assets is deducted. The calculation is performed by a qualified actuary using the Projected Unit Credit Method.

Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised as income or expense when the net cumulative unrecognised actuarial gains and losses at the end of the previous report year exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets as at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plan.

Past service cost is recognised as an expense on a straight line basis over the average period until the benefits become vested. If the benefits vest immediately, the past service cost is recognised immediately. Any net defined benefit surplus is limited to the benefit that is available to the Bank.

Where the calculation results in a benefit to the Bank, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reduction in future contributions to the plan. Actuarial gains and losses are charged to the income statement over the remaining working lives of the employees participating in the scheme.

The Bank also makes contributions to a statutory pension scheme, the National Social Security Fund (NSSF). Contributions to the scheme are determined by local statute and are shared between the employer and employee.

**(ii) Other employee benefits**

The Bank provides free medical treatment to staff, spouse and up to a maximum of four children below the age of 23 years. The related expenses are recognised once incurred.

The estimated monetary liability for employees' accrued leave entitlement at the balance sheet date is recognised as an expense accrual.

**(g) Property and equipment**

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation is computed on the straight line basis over the estimated useful lives of the assets at the following rates:

Building improvements	over the estimated future lives which range from ten to twenty-five years
Motor vehicles, furniture and equipment	over periods ranging from two to five years

Property that is being constructed or developed for future use to support operation is classified as Work-in-Progress (WIP) and stated at cost until construction or development is complete, at which time it is reclassified as property, plant and equipment in use.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(g) Property and equipment (continued)**

Subsequent expenditures are capitalized only when they increase the current economic benefits and meet the recognition criteria. Expenditure incurred to replace a component of item of property, plant and equipment is accounted for separately and capitalized while the major replaced component is derecognised.

All other expenditure items which do not meet recognition criteria are recognised in the income statement as expenses as they are incurred.

An item of property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any loss or gain on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in other operating income in the income statement in the year the asset is derecognised

The assets residual values, useful lives and methods of depreciation are reviewed and adjusted if appropriate at the each financial year end. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

**(h) Intangible assets**

Intangible assets include the value of computer software. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and any accumulated impairment loss.

Intangible assets that are being developed for future use to support operations are classified as Work –in – Progress (WIP) and stated at cost until development is complete, at which time they are reclassified as Intangible assets.

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The amortisation period with a finite useful life are reviewed at least at each financial year end. The amortisation expense on intangible assets with finite lives is recognised in the income statement.

Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software - over periods ranging from two to five years

**(i) Impairment of non-financial assets**

Impairment of assets is assessed at each balance sheet date or more frequently where any events or changes in circumstances dictate for indications of impairment. If significant indications are present, these assets are subject to an impairment review by estimating the recoverable amount. An impairment loss is charged to income statement when the carrying amount of an asset exceeds the recoverable amount.

Previously recognised impairment loss of related asset may be reversed in part or in full when a change in circumstances leads to an increase of the recoverable amount. The carrying amount of the asset will only be increased up to the amount that it would have been had the original impairment not been recognised. For the purpose of measuring and accounting for impairment loss; either fair value or value in use of an asset is compared with carrying amount.



**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial instruments**

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

**(i) Date of recognition**

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, which is the date that the Bank commits to purchase or sell the asset.

**(ii) Recognition and initial measurement**

The classification of financial instruments at initial recognition depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

**(iii) Classification and measurement**

The Bank classifies its financial assets in the following categories: loans and advances and investments that are held to maturity. The Bank determines the classification of its investments at initial recognition.

**(1) Loans, advances and receivables**

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money or services directly to counterparty with no intention of trading the receivable. The Bank has classified the following financial assets as loans and receivables originated by the entity: loans and advances, amounts due from the Government, other assets, International Monetary Fund (IMF) related assets and cash and cash equivalents. After initial measurement, loans and receivables are carried at amortised cost using effective interest method less any allowance for impairment.

As the lender of last resort, the Bank may grant loans or advances for fixed periods not exceeding six months to commercial banks that pledge Government securities specified by the Bank. In its capacity as the fiscal agent and banker to the Government of Kenya (GoK), the Bank may make direct advances to the Government for the purpose of offsetting fluctuations between receipts from the budgeted revenue and the payments of the Government. The total amount of advances to the Government outstanding shall not exceed five percent of the gross recurrent revenue of the Government as shown in the Appropriation Accounts for the latest year for which those financial statements have been audited by the Controller and Auditor-General.

The Bank also operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The Bank determines the terms and conditions for granting of the above loans with reference to the prevailing market interest rates and may determine different rates for different classes of transactions and maturities.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial Instruments (continued)**

**(2) Held to maturity**

Investments classified as held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in 'Interest income' in the income statement. The losses arising from impairment of such investments are recognised in the income statement line 'Impairment losses on financial investments'. Were the Bank to sell other than an insignificant amount of such assets, the entire category would be reclassified as available for sale. The Bank currently classifies term deposits, Government securities, repurchase and reverse purchase instruments as held to maturity.

**(3) Financial liabilities**

Financial liabilities are measured at amortised cost except for financial liabilities designated at fair value through profit and loss. Financial liabilities are initially recognised at fair value less, in the case of liabilities carried at amortised cost (including due to banks, due to International Monetary Fund other deposits and other funds borrowed), transaction costs incurred and any difference between the proceeds net of transaction costs and the redemption amount is recognised in the income statement as interest expense over the period to maturity using the effective interest rate method. Financial liabilities which are repayable on demand are recorded at nominal value. Deposits represent reserve deposits of depository institutions' participants and current accounts of the Bank. The Bank has classified the following financial instruments as financial liabilities: currency in circulation, deposits, IMF related liabilities and other liabilities.

**(4) Financial assets at fair value through income statement: Held for Trading**

A financial asset is classified in this category if it is acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are classified as held at fair value through income statement. The Bank has classified the Reserve Asset Management Programme (RAMP) financial instruments as held for trading.

**(iv) Derecognition**

Financial assets are de-recognized when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all of the risks and rewards of ownership.

A financial liability is de-recognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

The gains and losses on investments held to maturity and loans and receivables are recognized in the income statement when the investments are derecognized.

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES (continued)  
FOR THE YEAR ENDED 30 JUNE 2009**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(j) Financial Instruments (continued)**

**(v) Gains and losses on subsequent measurement**

Gains and losses on amortisation of premiums or discounts of financial instruments carried at amortised cost are recognised in the income statement of the period in which they arise. Gains and losses due to impairment are recognised as stated in the paragraph dealing with impairment.

**(vi) Offsetting**

Financial assets and financial liabilities are offset and the net amount reported on the balance sheet where there is a legally enforceable right to set off the recognised amount and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

**(vii) Impairment of financial assets**

Loans are stated at outstanding amount less provision for impairment.

A review for impairment is carried out at each financial year-end. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

Specific provisions for loan impairment are made in respect of advances. The provisions are based on periodic evaluations of advances and take account of past loss experience, economic conditions and the estimated value of any underlying collateral, and are charged to the income statement.

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (which is the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss is recognised in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognized in the income statement.

**(k) Amounts Repayable under Repurchase Agreements (REPOs)**

REPO is an arrangement involving the sale for cash, of security at a specified price with a commitment to repurchase the same or similar securities at a fixed price either at a specific future date or at maturity.

For monetary purposes (liquidity management), the Bank from time to time mops up money from the market (REPO) or injects money into the economy (Reverse REPO). The Bank engages in the above with commercial banks only.

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(k) Amounts Repayable under Repurchase Agreements (REPOs) (continued)**

When the Bank mops money from commercial banks, it creates a liability in its books and secures this borrowing (liability) by assigning part of the Government loan to the commercial banks it has mopped from. The Bank freezes the money mopped and pays interest at market rates on the money. The money mopped stays until maturity (7 to 91 days).

Similarly the Bank also lends money to commercial banks (reverse repo). The Bank creates an asset in its books and takes a security from the borrowing bank usually in form of Treasury Bills or Bonds. The Bank earns interest from the borrowing commercial bank on this lending. The injected money stays with the borrowing bank until maturity (1 to 7 days).

- (i) The Bank treats REPOs as collateralized loans for accounting purposes. In this case, a REPO is recorded as a secured advance and is shown separately as REPO Agreement.
- (ii) REPOs continue to be recognised in the balance sheet and are measured in accordance with policies for non-trading investment.
- (iii) The difference between sales and repurchase price is treated as interest expenditure and is recognised in the income statement

The Bank also accepts deposits from commercial banks on a voluntary basis at market terms for an agreed period. This is a new monetary instrument that the Bank uses in addition to REPO and is similar to REPO only that it is not secured.

**(l) Currency in circulation**

Currency issued by the Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in these financial statements. Currency in circulation represents the face value of notes and coins in circulation. Notes and coins held by the Bank as cash in main vault, intermediary vault, and cashier at the end of financial year are netted off against the liability for notes and coins in circulation because they do not represent currency in circulation.

**(m) Deposits**

Deposits are non-derivative financial liabilities with fixed or determinable receipts that are not quoted in an active market. They arise when the Bank receives money or services directly from counterparty with no intention of trading the payable. Deposits held are carried at cost with interest income accruing on an effective interest rate basis.

Cash Ratio Deposits are taken to fund certain activities of the Bank in accordance with the Banking Act and are interest free. Cash Ratio Reserves is a monetary policy instrument used to manage liquidity. The deposits earn no interest to commercial banks and the Bank does not trade on these deposits in any way. Subsequent to year end, the deposits are currently computed at 4.5% of each commercial bank's deposits it has taken from the public; previously the rate was 5%. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

**(n) Dividends payable**

Dividends are recognised as a liability in the period in which they are declared. Proposed dividends are disclosed as a separate component of equity until they are declared.

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES (continued)  
FOR THE YEAR ENDED 30 JUNE 2009**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(o) Provisions**

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

The calculated monetary liability for employees' accrued annual leave entitlement at the balance sheet date is recognised as an expense accrual.

**(p) Leasing**

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

**(i) Bank as a lessee**

Finance leases, which transfer to the Bank substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in 'Property and equipment' with the corresponding liability to the lessor included in 'Other liabilities.' Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income in 'Interest and similar expense.'

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Bank will obtain ownership by the end of the lease term. Operating lease payments are not recognised in the balance sheet. Any rentals payable are accounted for on a straight-line basis over the lease term and included in 'Other operating expenses'.

**(ii) Bank as a lessor**

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. The Bank leases out all of its properties as operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

**(q) Other assets**

Other assets are stated at fair value and subsequently at amortised cost using effective interest rate method less allowance for impairment. Due to their short term nature, the nominal value or cost are considered to approximate the fair value and as such stated at cost less any impairment loss.

**(r) Other liabilities**

Other liabilities are stated at their nominal value/cost, which approximates fair value due to the short term nature thereof.

**CENTRAL BANK OF KENYA  
ACCOUNTING POLICIES (continued)  
FOR THE YEAR ENDED 30 JUNE 2009**

**1. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**(s) Cash and cash equivalents**

Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of up to 3 months from the date of issue.

**(t) Commitments on behalf of Treasury**

Commitments on behalf of Treasury arising from the issue of Treasury bills and Treasury bonds are not included in these financial statements as the Bank is involved in such transactions only as an agent.

**CENTRAL BANK OF KENYA  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 30 JUNE 2009**

	<b>2009</b>	<b>2008</b>
<b>2 INTEREST INCOME</b>	<b>KShs million</b>	<b>KShs million</b>
Cash and cash equivalents ( Note 2a)	21	70
Held to maturity investments (Note 2b)	6,889	10,241
Loans and advances (Note 2c)	1,821	1,797
Held for trading investments (Note 2d)	<u>121</u>	<u>-</u>
	<u><b>8,852</b></u>	<u><b>12,108</b></u>
<b>2(a) Interest income from cash and cash equivalents</b>		
Interest on Sterling Pound deposits	3	6
Interest on US Dollar deposits	5	48
Interest on Euro deposits	9	10
Income from IMF	<u>4</u>	<u>6</u>
	<u><b>21</b></u>	<u><b>70</b></u>
<b>2(b) Interest income from held to maturity investments</b>		
Interest on Sterling Pound term deposits	3,436	5,143
Interest on US Dollar term deposits	2,060	4,032
Interest on Euro term deposits	<u>1,393</u>	<u>1,066</u>
	<u><b>6,889</b></u>	<u><b>10,241</b></u>
The weighted average interest rates for term deposits were		
US Dollar	1.72%	4.75%
UK Sterling Pounds	2.48%	5.90%
Euro	2.58%	4.44%
<b>2(c) Interest income from loans and advances</b>		
Interest on loan due from Government (Note 18)	1,025	1,061
Interest on Government overdraft	466	291
Interest on staff loans	75	73
Interest on reverse REPOs	70	107
Interest on local commercial banks overnight loans	45	68
Interest on foreign commercial banks overnight loans	26	120
Other interest income	<u>114</u>	<u>77</u>
	<u><b>1,821</b></u>	<u><b>1,797</b></u>
<b>2(d) Interest income from held for trading investments</b>		
Interest income - World Bank RAMP	<u>121</u>	<u>-</u>

During the year, the Bank engaged the services of Reserve Asset Management Programme (RAMP) which is the investment arm of the World Bank to assist in building capacity in foreign reserves management. The Bank has availed US \$ 200 million for the Programme.

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	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>2(e)</b> Additional disclosure on income by source		
Foreign investments earnings	7,058	10,431
Local investments earnings	1,719	1,604
Other interest earnings	<u>75</u>	<u>73</u>
	<u><b>8,852</b></u>	<u><b>12,108</b></u>
<b>3 INTEREST EXPENSE</b>		
Interest on monetary policy issues/ REPOs	334	1,640
Interest paid to IMF	<u>98</u>	<u>76</u>
	<u><b>432</b></u>	<u><b>1,716</b></u>
<b>4 COMMISSION AND FEES INCOME</b>		
Commission on sale of Government securities	3,000	3,150
Poverty Reduction and Growth Facility (PRGF)		
(IMF-GoK) Commission	5	4
Others	<u>-</u>	<u>2</u>
	<u><b>3,005</b></u>	<u><b>3,156</b></u>
<p>The Bank earns a commission of 1.5% from the Government for its agency role in the issuance of Treasury bills and bonds. The commission income is limited to KShs 3 billion as per an agreement between the Bank and Treasury. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.</p>		
<b>5 FOREIGN EXCHANGE GAIN/(LOSS)</b>		
Foreign exchange dealing profit (Note 5a)	1,470	1,319
Foreign exchange translation gain/(loss) (Note 5b)	<u>11,992</u>	<u>(1,265)</u>
	<u><b>13,462</b></u>	<u><b>54</b></u>
<b>5(a) Foreign exchange dealing profit</b>		
Gains on sale of foreign exchange to Government	1,227	1,230
Foreign exchange dealing profit on commercial banks	<u>243</u>	<u>89</u>
	<u><b>1,470</b></u>	<u><b>1,319</b></u>
<b>5(b) Foreign exchange translation (loss)/gain</b>		
Revaluation gain/(loss) on current accounts	(1,242)	9
Revaluation gain/(loss) on foreign deposits	15,546	(532)
Revaluation loss on IMF accounts	(2,318)	(771)
Others	<u>6</u>	<u>29</u>
	<u><b>11,992</b></u>	<u><b>(1,265)</b></u>
<b>Exchange rates</b>	KShs	KShs
US Dollar	77.05	64.60
GBP	128.83	128.77
Euro	108.90	101.99



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	<b>2009</b>	<b>2008</b>
<b>Foreign Currency Investment mix</b>		
US Dollar	42%	39%
GBP Sterling Pound	35%	57%
Euro	<u>23%</u>	<u>4%</u>
	<u>100%</u>	<u>100%</u>

The foreign currency investment mix is determined by the Investment Committee and is revised from time to time in line with the Bank's monetary objectives.

<b>6 OTHER OPERATING INCOME</b>	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Recovery on impaired loan (Note 6a)	3,141	-
Actuarial gain on retirement benefit obligations	1,370	-
KSMS hospitality services	185	159
Miscellaneous income	90	132
KSMS tuition fees and other charges	37	33
Rent received	16	16
Proceeds from disposal of property and equipment	<u>10</u>	<u>81</u>
	<u>4,849</u>	<u>421</u>
	<b>US\$</b>	<b>KShs</b>
	<b>Million</b>	<b>Million</b>
<b>6 (a) Recovery on impaired loan</b>		
10% on sale of Grand Regency Hotel	4.5	277
90% on sale of Grand Regency Hotel	40.5	2,671
Receipt from the Receiver Manager	-	297
Retirement benefits of employees of the Hotel	<u>-</u>	<u>(104)</u>
	<u>45</u>	<u>3,141</u>

The recovery on impaired loan relates to write back of provisions for Exchange Bank Limited loan. In 1992, during a period of severe shortage of foreign currency in Kenya, Exchange Bank sold foreign currency amounting to US\$ 210 million to the Bank. Exchange Bank was credited with KShs 13.5 billion being the Kenya shilling equivalent but did not deliver the foreign currency in the Bank's overseas correspondent accounts as required to. The amount of KShs 13.5 billion owing from Exchange Bank was eventually off set by repayments and against deposits held at the Bank and the outstanding balance of about KShs 4.5 billion was secured by way of a legal charge on L.R. No. 209/9514 (belonging to Uhuru Highway Development Limited and trading as Grand Regency Hotel) valued KShs 2.5 billion. The Hotel was sold in 2008 for US \$ 45 million (KShs 3.1 billion) leaving an irrecoverable balance of KShs 1.5 billion that was already fully provided for and has now, with the sale of the hotel, been extinguished from the books of the Bank.

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7	OPERATING EXPENSES	2009 KShs million	2008 KShs million
	Staff costs (Note 7a)	3,260	3,261
	Currency expenses (Note 7b)	1,260	403
	Property maintenance expenses (Note 7c)	660	519
	Depreciation on property and equipment (Note 15)	231	144
	Amortisation on intangible assets (Note 17)	28	31
	Other expenses (Note 7d)	1,057	659
	Auditors' remuneration	4	4
	Banking expenses	4	4
	Operating lease rentals	<u>3</u>	<u>3</u>
		<u>6,507</u>	<u>5,028</u>
<b>7(a)</b>	<b>Staff costs</b>		
	Personnel emoluments	2,925	3,010
	Medical benefit	135	115
	Staff training and development costs	188	123
	Directors' expenses	<u>12</u>	<u>13</u>
		<u>3,260</u>	<u>3,261</u>
<b>7(b)</b>	<b>Currency expenses</b>		
	Notes production	1,108	330
	Coins production	140	59
	Notes issue	7	10
	Coins issue	<u>5</u>	<u>4</u>
		<u>1,260</u>	<u>403</u>
<b>7(c)</b>	<b>Property maintenance expenses</b>		
	Upkeep of property	234	241
	Security of premises	193	154
	Property renovation	121	30
	Electricity	71	46
	Others	<u>41</u>	<u>48</u>
		<u>660</u>	<u>519</u>
<b>7(d)</b>	<b>Other expenses</b>		
	Transport and travelling	125	98
	Office expenses	126	107
	Postal service expenses	88	93
	Legal and professional fees	105	8
	Other administrative expenses	<u>613</u>	<u>353</u>
		<u>1,057</u>	<u>659</u>

**CENTRAL BANK OF KENYA**  
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**8 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Cash and cash equivalents ( Note 8a)	8,975	10,318
Held for trading investments (Note 8b)	15,449	-
Held to maturity investments (Note 8c)	222,276	213,140
Gold holdings	<u>34</u>	<u>28</u>
	<u><b>246,734</b></u>	<u><b>223,486</b></u>
<b>8(a) Cash and cash equivalents</b>		
Special project accounts	4,695	4,451
Current account	2,598	4,423
Domestic forex currency cheque clearing	1,676	1,438
Forex travellers cheques	<u>6</u>	<u>6</u>
	<u><b>8,975</b></u>	<u><b>10,318</b></u>
<b>8(b) Held for trading</b>		
US Dollar deposits	925	-
Fixed income securities	14,469	-
Accrued interest	<u>55</u>	<u>-</u>
	<u><b>15,449</b></u>	<u><b>-</b></u>
<b>8(c) Held to maturity investments</b>		
Term deposits (Note 8 c(i))	221,824	210,866
Accrued interest on term deposits	<u>452</u>	<u>2,274</u>
	<u><b>222,276</b></u>	<u><b>213,140</b></u>
<b>8 c(i) Term deposits</b>		
Dollar deposits	90,534	106,367
Sterling Pound deposits	80,649	68,799
Euro deposits	<u>50,641</u>	<u>35,700</u>
	<u><b>221,824</b></u>	<u><b>210,866</b></u>

**CENTRAL BANK OF KENYA**  
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**9 INTERNATIONAL MONETARY FUND**

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Bank is the designated depository for the IMF's holdings of Kenya's currency. IMF currency holdings are held in the No. 1 and No 2 Accounts, which are deposit accounts of the IMF with the Bank.

	2009		2008	
	SDR Million	KShs Million	SDR' Million	KShs Million
<b>Assets</b>				
IMF balances( SDR asset account)	<u>8</u>	<u>914</u>	<u>2</u>	<u>206</u>
<b>Liabilities</b>				
International Monetary Fund Account No. 1	20	3,128	20	2,134
International Monetary Fund Account No. 2	-	3	-	-
International Monetary Fund – PRGF Account	281	33,599	122	16,510
International Monetary Fund loans to Government of Kenya	<u>6</u>	<u>718</u>	<u>10</u>	<u>1,053</u>
	<u>307</u>	<u>37,448</u>	<u>152</u>	<u>19,697</u>
Security at 30 June	<u>238</u>	<u>28,079</u>	<u>246</u>	<u>24,015</u>

Borrowings from and repayments to the IMF are denominated in Special Drawing Rights (SDRs). The SDR balances in IMF accounts are translated into KShs and any unrealized gains or losses are accounted for in accordance with accounting policy on foreign currencies.

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository

Kenya's Quota in IMF and SDRs allocations amounting to SDR 271.4 million and SDR 36.9 million respectively, are accounted for in the books of the Government of Kenya.

**10 ITEMS IN THE COURSE OF COLLECTION**

	2009 KShs million	2008 KShs million
Items in the course of collection	<u>1,430</u>	<u>2,885</u>

The balance represents values of clearing instruments which are held by the Bank while awaiting clearing by respective commercial banks.

**11 ADVANCES TO BANKS**

REPO Treasury Bills	9,552	-
REPO Treasury Bonds	5,437	7,042
Treasury Bonds Discounted	10	1,467
Treasury Bills Discounted	9	-
Accrued interest	<u>3</u>	<u>33</u>
	<u>15,011</u>	<u>8,542</u>

The Bank lends money to commercial banks through reverse Repo for a short duration of 7 days only. These advances are secured against government securities of any maturity. The discounted government securities held are of varying maturities.

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12	LOANS AND ADVANCES	2009 KShs million	2008 KShs million
	Irrecoverable amount from banks under liquidation	3,767	8,337
	Government overdraft account (see below and Note 28)	5,124	-
	Loan from IMF to the Government of Kenya (Note 28)	718	1,053
	Advances to employees		
	Salary advance	178	176
	Car loans	379	350
	Housing scheme	1,746	1,736
	Development loan	<u>189</u>	<u>160</u>
		12,101	11,812
	Provision for loan impairment (banks & staff)	<u>(3,784)</u>	<u>(8,352)</u>
	Net advances as at 30 June	<u>8,317</u>	<u>3,460</u>
	Movement in the loan impairment allowance is as follows:		
	At start of the year	(8,352)	(8,281)
	Additional impairment allowance made during the year	(63)	(78)
	Irrecoverable amount on sale of the Hotel	1,490	-
	Recoveries on sale of the Hotel in the year (Note 6a)	3,141	-
	Other recoveries	<u>-</u>	<u>7</u>
	At end of the year	<u>(3,784)</u>	<u>(8,352)</u>

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest audited financial statements. The limit stands at KShs 16,882,643,732 based on the Government financial statements for 2006/2007, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 14,818,512,441 based on the Government financial statements for 2005/2006.

13	OTHER ASSETS	2009 KShs million	2008 KShs million
	Prepayments	972	966
	Deferred currency expenses	1,580	-
	Advances	<u>318</u>	<u>275</u>
		<u>2,870</u>	<u>1,241</u>

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation. The expense is amortised over the lifespan of the respective bank notes as follows:

Notes	Depreciation
KShs 50 and KShs 100	Over one year on a prorata basis
KShs 200, 500 and 1,000	Over two years on a prorata basis

In prior years, the policy of the Bank was to recognise currency notes expenses on receipt from the printers. Costs on coins are expensed upon delivery of the currency stock from the minters.

**CENTRAL BANK OF KENYA**  
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**14 RETIREMENT BENEFIT ASSET**

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund. The defined benefit plan is funded by the Bank and the Deposit Protection Fund Board, a related party. The retirement benefit asset is wholly recognised in the financial statements of the Bank while the Deposit Protection Fund Board recognises contributions to the fund as if it were a defined contribution scheme.

The amounts recognised in the balance sheet are determined on the basis of an actuarial review carried out by Alexander Forbes Financial Services as at 30 June.

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Present value of funded obligations	9,582	10,496
Fair value of plan assets	<u>(11,678)</u>	<u>(12,136)</u>
Present value of net asset	(2,096)	(1,640)
Unrecognised actuarial gain	<u>671</u>	<u>1,585</u>
Asset in the balance sheet	<u>(1,425)</u>	<u>(55)</u>

The amounts recognised in the income statement are as follows:

Current service costs	453	532
Interest costs	921	847
Expected return on plan assets	(1,085)	(955)
Net gains recognised in the year	(65)	(5)
Adjustment for previous year values	(135)	-
Past service cost	<u>(1,138)</u>	<u>-</u>
Total expenses included in operating expenses	<u>(1,049)</u>	<u>419</u>

Movements in the net asset recognised in the balance sheet are as follows:

Net liability at start of period	(55)	(240)
Net expense recognised in the income statement	(1,051)	419
Employer contributions	<u>(319)</u>	<u>(234)</u>
Net liability at end of period	<u>(1,425)</u>	<u>(55)</u>
Actual return on plan assets	<u>(380)</u>	<u>1,679</u>

The principal actuarial assumptions at the balance sheet date were:

	2009	2008
Discount rate (p.a.)	9%	9%
Salary increase (p.a.)	7%	7%
Expected return on plan assets (p.a.)	9%	9%
Future pension increases	0%	0%

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**15 PROPERTY AND EQUIPMENT**

	<b>Land and buildings KShs million</b>	<b>Motor vehicles KShs million</b>	<b>Furniture and equipment KShs million</b>	<b>Total KShs million</b>
<b>30 June 2009</b>				
Cost				
At start of year	987	215	3,130	4,332
Additions	1	13	683	697
Disposals	<u>-</u>	<u>(32)</u>	<u>-</u>	<u>(32)</u>
At end of the year	<u>988</u>	<u>196</u>	<u>3,813</u>	<u>4,997</u>
Depreciation				
At start of the year	945	168	2,651	3,764
Charge for the year	9	39	183	231
Eliminated on disposal	<u>-</u>	<u>(32)</u>	<u>-</u>	<u>(32)</u>
At end of the year	<u>954</u>	<u>175</u>	<u>2,834</u>	<u>3,963</u>
<b>Net book value at 30 June 2009</b>	<b><u>34</u></b>	<b><u>21</u></b>	<b><u>979</u></b>	<b><u>1,034</u></b>
<b>30 June 2008</b>				
Cost				
At start of year	1,004	184	3,065	4,253
Additions	-	54	66	120
Disposals	<u>(17)</u>	<u>(23)</u>	<u>(1)</u>	<u>(41)</u>
At end of the year	<u>987</u>	<u>215</u>	<u>3,130</u>	<u>4,332</u>
Depreciation				
At start of the year	953	157	2,552	3,662
Charge for the year	9	34	100	143
Eliminated on disposal	<u>(17)</u>	<u>(23)</u>	<u>(1)</u>	<u>(41)</u>
At end of the year	<u>945</u>	<u>168</u>	<u>2,651</u>	<u>3,764</u>
<b>Net book value at 30 June 2008</b>	<b><u>42</u></b>	<b><u>47</u></b>	<b><u>479</u></b>	<b><u>568</u></b>

**CENTRAL BANK OF KENYA**  
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**16 PREPAID OPERATING LEASE RENTALS**

Operating lease rentals are carried at historical cost less amortisation over the period of the lease. The breakdown is as follows:

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>Cost</b>		
At 30 June	<u>300</u>	<u>300</u>
<b>Amortisation</b>		
At 1 July	22	18
Amortisation for the year	<u>3</u>	<u>4</u>
At end of the year	<u>25</u>	<u>22</u>
Net carrying value at end of the year	<u>275</u>	<u>278</u>

The prepaid operating lease rentals relate to L.R. No. IR 53398 which has a lease term of 99 years. The leasehold land was acquired by the Bank in 2002 at a cost of KShs 300,000,000. The cost is amortised on the basis of the remaining life of the lease.

**17 INTANGIBLE ASSETS**

	<b>Software</b>	<b>Work-in-</b>	<b>2009</b>	<b>2008</b>
	<b>KShs</b>	<b>Progress</b>	<b>Total</b>	<b>Total</b>
	<b>KShs</b>	<b>KShs</b>	<b>KShs</b>	<b>KShs</b>
<b>Cost</b>				
At 1 July	180	-	180	180
Additions	<u>37</u>	<u>351</u>	<u>388</u>	<u>-</u>
At end of the year	<u>217</u>	<u>351</u>	<u>568</u>	<u>180</u>
<b>Amortisation</b>				
At 1 July	162	-	162	131
Amortisation for the year	<u>28</u>	<u>-</u>	<u>28</u>	<u>31</u>
At end of the year	<u>190</u>	<u>-</u>	<u>190</u>	<u>162</u>
Net carrying value at end of the year	<u>27</u>	<u>351</u>	<u>378</u>	<u>18</u>

The work-in-progress relates to software acquired for the System of Integrated Management Banking and Accounting (SIMBA) project.



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<b>18 DUE FROM GOVERNMENT OF KENYA</b>	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
At start of the year	34,439	35,549
Receipts during the year	<u>(1,110)</u>	<u>(1,110)</u>
At end of the year	<u>33,329</u>	<u>34,439</u>

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay KShs 1.11 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a held-to-maturity investment and is carried at amortized cost. The Directors have assessed the loan for impairment and the amount of the impairment is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate of 3% per annum. The assessment has indicated that the loan is not impaired.

<b>19 CURRENCY IN CIRCULATION</b>	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Kenya notes	104,002	95,992
Kenya coins	4,034	3,753
Commemorative coins	<u>6</u>	<u>5</u>
	<u>108,042</u>	<u>99,750</u>
Balance at the beginning of the year	99,750	89,799
Deposits by banks	(283,489)	(269,105)
Withdrawals by banks	<u>291,781</u>	<u>279,056</u>
Balance at the end of the year	<u>108,042</u>	<u>99,750</u>

Currency in circulation represents the face value of notes and coins in circulation. Notes and coins held by the Bank as cash in main vault, intermediary vault, and cashier/ teller at the end of financial year have been netted off against the liability for notes and coins in circulation because they do not represent currency in circulation. Currency notes and coins are issued in the following denominations:

Notes: 1,000/=, 500/=, 200/= and 50/=.

Coins: 40/=, 20/=, 10/=, 5/=, 2/=, 1/=, /50, /10 and /05.

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<b>20</b>	<b>DEPOSITS</b>	<b>2009</b>	<b>2008</b>
		<b>KShs million</b>	<b>KShs million</b>
	Local commercial banks (Note 20 a)	51,901	53,868
	Local banks forex settlement accounts (Note 20 b)	1,297	1,239
	External banks forex settlement accounts	89	21
	Other public entities and project accounts	8,181	8,506
	Government of Kenya (Note 20 c)	<u>64,169</u>	<u>67,507</u>
		<u>125,637</u>	<u>131,141</u>

<b>20(a)</b>	Local commercial banks		
	Clearing accounts	7,974	4,166
	Cash reserve ratio	43,927	49,002
	Open Market Operations (OMO) deposits	<u>-</u>	<u>700</u>
		<u>51,901</u>	<u>53,868</u>

The cash reserve ratio is a statutory ratio for monetary policy. Commercial Banks and Non-Bank Financial Institutions (NBFI's) are required to hold at the Central Bank of Kenya a prescribed percentage of their total deposits. The ratio was revised to 5% in December 2008. Prior to that, the ratio was 6% and it is currently at 4.5%. The statutory deposits are determined from commercial banks monthly returns submitted to Central Bank of Kenya on or before the tenth day of every month. Currently there are 43 licensed commercial banks and 2 mortgage finance companies.

<b>20(b)</b>	Local banks forex settlement accounts	<b>2009</b>	<b>2008</b>
		<b>KShs million</b>	<b>KShs million</b>
	Euro	228	162
	Dollar	952	950
	Sterling Pound	<u>117</u>	<u>127</u>
		<u>1,297</u>	<u>1,239</u>
<b>20(c)</b>	Government of Kenya		
	Paymaster General	23,785	21,183
	Treasury Funding Account	15,747	35,515
	The Exchequer Account	18,417	7,990
	Others	<u>6,220</u>	<u>2,819</u>
		<u>64,169</u>	<u>67,507</u>

Under the Central Bank of Kenya Act Cap 491 section 4A (e) the Bank acts as the banker, advisor to, and as fiscal agent of the Government. The Bank receives instructions to transfer funds from the Exchequer Account to voted accounts as per the Exchequer and Audit Act 1955, Part IV Paragraph 17 (2). The instructions are given by the Treasury and specify the Exchequer Account to be debited.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**21 AMOUNTS REPAYABLE UNDER REPURCHASE AGREEMENTS**

This is money mopped up from commercial banks by the Central Bank of Kenya for monetary policy purpose (liquidity management) and is shown in the books of the Bank as a liability to the commercial banks. The money is secured by the Bank using treasury bills and bonds that are described technically as Repos (or repurchase agreements). The balance at year end was nil (2008: KShs 1,807 million) due to the Bank injecting liquidity (reverse Repo) into the economy in contrast to mop-up activities in 2008.

<b>22 OTHER LIABILITIES</b>	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Impersonal accounts	325	3,467
Sundry creditors	663	662
Refundable deposits	421	234
Development deposits	<u>79</u>	<u>100</u>
	<u>1,488</u>	<u>4,463</u>
<b>23 PROVISIONS</b>		
Leave accrual	66	36
Gratuity to staff members	<u>31</u>	<u>30</u>
	<u>97</u>	<u>66</u>
<b>24 SHARE CAPITAL</b>		
Authorised share capital	<u>5,000</u>	<u>5,000</u>
Issued and fully paid	<u>5,000</u>	<u>1,500</u>

The ownership of the entire share capital is vested in the Permanent Secretary to the Treasury.

**25 GENERAL RESERVE FUND**

The general reserve fund is a fund into which at least 10% of the net annual profits of the Bank is transferred at the end of each financial year. This is after allowing for expenses for operation and after provision has been made for bad and doubtful debts, depreciation in assets, contribution to staff benefit fund, and such other contingencies and accounting provisions as the Bank deems appropriate.

**26 DIVIDENDS**

The directors recommend the payment of KShs 7.2 billion dividend for the year ended 30 June 2009 (2008: KShs 4 billion).

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**27 (a) NOTES TO THE CASH FLOW STATEMENT**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>Cash flows from operating activities</b>		
Net profit for the year	23,229	8,995
Adjustments for:		
Depreciation of property and equipment	231	143
Amortization of prepaid operating leases	3	4
Amortization of intangible assets	28	31
Revaluation of currency production costs	1,522	-
Exchange rate effects	(13,462)	(54)
Gain on disposal of property and equipment	(10)	(81)
Revaluation (surplus)/ deficit in defined benefit scheme	<u>(1,370)</u>	<u>185</u>
<b>Operating profit before working capital changes</b>	<b>10,171</b>	<b>9,223</b>
Net (increase)/decrease in loans and advances	(4,857)	282
Decrease in amounts repayable under repurchase agreements	(1,807)	(13,819)
(Decrease)/increase in deposits	(5,504)	39,802
Increase in balance with International Monetary Fund	17,751	3,957
Decrease/(increase) in project accounts	(244)	34
Decrease/(increase) in accrued interest on balances due from banking institutions	1,767	(1,142)
Decrease/(increase) in items in the course of collection	1,455	(2,296)
(Increase)/decrease in other assets	(1,626)	318
(Decrease) / increase in other liabilities	<u>(2,945)</u>	<u>2,801</u>
<b>Net cash generated by operations</b>	<b><u>14,161</u></b>	<b><u>39,160</u></b>

**(b) Cash and cash equivalents**

Cash and cash equivalents included in the cash flow statement comprise the following:

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
Term deposits	221,824	210,866
Current accounts	2,598	4,423
Domestic forex cheques clearing	1,676	1,438
Travellers Cheques	6	6
Gold holdings	<u>34</u>	<u>28</u>
	226,138	216,761
Investment in Government securities	15,010	8,539
Investments with RAMP	<u>15,394</u>	<u>-</u>
	<b><u>256,542</u></b>	<b><u>225,300</u></b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**28 RELATED PARTY TRANSACTIONS**

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya, the ultimate owner of the Bank, and the Deposit Protection Fund Board.

**(i) Loans**

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 12) include advances to employees that as at 30 June 2009 amounted to KShs 2,493 million (2008: KShs 2,422 million). The advances are at preferential rates of interest determined by the Bank.

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
<b>(ii) Loans to executive directors</b>		
At start of the year	1	2
Loans advanced during the year	10	-
Loan repayments	<u>(2)</u>	<u>(1)</u>
At end of the year	<u>9</u>	<u>1</u>
<b>(iii) Loans to key management personnel</b>		
At start of the year	18	22
Loans advanced during the year	41	34
Loan repayments	<u>(20)</u>	<u>(23)</u>
At end of the year	<u>39</u>	<u>33</u>
<b>(iv) Directors' emoluments:</b>		
Fees to non executive directors	25	13
Other remuneration to executive directors	<u>50</u>	<u>35</u>
	<u>75</u>	<u>48</u>
<b>(v) Remuneration to senior management</b>	<u>148</u>	<u>134</u>
<b>(vi) Post –employment pension</b>	<u>2</u>	<u>2</u>
<b>(vii) Government of Kenya</b>		

Transactions entered into with the Government include:

- (a) Banking services;
- (b) Management of issue and redemption of securities at a commission and;
- (c) Foreign currency denominated debt settlement and other remittances at a fee.

As at the close of business on 30 June, the following balances, which are included in various balance sheet categories, were outstanding:

Due from Government of Kenya (Note 18)	33,329	34,439
Overdraft account (Note 12)	5,124	-
Loan from IMF to the Government of Kenya (Note 9)	718	1,053
Government of Kenya deposits (Note 20)	<u>64,169</u>	<u>67,507</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**28 RELATED PARTY TRANSACTIONS (continued)**

**(vi) Deposit Protection Fund Board**

The Bank has a close working relationship with the Deposit Protection Fund Board, an entity incorporated under the Banking Act, and provides it with staff and office accommodation. Certain costs incurred on behalf of the Deposit Protection Fund Board are fully reimbursed to the Bank.

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was KShs 13 million (2008: KShs 15million).

**(vii) Kenya School of Monetary Studies**

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank. The School is operated as a department and results of its operations are incorporated in the financial statements of the Bank.

**29 RISK MANAGEMENT**

**(i) Structure and Reporting**

The Board of Directors is responsible for the overall risk management approach and for approving the risk management policy and strategies. There are other organs that monitor the assessment and management of risks within the Bank including;

**a) Audit Committee of the Board**

The Audit Committee assists the Board in the fulfilment of its oversight responsibilities. Regarding risk management, the Committee oversees the process of risk management by receiving and discussing risk management reports and guiding and monitoring the implementation of recommended mitigating controls/ initiatives.

**b) Bank Risk Management Committee**

The purpose of the Bank Risk Management Committee is to identify the nature of risks affecting the Bank and the processes by which these risks are to be managed. The Committee monitors external developments relating to all financial, business and strategic risks associated with the operations of the Bank. The Committee is further, charged with the responsibility of reviewing the adequacy and overall effectiveness of the Bank's risk management and business continuity management frameworks and oversees the inculcation of a risk philosophy and implementation of a risk strategy and policy across the Bank. In executing its mandate, the Committee receives and considers risk assessment reports from Internal Audit and Risk Management Department.

**c) Internal Audit and Risk Management Department (IARM)**

The Internal Audit arm of IARM Department employs risk-based audit approach in planning and carrying out its audit engagements. The Risk Management function facilitates risk assessments by individual departments where risks are identified, analyzed and mitigating measures agreed upon.

**29 RISK MANAGEMENT(continued)**

The business processes are assessed with regard to business continuity procedures, physical safety, system safety, conformity to legal requirements and regulations, sufficiency of human resources and information safety. In addition, the financial risks and reputation risks are also determined. Controls that are designed to reduce these risks to acceptable levels are assessed in terms of sufficiency and effectiveness; additional controls are recommended in order to increase effectiveness. Following the risk assessments, the major risks and recommendations are used to update the Bank's risk register and regularly reported to the Bank Risk Management Committee and the Audit Committee. Action plans that are taken to reduce the risks to acceptable levels are monitored.

**ii) Strategy in Using Financial Instruments**

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate movements. The Bank can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

In view of the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya. The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach. Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

**iii) Risks facing the Bank**

The following are the main types of risks that the Bank is exposed to in the course of executing its operations:

Financial Risks include:

- 1) Credit risk
- 2) Market risk
  - Interest risk
  - Foreign currency exchange risk
- 3) Liquidity risk

Non financial Risks include:

- 4) Operational risk
- 5) Human resource risk
- 6) Legal risk
- 7) Reputation risk

**Financial Risks**

**a) Credit risk**

During its financial operations, the Bank is exposed to credit risk, defined as the probability of a complete or partial failure of counterparty to fulfil its obligations arising from a financial transaction. The credit risk basically originates from the investments made of deposit placements, if on their maturity the depository bank is unable to pay.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**29 RISK MANAGEMENT (continued)**

**a) Credit risk (continued)**

The management of the credit risk that the Bank is exposed to during the foreign exchange reserve management is based on the principle of minimizing default probabilities of the counterparties and the financial loss in case of default. The choice of depository banks for deposit placements is a crucial consideration in credit and sovereign risk management. Currently, the Bank's choice of depository banks is confined to the top 200 international banks that meet the set eligibility criteria of financial soundness on long-term credit rating, short-term credit rating, composite rating and capital adequacy. The current active approved depository banks holding the Bank's deposits number twenty one (21) and their performance is reviewed periodically, based on performance ratings provided by international rating agency, Fitch IBCA. Deposit placement limits are allocated to individual banks based on their financial strength, and no individual bank holds more than 10% of the entire deposit portfolio.

To minimize the sovereign risk exposure, the eligible banks are distributed among 10 countries under the following set criteria; long-term credit rating of A+, short-term credit rating of F1, composite rating of B and BIS capital adequacy ratio of 8%.

The Bank undertakes its operations in the Republic of Kenya. An analysis of the Bank's assets and liabilities by geographical area is given below:

	<b>2009</b>	<b>2008</b>
	<b>KShs Millions</b>	<b>KShs Millions</b>
<b>Assets</b>		
Republic of Kenya	65,736	51,612
United Kingdom	194,138	124,291
Rest of Europe	31,343	95,413
United states of America	20,481	3,338
Rest of the World	<u>21</u>	<u>524</u>
	<b><u>311,717</u></b>	<b><u>275,178</u></b>
<b>Liabilities</b>		
Republic of Kenya	<b><u>311,717</u></b>	<b><u>275,178</u></b>



**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**b) Interest risk**

This table shows the extent to which the Bank's interest rate exposures on assets and liabilities are matched. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and maturity date.

As at 30 June 2009

	<b>3 months or less KShs million</b>	<b>Between 3-12 months KShs million</b>	<b>Over 1 year KShs million</b>	<b>Non- interest bearing KShs million</b>	<b>Total KShs million</b>
<b>Assets</b>					
Balances due from banking institutions and gold holdings	242,039	-	-	4,695	246,734
International Monetary Fund (SDR Account)	914	-	-	-	914
Items in the course of collection	-	-	-	1,430	1,430
Advances to Banks	15,011	-	-	-	15,011
Loans and advances	74	934	7,309	-	8,317
Other assets	-	-	-	2,870	2,870
Property, plant and equipment	-	-	-	1,034	1,034
Prepaid leasehold land	-	-	-	275	275
Intangible assets	-	-	-	378	378
Retirement benefit asset	-	-	-	1,425	1,425
Due from Government of Kenya	-	<u>1,110</u>	<u>32,219</u>	-	<u>33,329</u>
<b>Total assets</b>	<u>258,038</u>	<u>2,044</u>	<u>39,528</u>	<u>12,107</u>	<u>311,717</u>
<b>Liabilities and equity</b>					
Currency in circulation	-	-	-	108,042	108,042
Deposits	<u>125,637</u>	-	-	-	125,637
International Monetary Fund	-	-	-	37,448	37,448
Amounts repayable under repurchase agreements	-	-	-	-	-
Other liabilities	-	-	-	1,585	1,585
Equity and reserves	-	-	-	<u>39,005</u>	<u>39,005</u>
<b>Total liabilities and equity</b>	<u>125,637</u>	<u>-</u>	<u>-</u>	<u>186,080</u>	<u>311,717</u>
<b>Interest sensitivity gap 2009</b>	<u>132,401</u>	<u>2,044</u>	<u>39,528</u>	<u>(173,973)</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**c) Interest risk (continued)**

**As at 30 June 2008**

	<b>3 months or less KShs million</b>	<b>Between 3-12 months KShs million</b>	<b>Over 1 year KShs million</b>	<b>Non- interest bearing KShs million</b>	<b>Total KShs million</b>
<b>Assets</b>					
Balances due from banking institutions and gold holdings	219,035	-	-	4,451	223,486
International Monetary Fund(SDR Account)	206	-	-	-	206
Items in the course of collection	-	-	-	2,885	2,885
Investment in government securities	8,539	-	-	-	8,539
Loans and advances	74	933	2,453	-	3,460
Other assets	-	-	-	1,244	1,244
Property, plant and equipment	-	-	-	568	568
Prepaid leasehold land	-	-	-	278	278
Intangible assets	-	-	-	18	18
Retirement benefit asset	-	-	-	55	55
Due from Government of Kenya	-	<u>1,110</u>	<u>33,329</u>	-	<u>34,439</u>
<b>Total assets</b>	<u>227,854</u>	<u>2,043</u>	<u>35,782</u>	<u>9,499</u>	<u>275,178</u>
<b>Liabilities and equity</b>					
Currency in circulation	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	131,141
International Monetary Fund	-	-	-	19,697	19,697
Amounts repayable under repurchase agreements	1,807	-	-	-	1,807
Other liabilities	-	-	-	4,529	4,529
Equity and reserves	-	-	-	<u>18,254</u>	<u>18,254</u>
<b>Total liabilities and equity</b>	<u>132,948</u>	-	-	<u>142,230</u>	<u>275,178</u>
<b>Interest sensitivity gap 2008</b>	<u>94,906</u>	<u>2,043</u>	<u>35,782</u>	<u>(132,731)</u>	<u>=</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**29 RISK MANAGEMENT (continued)**

**c) Foreign currency exchange rate risk**

Foreign currency exchange rate risk signifies the probability of incurring a loss stemming from adverse market movements, usually in interest rates, currency exchange rates and asset prices.

For the purpose of managing foreign currency exchange rate risk, the Bank holds a diversified portfolio that spreads over the major world currencies with the following features; stability, widely traded, international acceptability and offering the best range of investment instruments. Guided by these features and the need to minimize transaction costs in external payments, the Bank invests its reserves in four key international currencies, namely, US dollar (USD), British pound (GBP), Euro (EUR) and the Swiss Franc (CHF).

The distribution of these currencies in the portfolio is subject to review from time to time. However, to allow for flexibility in portfolio management, the mix benchmarks are allowed +5% within the following ranges:

USD: 30 - 40%

GDP: 45 - 55%

EUR: 10 - 20%

CHF: 0 - 5%

The net foreign currency position of the Bank as of 30 June 2009 and 2008 is summarized below. The table presented below provides the Bank's assets, and liabilities, at carrying amounts, categorized by currency.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**c) Foreign currency exchange rate risk (continued)**

The various currencies to which the Bank is exposed at 30 June 2009 are summarised below (all expressed in KShs million):-

	<b>USD</b>	<b>GBP</b>	<b>EURO</b>	<b>SDR</b>	<b>GOLD</b>	<b>OTHER</b>	<b>TOTAL</b>
<b>Assets</b>							
Balances due from banking institutions	112,263	82,955	51,425	-	-	57	246,700
Special Drawing Rights	-	-	-	914	-	-	914
Gold holdings	-	-	-	-	34	-	34
Total assets	<u>112,263</u>	<u>82,955</u>	<u>51,425</u>	<u>914</u>	<u>34</u>	<u>57</u>	<u>247,648</u>
<b>Liabilities</b>							
Balances due to IMF	-	-	-	37,448	-	-	37,448
Commissions for EEC Development Fund	-	-	79	-	-	-	79
Local Banks forex settlements	952	118	229	-	-	-	1299
Local bank guarantees	272	-	-	-	-	-	272
Forex bureaux deposits	<u>148</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>148</u>
Total liabilities	<u>1,372</u>	<u>118</u>	<u>308</u>	<u>37,448</u>	<u>-</u>	<u>-</u>	<u>39,246</u>
<b>Net balance sheet position 2009</b>	<b><u>110,891</u></b>	<b><u>82,837</u></b>	<b><u>51,117</u></b>	<b><u>(36,534)</u></b>	<b><u>34</u></b>	<b><u>57</u></b>	<b><u>208,402</u></b>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

c) **Foreign currency exchange rate risk (continued)**

As at 30 June 2008 (all expressed in KShs million):-

	<b>USD</b>	<b>GBP</b>	<b>EURO</b>	<b>SDR</b>	<b>GOLD</b>	<b>OTHER</b>	<b>TOTAL</b>
<b>Assets</b>							
Balances due from banking institutions	73,789	108,802	40,326	-	-	541	223,458
Special Drawing Rights	-	-	-	206	-	-	206
Gold holdings	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>28</u>	<u>-</u>	<u>28</u>
Total assets	<u>73,789</u>	<u>108,802</u>	<u>40,326</u>	<u>206</u>	<u>28</u>	<u>541</u>	<u>223,692</u>
<b>Liabilities</b>							
Balances due to IMF	-	-	-	19,697	-	-	19,697
Commissions for EEC Development Fund	-	100	-	-	-	-	100
Forex bureaux deposits	<u>1,112</u>	<u>123</u>	<u>161</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,396</u>
Total liabilities	<u>1,112</u>	<u>223</u>	<u>161</u>	<u>19,697</u>	<u>-</u>	<u>-</u>	<u>21,193</u>
<b>Net balance sheet position 2008</b>	<u><b>72,677</b></u>	<u><b>108,579</b></u>	<u><b>40,165</b></u>	<u><b>(19,491)</b></u>	<u><b>28</b></u>	<u><b>541</b></u>	<u><b>202,499</b></u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**29 RISK MANAGEMENT (continued)**

**d) Liquidity risk**

Liquidity risk is defined as having difficulty in finding sufficient cash to meet the commitments that are due or being compelled to convert assets into cash at a price lower than their fair value. The choice of the types of instruments to invest the reserves in is part of liquidity risk management. The available instruments are governed by Section 26 of the Central Bank of Kenya Act which specifies the eligible instruments in which the Bank can invest its reserves including; gold, demand or time deposits and convertible and marketable securities of or, guaranteed by foreign governments or international financial institutions.

In order to manage liquidity risk, the Bank invests its surplus reserves in time deposits with maturities concentrated in short-term maturity span of one to three months. The portfolio is structured in such a manner that a mix of deposits matures every week to ensure availability of funds to meet scheduled government and the Bank's obligations.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

e) **Liquidity risk (continued)**

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 30 June 2009 to the contractual maturity date.

	<b>On demand KShs million</b>	<b>Due within 3 months KShs million</b>	<b>Due between 3-12 months KShs million</b>	<b>Due between 1-5yrs KShs million</b>	<b>Due after 5 years KShs million</b>	<b>Total KShs million</b>
<b>ASSETS</b>						
Balances due from banking institutions and gold holdings	25,790	220,910	-	-	34	246,734
International Monetary Fund (SDR Account)	914	-	-	-	-	914
Loans and advances	5,124	118	702	1,772	601	8,317
Advances to Banks against government securities	-	15,011	-	-	-	15,011
Items in the course of collection	1,430	-	-	-	-	1,430
Other assets	-	2,870	-	-	-	2,870
Property, plant and equipment	-	-	-	-	1,034	1,034
Prepaid leasehold land	-	-	-	-	275	275
Intangible assets	-	-	-	-	378	378
Retirement benefit asset	-	-	-	-	1,425	1,425
Due from Government of Kenya	-	-	1,110	4,440	27,779	33,329
<b>TOTAL ASSETS</b>	<u>33,258</u>	<u>238,909</u>	<u>1,812</u>	<u>6,212</u>	<u>31,526</u>	<u>311,717</u>
<b>LIABILITIES</b>						
Currency in circulation	-	-	-	-	108,042	108,042
Deposits	125,637	-	-	-	-	125,637
International Monetary Fund	-	-	413	1,535	35,500	37,448
Amounts repayable under repurchase agreements	-	-	-	-	-	-
Other liabilities	-	1,585	-	-	-	1,585
Equity and reserves	-	-	-	-	39,005	39,005
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>125,637</u>	<u>1,585</u>	<u>413</u>	<u>1,535</u>	<u>182,547</u>	<u>311,717</u>
<b>Liquidity gap 2009</b>	<u>(92,379)</u>	<u>237,324</u>	<u>1,399</u>	<u>4,677</u>	<u>(151,021)</u>	<u>-</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

f) **Liquidity risk (continued)**

As at 30 June 2008

	<b>On demand</b>	<b>Due within 3 months</b>	<b>Due between 3-12 months</b>	<b>Due between 1-5yrs</b>	<b>Due after 5 years</b>	<b>Total</b>
<b>ASSETS</b>	<b>KShs million</b>	<b>KShs million</b>	<b>KShs million</b>	<b>KShs million</b>	<b>KShs million</b>	<b>KShs million</b>
Balances due from banking institutions and gold holdings	12,798	210,660	-	-	28	223,486
International Monetary Fund(SDR Account)	206	-	-	-	-	206
Loans and advances	41	118	701	1,772	828	3,460
Investments in government securities	-	8,539	-	-	-	8,539
Items in the course of collection	2,885	-	-	-	-	2,885
Other assets	-	1,244	-	-	-	1,244
Property, plant and equipment	-	148	366	54	-	568
Prepaid leasehold land	-	1	3	14	260	278
Intangible assets	-	9	9	-	-	18
Retirement benefit asset	-	-	-	-	55	55
Due from Government of Kenya	-	-	<u>1,110</u>	<u>4,440</u>	<u>28,889</u>	<u>34,439</u>
<b>TOTAL ASSETS</b>	<u>15,930</u>	<u>220,719</u>	<u>2,189</u>	<u>6,280</u>	<u>30,060</u>	<u>275,178</u>
<b>LIABILITIES</b>						
Currency in circulation	-	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	-	131,141
International Monetary Fund	-	-	413	1,535	17,749	19,697
Amounts repayable under repurchase agreements	-	1,807	-	-	-	1,807
Other liabilities	-	4,529	-	-	-	4,529
Equity and reserves	-	-	-	-	<u>18,254</u>	<u>18,254</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<u>131,141</u>	<u>6,336</u>	<u>413</u>	<u>1,535</u>	<u>135,753</u>	<u>275,178</u>
<b>Liquidity gap 2008</b>	<u>(115,211)</u>	<u>214,383</u>	<u>1,776</u>	<u>4,745</u>	<u>(105,693)</u>	<u>-</u>



**29 RISK MANAGEMENT (continued)**

**Non-Financial Risk**

**f) Operational risk**

Operational risk is the risk of loss due to human or system errors, incompatibility or failure of internal business processes, or external events. The Bank seeks to minimize losses from operational risk by establishing effective internal control systems which prevent or detect all errors and situations which might cause loss through failure of people or processes in such a way that losses are avoided or reduced to the minimum possible extent. The Bank has assigned the responsibility for managing operational risks to the management of the departments.

The assessment of risks in terms of their effects and probabilities of occurrence and the adequacy, effectiveness and efficiency of the controls established to mitigate the risks is done vide audits and risk assessments conducted by the Internal Audit and Risk Management Department(IARM).

**g) Human Resource Risk**

The particular nature of the activities of the Bank necessitates specialized knowledge in many areas.

The Bank ensures that there is an adequate knowledge base for all specialized job requirements by investing significantly in human resource development in terms of capacity building and practical exposure. The Bank also organizes workshops, seminars, conferences and job attachments to its staff as an effort to improve its human resource requirements.

**h) Legal Risk**

Legal risks arise from any uncertainty of enforceability, whether through legal or judicial processes, of the obligations of the Bank's clients and counter parties. These are the risks that the Bank may not be complying fully with the relevant laws and legislations. The Bank aims at minimizing such uncertainties through continuous consultations with all relevant parties.

In mitigating these types of the risks, the Bank ensures that all business agreements are subjected to extensive legal reviews before contracting.

**i) Reputation Risk**

The concern about reputation flows from the fact that the Bank is a public institution with important responsibilities for stability in the value of money, the soundness and efficiency of the financial system and the issue of currency (notes and coins). All of these matters have direct impact on all citizens and the credibility and the reputation of the Bank is an important factor in the successful fulfilment of these responsibilities.

In managing this risk, the Bank adheres to the best practices and applies principles of sound corporate governance. It also ensures that all key staff has a clear understanding of the appropriate processes in respect of the best practice and principles of good corporate governance.

The Bank therefore, sets out policies and guidelines that govern sound functional operations within the Bank. The performance of these policies and guidelines are periodically reported to different levels of the Bank's Management for Control and Compliance Monitoring.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**30 SENSITIVITY ANALYSIS**

The Bank uses models to assess the impact of possible changes in market risks. These risks include interest rate risk and foreign exchange risk. The Board is yet to establish limits on exposure gaps; these limits will be utilised to ensure risk positions are effectively managed. The limits will provide possible alternative assumptions to be applied as well as professional judgement to an analysis of the data available to support each assumption.

**(i) Interest rate risk**

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 29). The sensitivity computations assume that financial assets maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Effect on profit before tax of a +13% change in interest rates	440	1,339
Effect on profit before tax of a -13% change in interest rates	(440)	(1,339)

**(ii) Currency risk**

Currency risk is the risk of loss resulting from changes in exchange rates. The Bank bases its analysis on the interest sensitivity gap (Note 29). The Bank has assets and liabilities in various currencies; however, the most significant exposure arises from assets denominated in the US dollar, GBP and Euro currencies. The following table demonstrates the sensitivity to reasonably possible change in the KShs/ US dollar exchange rate, with all other variables held constant, of the Bank's profit earned.

	<b>2009</b> <b>KShs million</b>	<b>2008</b> <b>KShs million</b>
Effect on profit before tax of a +7% change in exchange rates	16,093	13,250
Effect on profit before tax of a -7% change in exchange rates	(16,093)	(13,250)

**31 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES**

In the opinion of the directors, the fair values of the Bank's financial assets and liabilities approximate their respective carrying amounts. Fair values are based on discounted cash flows using a discount rate based on the borrowing rate that directors expect would be available to the Bank at the balance sheet date.

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**31 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (continued)**

The effective interest rates for the principal financial assets and liabilities at 30 June 2009 and 2008 were in the following ranges:

	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Government securities	6.64%	6.64%
Deposits with overseas correspondent banks		
- current accounts	0.0%	0.0%
- term deposits (USD)	1.72%	4.75%
- term deposits (Sterling Pounds)	2.48%	5.90%
- term deposits (Euro)F	2.58%	4.44%
Loans and advances - commercial banks	8.50%	8.50%
- Government of Kenya	8.50%	8.50%
- employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%
<b>Liabilities</b>		
- deposits	0.0%	0.0%

**32 CONTINGENCIES**

- (i) The Bank is party to various legal proceedings with potential liability of KShs 496.5 million as at 30 June 2009. Having regard to all circumstances and the legal advice received, the directors are of the opinion that these legal proceedings will not give rise to liabilities.
- (ii) The Bank has applied for waiver of interest and penalties amounting to KShs 22,530,780 relating to PAYE and withholding tax arising from an assessment conducted by Kenya Revenue Authority. The directors are of the opinion that the liability will not crystallize because of the expected success of the request for waiver.

**33 COMMITMENTS**

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
(a) Capital: Authorised and contracted for	<u>17</u>	<u>10</u>
(b) Capital: Authorised and not contracted for		
Office furniture	491	16
Office equipment	1,291	1,761
Computer equipment	1,136	1,372
Computer equipment - SIMBA Software	677	-
Computer equipment - SIMBA Hardware	261	-
Fixtures & fittings	158	121
Motor vehicles	53	143
Consultancy contracts	358	-
Plot acquisition & development	650	665
Others	<u>86</u>	<u>59</u>
	<u>5,161</u>	<u>4,137</u>

**CENTRAL BANK OF KENYA**  
**NOTES TO THE FINANCIAL STATEMENTS (continued)**  
**FOR THE YEAR ENDED 30 JUNE 2009**

**34 OPERATING LEASE COMMITMENTS**

**AS LESSEE:**

The total future minimum lease payments due to third parties under non-cancellable operating leases are as follows:

	<b>2009</b>	<b>2008</b>
	<b>KShs million</b>	<b>KShs million</b>
One year	11	11
Between two and five years	7	7
Over five years	<u>140</u>	<u>140</u>
	<b><u>158</u></b>	<b><u>158</u></b>

Lease commitments relate to lease rentals for L.R No. 209/11441.

**35 EMPLOYEES**

The average number of employees during the year was 1,220 (2008: 1,255).

**36 TAXES**

No provision for tax is made as Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

**37 COMPARATIVES**

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