

CENTRAL BANK OF KENYA

REPORT AND FINANCIAL STATEMENTS

AT

30 JUNE 2011

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011

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CENTRAL BANK OF KENYA

BANK INFORMATION **FOR THE YEAR ENDED 30 JUNE 2011**

DIRECTORS

Prof. Njuguna Ndung'u	-	Governor and Chairman	Reappointed on 4 March 2011
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman	
Mr. Joseph K. Kinyua	-	Permanent Secretary - Treasury, Member	
Mr. Joseph K. Waiguru	-	Member	Retired on 28 September 2010
Dr. William O. Ogara	-	Member	Reappointed on 14 March 2011
Mr. Nicholas A. Nesbitt	-	Member	Retired on 28 September 2010
Ms. Agnes Wanjiru	-	Member	Retired on 4 January 2011
Dr. Mbui Wagacha	-	Member	Appointed on 14 March 2011
Ms. Vivienne Y. Apopo	-	Member	Appointed on 14 March 2011
Ms. Florence K. Muindi	-	Member	Appointed on 1 June 2011
Mr. John G. Msafari	-	Member	Appointed on 1 June 2011

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	-	Governor
Dr. Hezron Nyangito	-	Deputy Governor
Mr. Kennedy K. Abuga	-	Director – Governors' Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director – Finance & IMS Department
Mr. Fredrick Pere	-	Director – Banking Supervision Department
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director – Internal Audit Department
Mr. Charles Koori	-	Director – Research Department
Mr. Cassian J. Nyanjwa	-	Director – Department of Estates, Supplies and Transport
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration Department
Mr. Jackson M. Kitili	-	Director – Banking & Risk Management Department (Transferred on 3 December 2010)
Mr. Gerald Nyaoma	-	Director – Financial Markets (Transferred on 3 December 2010)
Mr. Peter K. Rotich	-	Director – Human Resources and Administration Department

REGISTERED OFFICE

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

BRANCHES AND CURRENCY CENTERS

Mombasa

Central Bank of Kenya Building
Nkrumah Road
P.O Box 86372
80100 Mombasa, Kenya

Kisumu

Central Bank of Kenya Building
Jomo Kenyatta Highway
P.O Box 4
40100 Kisumu, Kenya

Nyeri

Kenya Commercial Bank Building
Kenyatta Street
P.O Box 840
10100 Nyeri

Eldoret

Kiptagich House
Uganda Road
P.O Box 2710
30100 Eldoret, Kenya

Kenya School of Monetary Studies

Thika Road
P.O Box 65041
00200 Nairobi, Kenya

Nakuru

George Morara Street
P.O.Box 14094
20100 Nakuru, Kenya

Meru

Co-operative Bank Building
Njuri Ncheke Street
P.O Box 2171
60200 Meru, Kenya

CENTRAL BANK OF KENYA

BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

AUDITORS

KPMG Kenya
Lonrho House, 16th Floor
Standard Street
P.O Box 40612
00100 Nairobi, Kenya

MAIN LAWYERS

Oraro and Co. Advocates
ACK Garden House
1st Ngong Avenue
P.O Box 51236
00200 Nairobi, Kenya

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2011

The directors submit their report together with the audited financial statements for the year ended 30 June 2011, 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 are set out on page 10. During the year under review, the Bank registered total income amounting to KShs 49,485m consisting of KShs 9,182m from ordinary operations, KShs 38,934m from foreign currency revaluations and KShs 1,369m from revaluation of fixed assets. During the same year, total expenditure amounting to KShs 8,560m was also recorded. As a result, the Bank recorded a net surplus of Kshs 40,925m including unrealized foreign currency revaluation gains amounting to KShs 38,934m and Kshs 1,369m from revaluation of fixed assets. The foreign currency revaluation gains were accumulated as the Kenya Shilling heavily lost value against major convertible currencies particularly towards the end of the year compared to the closing position as at June 30, 2010. The comparative amount for previous year was a loss of KShs 1,639 million (inclusive of foreign currency translation losses of KShs 1,247 million). The performance in the year 2010-2011 is higher than the previous year due to improved international deposit interest rates in the year under review and the effects of the depreciation of the local currency against the Bank's reserve currencies. Owing to expenditure control during the year, operating expenses were generally lower than the previous year. However, these savings were more than offset by higher depreciation charge for the year brought about by fixed asset census and revaluation carried out during the year that generated higher depreciation owing to new asset values. Overall, the financial performance of the Bank has over the last two years been about 60% lower than normal owing to the effects of the sluggish World economy which has adversely affected the Bank's main source of income.

3.2 Financial position

The financial position of the Bank is set out in the statement of financial position on page 11. During the year under review, the assets of the Bank increased by KShs 72,694 million (20%). This was mainly due to net purchases of foreign currency, receipt of some money from IMF and weakening of the Kenya Shilling against World main currencies. The other factor that added to the growth in assets is overnight lending to commercial banks whose balance stood at KShs 19,873m at the end of the year compared to nil balance at the end of the previous year. This rise was mitigated by Government borrowing from the Bank that reduced by KShs 10 billion from the position at the end of the previous year.

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

3.2. Financial position (Continued)

Tight liquidity in the market towards end of the year compelled commercial banks to resort to lender of last resort.

Total liabilities and equity correspondingly went up by KShs 72,694m mainly due to rise in currency in circulation (10%) and increase in IMF liabilities in USA Dollars that were allocated to the Bank by the Fund for BOP purposes. The recorded net surplus for the period of KShs 40,925m also significantly contributed to the growth in equity and therefore totals liabilities. These increases were mitigated by a net decrease of KShs 7.4 billion in commercial bank and Government deposits.

4. Dividend

The Board of Directors does not recommend payment of a dividend (2010: KShs 2 billion).

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, KPMG Kenya, were appointed during the financial year 2009/2010 in line with the Public Procurement and Disposal Act, 2005 for a period of three years and are serving their second year in the audit of the year under review.

BY ORDER OF THE BOARD

K. K. Abuga
BOARD SECRETARY

Date: 12 September 2011

CENTRAL BANK OF KENYA

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of Central Bank of Kenya set out on pages 10 to 60 which comprise the statement of financial position as at 30 June 2011, and the statement of comprehensive income, statement of changes in equity and statement of cashflows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors' responsibilities include: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances, preparation and presentation of financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Central Bank Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of the Bank's operating results.

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

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

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 12 September 2011 and were signed on its behalf by:

Governor

Director

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 be composed of 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 four Non-Executive Directors namely Dr. Mbui Wagacha, Mr. John Gerin Msafari, Ms. Vivienne Yeda Apopo and Ms. Florence Kagendi Muindi who are all serving their first term. Dr. William Otiende Ogara is serving his second 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 members of the Audit Committee are Dr. William Otiende Ogara (Chairman), Dr. Mbui Wagacha, Mr. John Gerin Msafari and Ms. Vivienne Yeda Apopo. The members are all Non-Executive Directors having experience in Accounting, Auditing, Economics, Banking, Financial and Business Management and Legal matters. 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.

CENTRAL BANK OF KENYA

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

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:

- The Governor who is also the Chairman-internal member
- The Deputy Governor who is the Deputy Chairman-internal member
- Permanent Secretary to the Treasury or his representative who shall be non-voting member
- Professor T. C. Ryan-external member appointed by Minister for Finance (Reappointed on 1 May 2011)
- Dr. Rose W. Ngugi-external member appointed by Minister for Finance (Resigned on 17 September 2010)
- Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance (Reappointed on 1 May 2011)
- Mr. Wycliffe Mukulu-external member appointed by Minister for Finance (Resigned on 30 April 2011)
- Prof. Francis M. Mwege-external member appointed by Minister for Finance (Appointed on 1 May 2011)
- Mrs. Farida Abdul-external member appointed by Minister for Finance (Appointed on 1 May 2011)
- Mr. Charles Koori- internal member appointed by Governor
- Mr. John K. Birech-internal member appointed by Governor

Human Resources Committee

The Committee was previously chaired by Ms Agnes Wanjiru till her retirement on January 4, 2011 and membership included three other Non-Executive Directors with the Governor and the Deputy Governor in attendance. The Committee is yet to be constituted under the new board which was appointed during the year. The committee once in place will meet regularly and 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 several 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 2010/2011 is disclosed in note 30 (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.

CENTRAL BANK OF KENYA

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

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.

Internal Audit and Risk Management

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 and placed in the website of the bank.

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

We have audited the financial statements of Central Bank of Kenya set out on pages 10 to 60 which comprise the statement of financial position at 30 June 2011, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

As stated on page 5, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

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 relevant 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 our 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, we consider 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 management, 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 opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of Kenya Act.

Date: 12 September 2011

CENTRAL BANK OF KENYA

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2011

	Note	2011 KShs'million	2010 KShs'million
Interest income	4	4,303	3,089
Interest expense	5	(30)	(91)
Net interest income		4,273	2,998
Fee and commission income	6	3,003	3,005
Foreign exchange gain/(loss)	7	40,017	(1,247)
Other operating income	8	<u>793</u>	<u>984</u>
Operating income		48,086	5,740
Operating expenses	9	(8,530)	(7,379)
Profit/(loss) for the year		39,556	(1,639)
Other comprehensive income			
Revaluation surplus		<u>1,369</u>	<u>-</u>
Total comprehensive income		<u>40,925</u>	<u>(1,639)</u>

The notes set out on pages 14 to 60 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2011

		2011	Restated
ASSETS	Note	KShs million	2010
			KShs million
Balances due from banking institutions and gold holdings	10	368,835	284,682
Funds held with International Monetary Fund	11	2,731	26,272
Items in the course of collection	12	409	316
Advances to banks	13	49	31
Loans and advances	14	30,642	20,674
Other assets	15	5,385	4,802
Retirement benefit asset	16	1,897	1,894
Property and equipment	17	2,849	1,024
Prepaid operating lease rentals	18	268	272
Intangible assets	19	1,171	853
Due from Government of Kenya	20	<u>32,380</u>	<u>33,102</u>
TOTAL ASSETS		<u>446,616</u>	<u>373,922</u>
LIABILITIES			
Currency in circulation	21	147,718	125,024
Deposits	22	135,792	143,228
Amounts due to International Monetary Fund	11	81,829	63,276
Other liabilities	23	9,447	9,474
Dividends payable	24	2,641	2,641
Provisions	25	<u>98</u>	<u>113</u>
TOTAL LIABILITIES		<u>377,525</u>	<u>343,756</u>
EQUITY AND RESERVES			
Share capital	26	5,000	5,000
General reserve fund	27	62,722	23,166
Revaluation reserve		1,369	-
Proposed dividend	28	<u>-</u>	<u>2,000</u>
TOTAL EQUITY AND RESERVES		<u>69,091</u>	<u>30,166</u>
TOTAL LIABILITIES AND EQUITY		<u>446,616</u>	<u>373,922</u>

The financial statements were approved by the Board of Directors for issue on 12 September 2011 and signed on its behalf by:

Governor

Director

The notes set out on pages 14 to 60 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2011

	Share capital KShs million	General reserve fund KShs million	Revaluation Reserve KShs million	Proposed Dividend KShs million	Total KShs million
At 1 July 2009	5,000	26,805	-	7,200	39,005
Comprehensive income for the year					
Loss for the year	-	(1,639)	-	-	(1,639)
Total comprehensive income for the year	-	(1,639)	-	-	(1,639)
Transactions with owners directly recorded in equity					
2009 dividends paid	-	-	-	(4,559)	(4,559)
Transfer to dividends payable (Earmarked)	-	-	-	(2,641)	(2,641)
Proposed dividends	-	(2,000)	-	2,000	-
Total contributions by and distribution to the owners	-	(2,000)	-	(5,200)	(7,200)
As at 30 June 2010	<u>5,000</u>	<u>23,166</u>	<u>-</u>	<u>2,000</u>	<u>30,166</u>
At 1 July 2010	5,000	23,166	-	2,000	30,166
Comprehensive income for the year					
Profit for the year	-	39,556	-	-	39,556
Other comprehensive income for the year					
Revaluation surplus	-	-	1,369	-	1,369
Total comprehensive income for the year	-	39,556	1,369	-	40,925
Transactions with owners directly recorded in equity					
2010 dividends paid	-	-	-	(2,000)	(2,000)
Proposed dividends	-	-	-	-	-
Total contributions by and distribution to the owners	-	-	-	(2,000)	(2,000)
As at 30 June 2011	<u>5,000</u>	<u>62,722</u>	<u>1,369</u>	<u>-</u>	<u>69,091</u>

The notes set out on pages 14 to 60 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 2011

	Note	2011 KShs'million	2010 KShs'million
Operating activities			
Net cash generated by operating activities	29(a)	<u>24,966</u>	<u>52,738</u>
Investing activities			
Receipts of government loan		722	227
Purchase of property and equipment		(1,523)	(650)
Purchase of intangible assets		(334)	(379)
Proceeds from disposal of property and equipment		1	-
Utilisation of/Proceeds from International Monetary Fund - SDR accounts		<u>23,541</u>	<u>(25,358)</u>
Net cash generated/ (used) in investing activities		<u>22,407</u>	<u>(26,160)</u>
Financing activities			
Dividends paid		(2,000)	(4,559)
Net cash outflow from financing activities		<u>(2,000)</u>	<u>(4,559)</u>
Net increase in cash and cash equivalents		45,373	22,019
Cash and cash equivalents at start of year		277,314	256,542
Exchange rate effects		<u>40,017</u>	<u>(1,247)</u>
Cash and cash equivalents at end of year	29(b)	<u>362,704</u>	<u>277,314</u>

The notes set out on pages 14 to 60 form an integral part of these financial statements

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS **FOR THE YEAR ENDED 30 JUNE 2011**

1. REPORTING ENTITY

The Central Bank of Kenya (the “Bank”) 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 “Act”) and is domiciled in Kenya. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

2. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

(i) *Basis of 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 and revaluation of property and equipment.

(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) *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.

In particular information about significant areas of estimations and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 3 – *Critical accounting estimates and judgements*.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (continued)

(v) *Functional and presentation currency*

These financial statements are presented in Kenya shillings (KShs), which is the Bank's functional currency.

Except for where indicated, financial information presented in Kenya shillings has been rounded to the nearest million.

(vi) *Change in accounting policy*

During the year, the Bank adopted the requirements of IAS 39 by fair valuing the staff loans and advances granted at low interest rates. The effect of this has been accounted for in the current year and prior year in line with IAS 8, on changes in Accounting policies. Three statement of financial position have not been presented as required by IAS 1 where retrospective adjustments have been made.

The impact of this restatement does not affect opening and prior period reserves and the impact of presentation of the third statement of financial position is deemed immaterial.

(b) Revenue recognition

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

(i) *Interest income and expenses*

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

(c) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Monetary assets and liabilities at the reporting date which are expressed in foreign currencies are translated into Kenya Shillings at rates ruling at that date. The resulting differences from conversion and translation are dealt with in the profit or loss 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Currency printing and minting expenses

Banknotes 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 profit or loss from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition. The life span of each bank note denomination is as described in note(3 (d)) below.

(e) 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 and employees of 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 credit 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 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 profit or loss over the remaining working lives of the employees participating in the scheme.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Employee benefits (continued)

(i) Retirement benefits - continued

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 estimated monetary liability for employees' accrued leave entitlement at the reporting date is recognised as accrued expense.

(f) Property and equipment

Items of property and equipment are measured at cost or as professionally revalued from time to time less accumulated depreciation and impairment losses. Depreciation is computed on the straight line basis over the estimated useful lives of the assets at the following rates:

Building improvements	Ten years
Motor vehicles, furniture and equipment	Two 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 and equipment in use.

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 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 profit or loss 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 profit or loss 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) 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 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 profit or loss.

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 - two years

(h) Impairment of non-financial assets

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

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the statement of comprehensive income. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro-rata basis.

(i) 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(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 determines the classification of its investments at initial recognition. The main categories include:

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 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.

Loans granted at a lower than market interest rates are measured at present value of anticipated future cashflows discounted using market interest rates. The difference between the fair value of the loans and the carrying amount is treated as a long term employee benefit and is accounted for as a prepayment. The long term benefit is recognised as interest income while prepayment is expensed to staff costs as the services are rendered to the bank over the period of the loan.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(iii) *Classification and measurement - continued*

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 profit or loss. The losses arising from impairment of such investments are recognised in the profit or loss 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.

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 profit or loss 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.

Financial assets at fair value through profit or loss: 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 profit or loss. 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 profit or loss.

The gains and losses on investments held to maturity and loans and receivables are recognized in the profit or loss when the investments are derecognized.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) 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 profit or loss 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 reporting date 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*

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

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

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in the statement of comprehensive income and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(vii) *Impairment of financial assets - continued*

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through the statement of comprehensive income. Impairment losses on available-for-sale investment securities are recognised by transferring the difference between the amortised acquisition cost and current fair value out of other comprehensive income to the statement of comprehensive income. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised directly in other comprehensive income. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(j) 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.

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 securitized debt owing from Government to the Bank 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). In this process, 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 reverse REPOs as collateralized loans for accounting purposes. In this case, a reverse REPO is recorded as a secured advance and is shown separately as Advance to Banks while repurchase agreements are shown as a liability in the books of bank.
- (ii) REPOs continue to be recognised in the statement of financial position 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 profit or loss.

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

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) 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 excluded from the liability of notes and coins in circulation because they do not represent currency in circulation.

(l) 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 from commercial banks for liquidity management (monetary policy purposes) 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. The deposits are currently computed at 4.75% of each commercial bank's deposits it has taken from the public. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

(m) Provisions

A provision is recognised when the Bank has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to that liability.

(n) 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.'

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Leasing (continued)

(i) *Bank as a lessee - continued*

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 statement of financial position. 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.

(o) Dividends

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% of realized income after taking into account expenses. In addition to this, the Board of Directors in the year 2007 set a policy that all dividends shall be net of unrealized income and other revaluations gains in addition to the retention allowed by the Act.

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.

(p) Other liabilities

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

(q) 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.

(r) 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

(s) Comparatives

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

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(t) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2011, and have not been applied in preparing these financial statements as follows:

- IFRS 9 *Financial Instruments* IFRS 9 will become mandatory for the Bank's 2014 financial statements.
- IAS 24 *Related Party Disclosures*. The amendments to IAS 24 will become mandatory for the Bank's 2011 financial statements.
- IFRS 10 *Consolidated Financial Statements* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 11 *Joint Arrangements* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 12 *Disclosure of Interests in Other Entities* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 13 *Fair Value Measurement* (effective for annual periods beginning on or after 1 January 2013).
- IAS 27 (2011) *Separate Financial Statements*.
- IAS 28 (2011) *Investments in Associates and Joint Ventures*.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including experience of future events that are believed to be reasonable under the circumstances. The most significant use of judgement and estimates are as follows:

(a) 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 profit or loss. 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.

(b) 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 16 for assumptions used.

(c) 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 (f) and (g) above.

(d) Useful life of currency

Banknotes 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 banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Previously the costs were expensed upon delivery of currency stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition.

Useful lives of the various banknotes 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

4 INTEREST INCOME	2011 KShs million	2010 KShs million
Cash and cash equivalents (Note 4a)	42	57
Held to maturity investments (Note 4b)	1,513	1,015
Loans and advances (Note 4c)	2,393	1,726
Held for trading investments (Note 4d)	<u>355</u>	<u>291</u>
	<u>4,303</u>	<u>3,089</u>
(a) Interest income from cash and cash equivalents		
Income from IMF	<u>42</u>	<u>57</u>
	<u>42</u>	<u>57</u>
(b) Interest income from held to maturity investments		
Interest on Sterling Pound term deposits	547	372
Interest on US Dollar term deposits	339	328
Interest on Euro term deposits	<u>627</u>	<u>315</u>
	<u>1,513</u>	<u>1,015</u>
The weighted average interest rates for term deposits were:		
US Dollar	0.21%	0.36%
UK Sterling Pounds	0.70%	0.48%
Euro	1.18%	0.54%
(c) Interest income from loans and advances		
Interest on loan due from Government Debt	958	993
Interest on Government overdraft	890	314
Interest on staff loans	271	80
Interest on reverse REPOs	36	245
Interest on local commercial banks overnight loans	115	11
Interest on foreign commercial banks overnight loans	2	3
Other interest income	<u>121</u>	<u>80</u>
	<u>2,393</u>	<u>1,726</u>
(d) Interest income from held for trading investments		
Interest income – World Bank RAMP	<u>355</u>	<u>291</u>

The Bank has 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 \$300 million (2010- US \$ 300 million) for the Programme.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

4	INTEREST INCOME (Continued)	2011	2010
(e)	Additional disclosure on income by source	KShs million	KShs million
	Foreign investments earnings	1,913	1,366
	Local investments earnings	2,119	1,643
	Other interest earnings	<u>92</u>	<u>80</u>
		<u>4,124</u>	<u>3,089</u>
5	INTEREST EXPENSE		
	Interest on monetary policy issues/ REPOs	29	2
	Interest paid to IMF	<u>1</u>	<u>89</u>
		<u>30</u>	<u>91</u>
6	FEE AND COMMISSION INCOME		
	Commission on sale of Government securities	3,000	3,000
	Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	<u>3</u>	<u>5</u>
		<u>3,003</u>	<u>3,005</u>
	The Bank earns from the Government a commission of 1.5% of amounts raised 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 effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.		
		2011	2010
		KShs million	KShs million
7	FOREIGN EXCHANGE GAIN/ (LOSS)		
	Foreign exchange dealing profit (Note 7a)	991	786
	Foreign Bonds Pending Receivables	92	13
	Foreign exchange translation gain/(loss) (Note 7b)	<u>38,934</u>	<u>(2,046)</u>
		<u>40,017</u>	<u>(1,247)</u>
(a)	Foreign exchange dealing profit		
	Gains on sale of foreign exchange to Government	989	784
	Foreign exchange dealing profit on commercial banks	<u>2</u>	<u>2</u>
		<u>991</u>	<u>786</u>
(b)	Foreign exchange translation gain/(loss)		
	Revaluation gain/(loss) on current accounts	533	(378)
	Revaluation gain/(loss) on foreign deposits	45,482	(3,545)
	Revaluation loss on IMF accounts	(9,924)	(363)
	Revaluation of RAMP securities	2,824	2,226
	Others-Revaluation gains on Gold Holdings	<u>19</u>	<u>14</u>
		<u>38,934</u>	<u>(2,046)</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

7	FOREIGN EXCHANGE GAIN/ (LOSS) (Continued)		
	Exchange rates	2011	2010
	US Dollar	89.70	81.80
	GBP	144.3	123.01
	Euro	<u>130.0</u>	<u>99.88</u>
		2011	2010
	Foreign currency investment mix		
	US Dollar	45%+ /-5%	45%+ /-5%
	GBP Sterling Pound	30%+/-5%	35%+/-5%
	Euro	<u>25%+/-5%</u>	<u>20%+/-5%</u>
		<u>100%</u>	<u>100%</u>
8	OTHER OPERATING INCOME	2011	2010
		KShs million	KShs million
	Actuarial gain on retirement benefit obligations	3	468
	Miscellaneous income	153	36
	Licence fees from Commercial Banks and bureaus	182	159
	Penalties Commercial banks and Forex Bureaus	48	-
	Rent received	1	3
	KSMS other operating income-hospitality services and tuition fee	405	318
	Proceeds from disposal of property and equipment	<u>1</u>	<u>-</u>
		<u>793</u>	<u>984</u>
9	OPERATING EXPENSES	2011	2010
		KShs million	KShs million
	Staff costs (Note 9(a))	3,992	3,790
	Currency expenses (Note 9(b))	1,766	1,491
	Property maintenance expenses (Note 9(c))	654	566
	Depreciation on property and equipment (Note 17)	1,066	545
	Amortisation on intangible assets (Note 19)	13	19
	Other expenses (Note 9(d))	1,029	956
	Auditors' remuneration	5	5
	Banking expenses	1	4
	Operating lease rentals (Note 18)	<u>4</u>	<u>3</u>
		<u>8,530</u>	<u>7,379</u>
(a)	Staff costs		
	Personnel emoluments	3,417	3,355
	Medical benefit	210	202
	Staff training and development costs	179	218
	Low interest benefit on staff loans	179	-
	Directors' expenses	<u>7</u>	<u>15</u>
		<u>3,992</u>	<u>3,790</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

9 OPERATING EXPENSES (Continued)	2011	2010
	KShs million	KShs million
(b) Currency expenses		
Notes production	1,162	1,047
Coins production	584	429
Notes issue	10	8
Coin Issue	5	5
Agency Centres	<u>5</u>	<u>2</u>
	<u>1,766</u>	<u>1,491</u>
(c) Property maintenance expenses		
Upkeep of property	288	197
Security of premises	234	204
Property renovation	28	56
Electricity	60	57
Others	<u>44</u>	<u>52</u>
	<u>654</u>	<u>566</u>
(d) Other expenses		
Transport and travelling	179	136
Office expenses	165	130
Postal service expense	121	102
Legal and professional fees	100	100
Other administrative expenses	<u>464</u>	<u>488</u>
	<u>1,029</u>	<u>956</u>
10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS		
	2011	2010
	KShs million	KShs million
Cash and cash equivalents (Note 10(a))	14,058	15,651
Held for trading investments (Note 10(b))	37,734	33,515
Held to maturity investments (Note 10(c))	316,967	235,459
Gold holdings	<u>76</u>	<u>57</u>
	<u>368,835</u>	<u>284,682</u>
(a) Cash and cash equivalents		
Special project accounts	5,846	7,051
Current account	2,640	4,350
Domestic forex currency cheque clearing	5,572	4,244
Forex travellers cheques	<u>-</u>	<u>6</u>
	<u>14,058</u>	<u>15,651</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS
(Continued)

	2011	2010
	KShs million	KShs million
(b) Held for trading		
US Dollar deposits	36	16
Fixed income securities	37,612	33,346
Accrued interest	<u>86</u>	<u>153</u>
	<u>37,734</u>	<u>33,515</u>
(c) Held to maturity investments		
Term deposits (Note 10 (c)(i))	316,719	235,264
Accrued interest on term deposits	<u>248</u>	<u>195</u>
	<u>316,967</u>	<u>235,459</u>
(i) Term deposits		
Dollar deposits	118,853	75,773
Sterling Pound deposits	94,548	94,070
Euro deposits	<u>103,318</u>	<u>65,421</u>
	<u>316,719</u>	<u>235,264</u>

11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF)

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.

	2011		2010	
	SDR	KShs	SDR'	KShs
	Million	Million	Million	Million
Assets- Funds held at IMF				
IMF balances (SDR asset account)	<u>19</u>	<u>2,731</u>	<u>218</u>	<u>26,272</u>
Liabilities- Amounts due to IMF				
International Monetary Fund Account No. 1	20	2,886	20	2,430
International Monetary Fund Account No. 2	-	1	-	4
International Monetary Fund – PRGF Account	328	47,042	279	33,734
IMF-SDR Allocation account	223	31,900	218	26,867
International Monetary Fund loans to Government of Kenya	<u>-</u>	<u>-</u>	<u>2</u>	<u>241</u>
	<u>571</u>	<u>81,829</u>	<u>519</u>	<u>63,276</u>
Security at 30 June	<u>241</u>	<u>32,550</u>	<u>238</u>	<u>28,079</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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

11. FUNDS HELD AT/AMOUNTS DUE TO INTERNATIONAL MONETARY FUND (IMF) (Continued)

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 259.6 million respectively. The Quota (SDR 271.4 million) and SDR allocations (36.99million) is not accounted for in the books of Bank.

12 ITEMS IN THE COURSE OF COLLECTION	2011 KShs million	2010 KShs million
Items in the course of collection	<u>409</u>	<u>316</u>

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

13 ADVANCES TO BANKS	2011 KShs million	2010 KShs million
Treasury Bonds Discounted	32	17
Treasury Bills Discounted	16	13
Accrued interest	<u>1</u>	<u>1</u>
	<u>49</u>	<u>31</u>

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

14 LOANS AND ADVANCES	2011 KShs million	2010 KShs million
Overnight Lending to commercial banks	19,873	-
Irrecoverable amount from banks under liquidation	3,706	3,767
Government overdraft account (see below and Note 30)	7,571	17,649
Loan from IMF to the Government of Kenya (Note 30)	(3)	241
Advances to employees		
Salary advance	177	186
Car loans	418	419
Housing scheme	2,227	1,916
Development loan	<u>398</u>	<u>280</u>
	34,367	24,458
Provision for loan impairment (banks & staff)	(3,725)	(3,784)
Net advances as at 30 June	<u>30,642</u>	<u>20,674</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

14 LOANS AND ADVANCES (Continued)	2011	2010
	KShs million	KShs million
Movement in the loan impairment allowance is as follows:		
At start of the year	(3,784)	(3,784)
Additional impairment allowance made during the year	(1)	-
Recoveries during the year	<u>60</u>	<u>-</u>
At end of the year	<u>(3,725)</u>	<u>(3,784)</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 Government of Kenya audited financial statements. The limit stands at KShs 22,926,066,860.60 based on the Government financial statements for 2008/2009, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was Kshs 21,002,541,033.05 based on the Government financial statements for 2007/2008. The Government overdraft attracts an interest at the CBR rate determined by the Bank which varies from time to time based on the monetary policy.

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. Commercial banks had utilised this facility amounting to KShs 19.8 million (2010 Nil). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

15. OTHER ASSETS

	2011	2010
	KShs million	KShs million
Prepayments and sundry debtors	2,374	3,018
Deferred currency expenses	2,796	1,570
Advances	<u>215</u>	<u>214</u>
	<u>5,385</u>	<u>4,802</u>

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation over a predetermined useful life of the notes.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

16 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 employees of the Bank. The retirement benefit asset is wholly recognised in the financial statements of the Bank. All employees of Deposit Protection Fund Board (DPF) are staff of the Bank and DPF only reimburses the bank their emoluments.

The amounts recognised in the statement of financial position are determined on the basis of an actuarial review carried out by Actuarial Services (EA) Limited as at 30 June.

	2011	2010
	KShs million	KShs million
Present value of funded obligations	12,137	11,550
Fair value of plan assets	<u>(15,872)</u>	<u>(14,868)</u>
Present value of net asset	(3,735)	(3,318)
Unrecognised actuarial gain	<u>1,838</u>	<u>1,424</u>
Balance at 30 June	<u>(1,897)</u>	<u>(1,894)</u>

The amounts recognised in the profit or loss are as follows:

Current service costs	601	507
Interest costs	1,022	844
Expected return on plan assets	(1,334)	(1,087)
Adjustment for previous year values	<u>58</u>	<u>(399)</u>
Total expenses included in operating expenses	<u>347</u>	<u>(135)</u>

Movements in the net asset recognised at the reporting date are as follows:

Net liability at start of period	(1,894)	(1,425)
Net expense recognised in the profit or loss	347	(135)
Employer contributions	<u>(350)</u>	<u>(334)</u>
Net liability at end of period	<u>(1,897)</u>	<u>(1,894)</u>
Actual return on plan assets	<u>1,173</u>	<u>2,852</u>

The principal actuarial assumptions at the reporting date were:

	2011	2010
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%	

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

16 RETIREMENT BENEFIT ASSET (Continued)

	2011 KShs million	2010 KShs million	2009 KShs million	2008 KShs million	2007 KShs million
Historical information					
Fair value of plan assets	15,872	14,868	11,678	12,136	10,774
Present value of funded obligations	(12,137)	(11,550)	(9,582)	(10,496)	(9,416)
Retirement benefit asset	<u>3,735</u>	<u>3,318</u>	<u>2,096</u>	<u>1,640</u>	<u>1,358</u>

17 PROPERTY AND EQUIPMENT

30 June 2011	Land and buildings KShs million	Motor vehicles KShs million	Furniture and Equipment KShs million	Total KShs million
Cost				
At start of year	1,086	217	4,220	5,523
Additions	249	48	1,225	1,523
Disposals	—	(2)	(1)	(3)
At end of the year	<u>1,335</u>	<u>263</u>	<u>5,444</u>	<u>7,042</u>
Accumulated depreciation				
At start of the year	964	187	3,348	4,499
Charge for the year	22	29	1,015	1,066
Revaluation surplus	—	—	(1,369)	(1,369)
On disposal	—	(2)	(1)	(3)
At end of the year	<u>986</u>	<u>214</u>	<u>2,993</u>	<u>4,193</u>
Net book value at 30 June 2011	<u>349</u>	<u>49</u>	<u>2,451</u>	<u>2,849</u>
30 June 2010:	Land and buildings KShs million	Motor Vehicles KShs million	Furniture and Equipment KShs million	Total KShs million
Cost				
At start of year	988	196	3,813	4,997
Reclassification to intangible asset	—	—	(115)	(115)
At 30 June 2009 as restated	988	196	3,698	4,882
Additions	98	30	522	650
Disposals	—	(9)	—	(9)
At end of the year	<u>1,086</u>	<u>217</u>	<u>4,220</u>	<u>5,523</u>
Accumulated depreciation				
At start of the year	954	175	2,834	3,963
Charge for the year	10	21	514	545
On disposal	—	(9)	—	(9)
At end of the year	<u>964</u>	<u>187</u>	<u>3,348</u>	<u>4,499</u>
Net book value At 30 June 2010	<u>122</u>	<u>30</u>	<u>872</u>	<u>1,024</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

17 PROPERTY AND EQUIPMENT (continued)

Furniture and equipments were revalued by Gimco Limited a firm of professional valuers on an open market basis and the resulting revaluation surplus has been included in the revaluation reserve.

18 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:

	2011 KShs million	2010 KShs million
Cost		
At 30 June	<u>300</u>	<u>300</u>
Amortisation		
At 1 July	28	25
Amortisation for the year	<u>4</u>	<u>3</u>
At end of the year	<u>32</u>	<u>28</u>
Net carrying value at end of the year	<u>268</u>	<u>272</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.

19 INTANGIBLE ASSETS

	Software KShs million	Work-in- Progress KShs million	2011 Total KShs million	2010 Total KShs million
Cost				
At 1 July	220	842	1,062	683
Impairment loss	(3)	-	(3)	-
Additions	<u>19</u>	<u>315</u>	<u>334</u>	<u>379</u>
At end of the year	<u>236</u>	<u>1,157</u>	<u>1,393</u>	<u>1,062</u>
Amortisation				
At 1 July	209	-	209	190
Amortisation for the year	<u>13</u>	<u>-</u>	<u>13</u>	<u>19</u>
At end of the year	<u>222</u>	<u>-</u>	<u>222</u>	<u>209</u>
Net carrying value at end of the year	<u>14</u>	<u>1,157</u>	<u>1,171</u>	<u>853</u>

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

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

20 DUE FROM GOVERNMENT OF KENYA	2011	2010
	KShs million	KShs million
At start of the year	33,102	33,329
Accrued interest receivable	716	328
Receipts during the year	(1,438)	(555)
At end of the year	<u>32,380</u>	<u>33,102</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 to limit lending to GoK to 5% of GoK audited revenue.

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.

21 CURRENCY IN CIRCULATION	2011	2010
	KShs million	KShs million
Kenya notes	143,022	120,574
Kenya coins	4,690	4,444
Commemorative coins	<u>6</u>	<u>6</u>
	<u>147,718</u>	<u>125,024</u>
Balance at the beginning of the year	125,024	108,042
Deposits by banks	(317,596)	(271,430)
Withdrawals by banks	<u>340,290</u>	<u>288,412</u>
Balance at the end of the year	<u>147,718</u>	<u>125,024</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 excluded from the liability of 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/=, 100/= and 50/=.

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

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

22	DEPOSITS	2011 KShs million	2010 KShs million
	Local commercial banks (Note 22 a)	72,731	85,236
	Local banks forex settlement accounts (Note 22 b)	5,129	3,669
	External banks forex settlement accounts	310	94
	Other public entities and project accounts	10,830	10,672
	Government of Kenya(Note 22 c)	<u>46,792</u>	<u>43,557</u>
		<u>135,792</u>	<u>143,228</u>
(a)	Local commercial banks		
	Clearing accounts	10,715	34,681
	Cash reserve ratio	<u>62,016</u>	<u>50,555</u>
		<u>72,731</u>	<u>85,236</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 from 6% previously. It was again revised downwards to 4.5% in June 2009, and then to 4.75% in June 2011. 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. The banking institutions are required to maintain balances at the Central Bank equivalent to the cash reserve requirement of 4.75% based on monthly averages, but should not fall below 3% at any time. Currently there are 43 licensed commercial banks and 1 mortgage finance company.

(b)	Local banks forex settlement accounts	2011 KShs million	2010 KShs million
	Euro	930	441
	Dollar	3,698	2,900
	Sterling Pound	<u>501</u>	<u>328</u>
		<u>5,129</u>	<u>3,669</u>
(c)	Government of Kenya		
	Paymaster General	20,791	22,504
	Treasury Funding Account	17,207	17,151
	The Exchequer Account	1,223	1,601
	Others	<u>7,571</u>	<u>2,301</u>
		<u>46,792</u>	<u>43,557</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 FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

23 OTHER LIABILITIES	2011	2010
	KShs million	KShs million
Impersonal accounts	4,095	4,707
Sundry creditors	1,124	733
Bonds Pending payables	1,536	1,026
Refundable deposits	531	668
Long term employee loan benefit (low interest)	<u>2,161</u>	<u>2,340</u>
	<u>9,447</u>	<u>9,474</u>
24 DIVIDENDS PAYABLE		
Dividends payable	<u>2,641</u>	<u>2,641</u>
The movement in dividends payable is as follows:		
Balance at 1 July	2,641	-
Dividends approved in the year	-	7,200
Paid during the year	<u>-</u>	<u>(4,559)</u>
Funds earmarked for an on-going project	<u>2,641</u>	<u>2,641</u>
25 PROVISIONS		
Leave accrual	75	60
Gratuity to staff members	<u>23</u>	<u>53</u>
	<u>98</u>	<u>113</u>
26 SHARE CAPITAL		
Authorised share capital	<u>5,000</u>	<u>5,000</u>
Issued and fully paid	<u>5,000</u>	<u>5,000</u>

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

27 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. The Bank utilises funds accumulated in this account to pay dividends once declared by the Board of Directors, increase paid up capital when necessary and to absorb any negative external shocks.

28 DIVIDENDS

The Board of Directors does not recommend payment of a dividend (2010: KShs 2 billion).

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

29(a) NOTES TO THE CASH FLOW STATEMENT

	2011	2010
	KShs million	KShs million
Cash flows from operating activities		
Net profit/(loss) for the year	39,556	(1,639)
Adjustments for:		
Depreciation of property and equipment	1,066	545
Amortization of prepaid operating leases	4	3
Amortization of intangible assets	13	19
Impairment loss on intangible assets	3	-
Exchange rate (gain)/loss effects	(40,017)	1,247
Gain on disposal of property and equipment	(1)	-
Surplus in defined benefit scheme	(4)	(469)
Operating profit before working capital changes	620	(294)
Net increase in loans and advances	(9,968)	(12,357)
Decrease in balance with International Monetary Fund	18,553	25,828
Increase in Project accounts	1,205	-
Decrease/(increase) in accrued interest on balances due from banking institutions	16	(2,196)
(Increase)/decrease in items in the course of collection	(93)	1,114
(Decrease)/increase in deposits	(7,436)	17,591
(Increase)/decrease in other assets	(583)	(1,932)
Increase in currency in circulation	22,694	16,982
(Decrease)/increase in other liabilities and provisions	(42)	8,002
Net cash generated by operations	<u>24,966</u>	<u>52,738</u>

(b) Cash and cash equivalents

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

	2011	2010
	KShs million	KShs million
Term deposits	316,719	235,264
Current accounts	2,640	4,350
Domestic forex cheques clearing	5,572	4,244
Travellers Cheques	-	6
Gold holdings	<u>76</u>	<u>57</u>
	325,007	243,921
Advances to Banks	49	31
Investments with RAMP	<u>37,648</u>	<u>33,362</u>
	<u>362,704</u>	<u>277,314</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

30 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 14) include advances to employees that as at 30 June 2011 amounted to KShs 3,218 million (2010: KShs 2,801 million). The advances are at preferential rates of interest determined by the Bank.

	2011	2010
	KShs million	KShs million
(ii) Loans to executive directors		
At start of the year	6	9
Loans advanced during the year	-	-
Loan repayments	(3)	(3)
At end of the year	<u>3</u>	<u>6</u>
(iii) Loans to key management personnel		
At start of the year	62	39
Loans advanced during the year	22	57
Loan repayments	(33)	(34)
At end of the year	<u>51</u>	<u>62</u>
(iv) Directors' emoluments:		
Fees to non executive directors	7	15
Other remuneration to executive directors	<u>50</u>	<u>50</u>
	<u>57</u>	<u>65</u>
(v) Remuneration to senior management	<u>172</u>	<u>182</u>
(vi) Post –employment pension	<u>2</u>	<u>2</u>
(vii) Government of Kenya		

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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

30 RELATED PARTY TRANSACTIONS (Continued)

(vii) *Government of Kenya - continued*

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

	2011	2010
	KShs million	KShs million
Due from Government of Kenya (Note 20)	32,380	33,102
Overdraft account (Note 14)	7,751	17,649
Loan from IMF to the Government of Kenya (Note 14)	(3)	241
Government of Kenya deposits (Note 22)	<u>46,792</u>	<u>43,557</u>

(viii) *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 86 million (2010: KShs 26million).

(ix) *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.

31 RISK MANAGEMENT

(a) **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:

(i) *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.

(ii) *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 Department and Risk Management Division in Banking & Risk Management Department.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(a) Structure and Reporting (continued)

(ii) Internal Audit Department (IA)

The Internal Audit 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.

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 Board Audit Committee. Action plans that are taken to reduce the risks to acceptable levels are monitored.

(b) 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) 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:
 - Credit risk
 - Market risk:
 - Interest risk
 - Foreign currency exchange risk
 - Liquidity risk
- Non financial risks include:
 - Operational risk
 - Human resource risk
 - Legal risk
 - Reputation risk

(i) *Financial risks*

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.

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%.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Credit risk - continued

Analysis of staff loans and advances, Due from Government loan and Government overdraft):

	2011 KShs million	2010 KShs million
Individually impaired:		
Staff loans	42	49
Banks in liquidation	<u>3,706</u>	<u>3,766</u>
	3,748	3,815
Allowance for impairment	(<u>3,725</u>)	(<u>3,784</u>)
	<u>23</u>	<u>31</u>
Loans past due but not impaired:		
Past due upto 30 days	32,380	33,102
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	<u>-</u>	<u>-</u>
	<u>32,380</u>	<u>33,102</u>
Loans neither past due nor impaired:		
Staff loans and advances	3,175	2,752
Overnight lending to commercial banks	19,873	-
IMF on let to the Government	-	241
Government Overdraft	<u>7,571</u>	<u>17,649</u>
	<u>30,619</u>	<u>20,642</u>

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: The banks exposure to credit risk is analysed as follows:

	2011 KShs Millions	2010 KShs Millions
Assets		
Republic of Kenya	79,331	65,748
United Kingdom	75,503	189,088
Rest of Europe	82,717	2,310
United states of America	209,025	116,243
Rest of the World	<u>40</u>	<u>533</u>
	<u>446,616</u>	<u>373,922</u>
Liabilities		
Republic of Kenya	<u>446,616</u>	<u>373,922</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

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 2011	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.21-1.18%	362,655	334	-	5,846	368,835
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,731	-	2,731
Items in the course of collection	-	-	-	-	409	409
Advances to Banks	-	49	-	-	-	49
Loans and advances	3%	19,984	333	10,325	-	30,642
Other assets	-	-	-	-	5,385	5,385
Property, plant and equipment	-	-	-	-	2,849	2,849
Prepaid leasehold land	-	-	-	-	268	268
Intangible assets	-	-	-	-	1,171	1,171
Retirement benefit asset	-	-	-	-	1,897	1,897
Due from Government of Kenya	3%	<u>1,271</u>	<u>1,110</u>	<u>29,999</u>	<u>-</u>	<u>32,380</u>
Total assets		<u>383,959</u>	<u>1,777</u>	<u>43,055</u>	<u>17,825</u>	<u>446,616</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued

As at 30 June 2011	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Liabilities and equity						
Currency in circulation	-	-	-	-	147,718	147,718
Deposits	-	-	-	-	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	-	-	9,447	9,447
Provisions	-	-	-	-	98	98
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	<u>69,091</u>	<u>69,091</u>
Total liabilities and equity		<u>-</u>	<u>-</u>	<u>-</u>	<u>446,616</u>	<u>446,616</u>
Interest sensitivity gap 2011		<u>383,959</u>	<u>1,777</u>	<u>43,055</u>	<u>(428,791)</u>	<u>-</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

As at 30 June 2010	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.36-0.54%	277,283	348	-	7,051	284,682
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	26,272	-	26,272
Items in the course of collection	-	-	-	-	316	316
Advances to Banks	-	31	-	-	-	31
Loans and advances	3%	74	241	20,359	-	20,674
Other assets	-	-	-	-	4,802	4,802
Property, plant and equipment	-	-	-	-	1,024	1,024
Prepaid leasehold land	-	-	-	-	272	272
Intangible assets	-	-	-	-	853	853
Retirement benefit asset	-	-	-	-	1,894	1,894
Due from Government of Kenya	3%	<u>883</u>	<u>1,110</u>	<u>31,109</u>	<u>-</u>	<u>33,102</u>
Total assets		<u>278,271</u>	<u>1,699</u>	<u>77,740</u>	<u>16,212</u>	<u>373,922</u>
Liabilities and equity						
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	-	-	-	-	143,228	143,228
Amounts due to International Monetary Fund	-	-	-	-	63,276	63,276
Other liabilities	-	-	-	-	9,474	9,474
Provisions	-	-	-	-	113	113
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	<u>30,166</u>	<u>30,166</u>
Total liabilities and equity		<u>-</u>	<u>-</u>	<u>-</u>	<u>373,922</u>	<u>373,922</u>
Interest sensitivity gap 2010		<u>278,271</u>	<u>1,699</u>	<u>77,740</u>	<u>(357,710)</u>	<u>-</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) *Financial risks - continued*

Sensitivity analysis on interest rate risk

The Bank uses models to assess the impact of possible changes in market risks. These risks include interest rate risk and foreign exchange 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 31(c)). 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:

	2011 KShs million	2010 KShs million
Effect on profit before tax of a +10% change in interest rates	621	324
Effect on profit before tax of a -10% change in interest rates	(621)	(324)

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: 40 - 50%
GDP: 25 - 35%
EUR: 20 - 30%
CHF: 0 - 5%

The net foreign currency position of the Bank as of 30 June 2011 and 2010 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 FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2011 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	167,589	95,438	105,643	-	-	92	368,762
Special Drawing Rights	-	-	-	2,731	-	-	2,731
Gold holdings	-	-	-	-	76	-	76
Total assets	<u>167,589</u>	<u>95,438</u>	<u>105,643</u>	<u>2,731</u>	<u>76</u>	<u>92</u>	<u>371,569</u>
Liabilities							
Balances due to IMF	-	-	-	81,829	-	-	81,829
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	3,698	501	930	-	-	-	5,129
Local bank guarantees	339	-	-	-	-	-	339
Bonds pending payables	1,536	-	-	-	-	-	1,536
Forex bureaux deposits	<u>192</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>192</u>
Total liabilities	<u>5,765</u>	<u>501</u>	<u>930</u>	<u>81,829</u>	<u>-</u>	<u>-</u>	<u>89,025</u>
Net statement of financial position at 30 June 2011	<u>161,824</u>	<u>94,937</u>	<u>104,713</u>	<u>(79,098)</u>	<u>76</u>	<u>92</u>	<u>282,544</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2010 are summarised below (all expressed in KShs million):

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	137,412	76,279	70,388	-	-	542	284,621
Special Drawing Rights	-	-	-	26,272	-	-	26,272
Gold holdings	-	-	-	-	57	-	57
Total assets	<u>137,412</u>	<u>76,279</u>	<u>70,388</u>	<u>26,272</u>	<u>57</u>	<u>542</u>	<u>310,950</u>
Liabilities							
Amounts due to IMF	-	-	-	63,276	-	-	63,276
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	2,900	328	441	-	-	-	3,669
Local bank guarantees	488	-	-	-	-	-	488
Bonds pending payable	1,026	-	-	-	-	-	1,026
Forex bureaux deposits	<u>180</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>180</u>
Total liabilities	<u>4,594</u>	<u>328</u>	<u>441</u>	<u>63,276</u>	<u>-</u>	<u>-</u>	<u>68,639</u>
Net statement of financial position at 30 June 2010	<u>132,818</u>	<u>75,951</u>	<u>69,947</u>	<u>(37,004)</u>	<u>57</u>	<u>542</u>	<u>242,311</u>

Sensitivity analysis on 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 30). 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.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) *Financial risks - continued*

	2011 KShs million	2010 KShs million
Effect on profit before tax of a +7% change in exchange rates	19,778	16,962
Effect on profit before tax of a -7% change in exchange rates	(19,778)	(16,962)

Liquidity risk

Liquidity risk is defined as not having 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
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2011 to the contractual maturity date.

LIABILITIES	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	147,718	147,718
Deposits	129,946	-	5,846	-	-	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	9,447	-	-	9,447
Provisions	-	-	98	-	-	98
Dividends payable	-	980	1,661	-	-	2,641
TOTAL LIABILITIES	<u>129,946</u>	<u>980</u>	<u>17,052</u>	<u>-</u>	<u>229,547</u>	<u>377,525</u>
Liquidity gap 2011	<u>(129,946)</u>	<u>(980)</u>	<u>(17,052)</u>	<u>-</u>	<u>(229,547)</u>	<u>(377,525)</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2010 to the contractual maturity date.

LIABILITIES	On Demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	136,177	-	7,051	-	-	143,228
Amounts due to International Monetary Fund	-	-	241	1,535	61,500	63,276
Other liabilities	-	-	9,474	-	-	9,474
Provisions	-	-	113	-	-	113
Dividends payable	-	-	2,641	-	-	2,641
TOTAL LIABILITIES	<u>136,177</u>	<u>-</u>	<u>19,520</u>	<u>1,535</u>	<u>186,524</u>	<u>343,756</u>
Liquidity gap 2010	<u>(136,177)</u>	<u>-</u>	<u>(19,520)</u>	<u>(1,535)</u>	<u>(186,524)</u>	<u>(343,756)</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

31 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(ii) *Non-financial risks*

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).

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.

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.

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 FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

32 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 reporting date.

The table below sets out the carrying amounts of each class of financial assets and liabilities, and their fair values:

30 June 2011:	Held for trading KShs million	Held-to- maturity KShs million	Loans and receivables KShs million	Available- for-sale KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Assets							
Balances due from banking institutions and Gold holdings	37,734	316,967	14,134	-	-	368,835	368,835
Funds held at International Monetary Fund	-	-	2,731	-	-	2,731	2,731
Items in the course of collection	-	-	409	-	-	409	409
Advances to Banks	-	-	49	-	-	49	49
Loans and advances	-	-	30,642	-	-	30,642	30,642
Other assets	-	-	-	-	5,385	5,385	5,385
Due from Government of Kenya	-	-	32,380	-	-	32,380	32,380
Total assets	37,734	316,967	80,345	-	5,385	440,431	440,431
Liabilities							
Currency in circulation	-	-	-	-	147,718	147,718	147,718
Deposits	-	-	-	-	135,792	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829	81,829
Other liabilities and provisions	-	-	-	-	9,545	9,545	9,545
Total liabilities	-	-	-	-	374,884	374,884	374,884

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

32 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (Continued)

30 June 2010:	Held for trading KShs million	Held-to - maturity KShs million	Loans and receivables KShs million	Available- for-sale KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Assets							
Balances due from banking institutions and Gold holdings	33,515	235,459	15,708	-	-	284,682	284,682
Funds held at International Monetary Fund	-	-	26,272	-	-	26,272	26,272
Items in the course of collection	-	-	316	-	-	316	316
Advances to Banks	-	-	31	-	-	31	31
Loans and advances	-	-	20,674	-	-	20,674	20,674
Other assets	-	-	-	-	4,802	4,802	4,802
Due from Government of Kenya	-	-	33,102	-	-	33,102	33,102
Total assets	33,515	235,459	96,103	-	4,802	369,879	369,879
Liabilities							
Currency in circulation	-	-	-	-	125,024	125,024	125,024
Deposits	-	-	-	-	143,228	143,228	143,228
Amounts due to International Monetary Fund	-	-	-	-	63,276	63,276	63,276
Other liabilities and provisions	-	-	-	-	9,587	9,587	9,587
Total liabilities	-	-	-	-	341,115	341,115	341,115

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

32 FAIR VALUES AND EFFECTIVE INTEREST RATES OF FINANCIAL ASSETS AND LIABILITIES (Continued)

Valuation hierarchy

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

	Level 1	Level 2	Level 3
Fair value determined using:	Unadjusted quoted prices in an active market for identical assets and liabilities	Valuation models with directly or indirectly market observable inputs	Valuation models using significant non-market observable inputs
Types of financial assets:	Actively traded government and other agency securities Listed derivative instruments Listed equities	Corporate and other government bonds and loans Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters Corporate bonds in illiquid markets
Types of financial liabilities:	Listed derivative instruments	Over-the-counter (OTC) derivatives	Highly structured OTC derivatives with unobservable parameters

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2011:

30 June 2011:	Level 1	Level 2	Level 3	Total
	KShs million	KShs million	KShs million	KShs million
Assets				
Balances due from banking institutions and Gold holdings	368,835	-	-	368,835
Other assets	-	5,381	-	5,381
Total assets	368,835	5,381	-	374,216
30 June 2010:	Level 1	Level 2	Level 3	Total
	KShs million	KShs million	KShs million	KShs million
Assets				
Balances due from banking institutions and Gold holdings	284,682	-	-	284,682
Other assets	-	5,141	-	5,141
Total assets	284,682	5,141	-	289,823

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

32 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 2011 and 2010 were in the following ranges:

	2011	2010
Assets		
Government securities	6.00%	6.64%
Deposits with overseas correspondent banks		
- current accounts		
- term deposits (USD)	0.21%	0.36%
- term deposits (Sterling Pounds)	0.71%	0.48%
- term deposits (Euro)F	1.18%	0.54%
Loans and advances - commercial banks	6.50%	6.50%
- Government of Kenya	3.0%	3.0%
- employees	3.0%	3.0%
Due from Government of Kenya		
Liabilities	0.0%	0.0%
- deposits	0.36%	0.36%

33 CONTINGENCIES

The Bank is party to various legal proceedings with potential liability of KShs 266.5 million as at 30 June 2011 (2010- KShs 496.8 million). 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.

34 COMMITMENTS	2011 KShs million	2010 KShs million
Capital: Authorised and not contracted for		
Office furniture	1	1
Office equipment	26	6
Computer equipment	27	3
Computer equipment - SIMBA Software	4	-
Computer equipment - SIMBA Hardware	-	164
Fixtures & fittings	1	-
Motor vehicles	31	4
Others	<u>64</u>	<u>15</u>
	<u>154</u>	<u>193</u>

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011 (CONTINUED)

35 OPERATING LEASE COMMITMENTS

AS LESSEE:

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

	2011 KShs million	2010 KShs million
One year	2	2
Between two and five years	9	10
Over five years	<u>174</u>	<u>180</u>
	<u>185</u>	<u>192</u>

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

36 IMPACT OF CHANGE IN ACCOUNTING POLICY

During the year, the Bank adopted the requirements of IAS 39 by fair valuing the staff loans and advances granted at low interest rates. The impact of this is presented within the financial statements under the following line items:

	2011 KShs million	2010 KShs million
Other assets – Prepayments and sundry debtors	<u>2,161</u>	<u>2,340</u>
Other liabilities – Long term employee benefit	<u>2,161</u>	<u>2,340</u>
Interest income	<u>179</u>	<u>Nil</u>
Staff costs	<u>179</u>	<u>Nil</u>

37 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.