CENTRAL BANK OF KENYA

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

30 JUNE 2006

CENTRAL BANK OF KENYA

ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2006

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DIRECTORS, OFFICERS AND ADMINISTRATION

DIRECTORS

Dr Andrew K Mullei	Governor and Chairman
Mrs Jacinta W Mwatela	Deputy Governor
Mr Joseph K Kinyua	Permanent Secretary – Treasury, Member
Mr. Nicholas A. Nesbitt	Member – Appointed on 28th September, 2006
Mr. Joseph K Waiguru	Member – Appointed on 28th September, 2006
Dr. William O Ogara	Member – Appointed on 28th September, 2006

SENIOR MANAGEMENT

Mrs JW Mwatela	Ag. Governor
Mr John M Gikonyo	Director Governor's Office & Board Secretary
Mr Aggrey J.K. Bett	Director – Banking Department Services
Mr Jackson M. Kitili	Director –Monetary Operations & Debt Management
Mr Jones M. Nzomo	Director – Finance & Resource Planning
Mr Lawrence C. Kungu	Director – Estates Management & Procurement
Mr Gerald A Nyaoma	Director – Banking Supervision Department
Ms Elizabeth C. A. Omolo	Executive Director – Kenya School of Monetary Studies
Mr Nicholas M. Kiritu	Director – Internal Audit & Risk Management
Mr Nicholas N. B. T. Korir	Director – Research Department
Mr Edwin L Ogola	Director – Currency Operations and Branch Administration
Mr Charles O Maranga	Director – Administration and Human Resources

REGISTERED OFFICE

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

BRANCHES

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

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

Eldoret
Kiptagich House
Uganda Road
PO Box 2710
30100 Eldoret, Kenya

Kenya School of Monetary Studies
Kenya School of Monetary Studies
Thika Road
PO Box 65041
00200 Nairobi City Square, Kenya

DIRECTORS, OFFICERS AND ADMINISTRATION (CONTINUED)

AUDITORS

KPMG Kenya
Lonrho House
Standard Street
PO Box 40612
00100 Nairobi GPO, Kenya

LAWYERS

Oraro and Co Advocates
ACK Garden House
1st Ngong Avenue
PO Box 51236
00200 Nairobi City Square, Kenya

BANK SECRETARY

Mr John M Gikonyo
Central Bank of Kenya
Haile Selassie Avenue
PO Box 60000
00200 Nairobi City Square, Kenya

CENTRAL BANK OF KENYA

DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2006

The directors submit their report together with the audited financial statements for the year ended 30 June 2006, incorporating Kenya School of Monetary Studies Limited, a company limited by guarantee and wholly owned by the Bank.

1. Establishment

The Bank was established under the Central Bank of Kenya Act (the Act), Cap.491.

2. Principal activities

The Bank is established and administered under the Central Bank of Kenya 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 the liquidity, solvency and proper functioning of a stable market-based financial system. The Bank acts as banker, advisor and fiscal agent of the Government of Kenya.

3. Results

The results for the year are set out on page 9.

4. Dividend

The board of directors recommend the payment of Kshs2 billion dividend for the year (2005 – Nil)

5. Directors

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

6. Auditors

KPMG Kenya were appointed the Auditors for two years ending after the approval of the financial statements for the year ending 30 June 2006.

7. Approval of financial statements

The financial statements were approved at a meeting of the directors held on 17th October, 2006.

BY ORDER OF THE BOARD

John M Gikonyo
Board Secretary

Date: 17th October, 2006

CENTRAL BANK OF KENYA

STATEMENT OF DIRECTORS' RESPONSIBILITIES

We, the directors certify that:

1. We are responsible for the preparation of financial statements for each financial year which present a true and fair view of the state of affairs of the Bank and of its operating results for that year. We are also responsible to ensure that the Bank keeps proper accounting records which disclose with reasonable accuracy, the financial position of the Bank.

2. We accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgement and estimates, in accordance with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act.

3. We are responsible for safeguarding the assets of the Bank.

4. We are responsible for establishing and maintaining systems of internal control designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.

5. We are of the opinion that the financial statements for the year ending 30 June 2006 fairly present the financial position and operating results of the Bank.

6. Nothing has come to the attention of the directors to indicate that the Bank will not remain a going concern for at least twelve months from the date of this statement.

Signed on behalf of the Board of Directors by:

___________________________	________________________
Ag.Governor	Director

Date: 17th October, 2006

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. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

Board of Directors

Section 11 of the CBK Act Cap 491 provides that the Board of Directors shall constitute 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, 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.

Mrs. Jacinta W. Mwatela was appointed Acting Governor on 23rd March, 2006 following the suspension of Dr. Andrew K. Mullei as Governor. Currently there are three Non-Executive Directors who are all serving their first term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

Board Meetings

The Board meets once every six weeks and has a formal schedule of matters reserved for it. The Directors are given appropriate and timely information so that they can 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..

Monetary Policy Advisory Committee

Section 4D of the CBK Act establishes the Monetary Policy Advisory Committee Members were appointed by the Minister for Finance on 29 July 2005 for three years with effect from 1 August 2005. Section 4D2(d) require that the six independent members and shall have knowledge, experience and expertise in matters relating to finance, banking and fiscal and monetary policy. The secretariat of this Committee is based in the Economics Department of the Bank and members have unlimited access to the Bank for purposes of research in any area which they consider useful. The Committee meets once every two months.

The duties of the Committee are to:

(a) Advise the Bank with respect to Monetary Policy and
(b) Perform such other functions as the Minister may prescribe by regulations.

The Committee is currently made up of the following:

(1) The Governor who is also the Chairman
(2) The Deputy Governor who is the Deputy Chairman
(3) Permanent Secretary to the Treasury or his alternative
(4) Professor T. C. Ryan
(5) Professor Francis Mwega
(6) Dr. Rose W. Ngugi

(7) Mrs Sheila S.M.R. M'Mbijjewe
(8) Mr. John Randa
(9) Mr. Wycliffe Mukulu

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

Audit Committee

The Audit Committee has been chaired by Mr. Paul Spence and membership includes three other members who are Non-Executive Directors having experience in Accounting, Auditing, Banking and Financial Management. The committee currently meets on a 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 improving the quality of financial reporting with particular attention to compliance with legal and reporting requirements;
- Receive and consider the Bank's annual budget;
- 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 Banks' Risk Management Policies and Procedures.

Tender Committee

The Committee has been chaired by Mr. Owen N. Koimburi and membership includes two other Non-Executive Directors, the Governor and the Deputy Governor together with three Heads of Departments. The Committee meets on monthly basis and as need arises. The roles and responsibilities of the Committee are as under:

- To award contracts through open tender, restricted tenders, request for proposals or direct procurement where the contract value per item exceeds five hundred thousand shillings;
- To approve bids through open tender for sale of Central Bank stores;
- To approve variations of contract conditions previously awarded by the Committee.
- To review tender documents and request for proposals where the estimated contract value exceeds KShs 1 million.

Functionally, the Committee formulates and oversees the implementation of all the procurement and disposal policies of the Central Bank and ensures that all the procurement regulations, standards and best practices are fully complied with in accordance with the Exchequer and Audit Act – Procurement Rules and Regulations (2002).

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 posts of Governor and Deputy Governor are set out by statute in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

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

Directors Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial year 2005/2006 is disclosed in a note to 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.

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 conflicts 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 under the Exchequer and Audit Rules and Regulations (2002). In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

Authorizations and Internal Audit

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 performance of the Bank.

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 Release, Statistical Bulletin and 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 Report is published in the Kenya Gazette.

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

We have audited the financial statements set out on pages 9 to 30 for the year ended 30 June 2006. We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. The financial statements are in agreement with the books of account.

Respective responsibilities of directors and independent auditors

As stated on page 4, the directors are responsible for the preparation of financial statements that give a true and fair view of the state of affairs of the Bank and its operating results. Our responsibility is to express an opinion on the financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by the directors, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, proper books of account have been kept and the financial statements give a true and fair view of the state of the Bank's financial position at 30 June 2006 and of its operating results and cash flows for the year then ended and comply with International Financial Reporting Standards and the Central Bank of Kenya Act.

Date: 17th October, 2006

CENTRAL BANK OF KENYA

INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006

	Note	2006 KShs million	2005 KShs million
Interest income	2	6,943	5,033
Interest expense	3	(1,039)	(364)
Net interest income		**5,904**	**4,669**
Fee and commission income	4	4,968	3,783
Net foreign exchange expenses	5	(109)	(3,071)
Other operating income	6	255	184
Operating income		**11,018**	**5,565**
Operating expenses	7	(6,267)	(5,685)
Impairment losses	9	(4)	(4,014)
Profit/(loss) for the year		**4,747**	**(4,134)**
Dividends:			
Proposed dividend for the year	10	**2,000**	**-**

The notes set out on pages 13 to 30 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

BALANCE SHEET
AS AT 30 JUNE 2006

	Note	2006 KShs million	2005 KShs million
ASSETS			
Balances due from banking institutions and gold holdings	11	172,997	119,757
Items in the course of collection		537	5,468
Investment in government securities	12	1	7
Loans and advances	13	9,283	9,414
Other assets	14	6,851	2,810
Retirement benefit asset	15	394	478
Property and equipment	16	706	1,193
Prepaid operating lease rentals	17	285	289
Due from Government of Kenya	18	35,549	35,917
TOTAL ASSETS		**226,603**	**175,333**
LIABILITIES			
Currency in circulation	19	76,207	67,322
Deposits	20	100,824	79,897
International Monetary Fund	21	13,588	14,873
Amounts repayable under repurchase agreements	22	23,342	5,334
Other liabilities	23	997	1,009
TOTAL LIABILITIES		**214,958**	**168,435**
EQUITY AND RESERVES (Page 11)			
Share capital	24	1,500	1,500
General reserve fund	25	8,145	5,398
Proposed dividend		2,000	-
TOTAL EQUITY AND RESERVES		**11,645**	**6,898**
TOTAL LIABILITIES AND EQUITY		**226,603**	**175,333**

The financial statements set out on pages 9 to 30 were approved by the Board of Directors for issue on 17th October, 2006 and signed on its behalf by:

____________________________ ____________________________

Ag. Governor Director

The notes set out on pages 13 to 30 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2006

	Share capital KShs million	General reserve fund KShs million	Proposed dividend KShs million	Total KShs million
Year ended 30 June 2005				
Balance at start of the year	1,500	9,532	4,500	15,532
Loss for the year	-	(4,134)	-	(4,134)
Dividends:				
- For 2004 paid	-	-	(2,500)	(2,500)
- 2004 Applied to amounts due from Government of Kenya (Note 18)	-	-	(2,000)	(2,000)
Balance at end of the year	**1,500**	**5,398**	**-**	**6,898**
Year ended 30 June 2006				
Balance at start of the year	1,500	5,398	-	6,898
Profit for the year	-	4,747	-	4,747
Proposed dividend for 2006 (Note 10)	-	(2,000)	2,000	-
Balance at end of the year	**1,500**	**8,145**	**2,000**	**11,645**

The notes set out on pages 13 to 30 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2006

	Note	2006 KShs million	2005 KShs million
Operating activities			
Net cash generated by operating activities	26 (a)	43,526	11,142
Investing activities			
Receipts from government loan		368	-
Purchase of property and equipment		(241)	(1,177)
Proceeds from disposal of property and equipment		10	9
Proceeds/(Investment) in International Monetary Fund-SDR accounts		37	(9)
Net cash generated/(utilised) from investing activities		**174**	**(1,177)**
Financing activities			
Dividends paid		-	(2,500)
Increase in currency in circulation		8,885	4,701
Net cash from financing activities		**8,885**	**2,201**
Net increase in cash and cash equivalents		52,585	12,166
Cash and cash equivalents at start of year		114,106	101,940
Cash and cash equivalents at end of year	26(b)	**166,691**	**114,106**

The notes set out on pages 13 to 30 form an integral part of these financial statements.

1 SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation and form of presentation

- **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 Kenya Shillings (KShs) and are prepared under the historical cost convention except for measurement at fair value of certain investments.

  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.

(b) Consolidation principle

The financial statements include the operations of the Bank and its subsidiary, Kenya School of Monetary Studies, which is a company limited by guarantee and where Central Bank of Kenya has full control.

(c) Revenue recognition

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

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. When loans and advances become impaired, they are written down to their recoverable amounts.

Rental income from lease of property is recognised in the income statement on a straight-line basis over the term of the lease.

(d) Foreign currency

(i) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at the exchange rate ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rate ruling at the net balance sheet date. Resulting exchange differences are recognised in the income statement for the year.

(ii) Functional and presentation currencies

Items included in the financial statements of the Bank are measured using the Kenya Shillings which is the currency of the primary economic environment in which the Bank operates ("functional currency"). The financial statements are presented in Kenya Shillings.

(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.

(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. Deposit Protection Fund Board, a related party, reimburses the Bank the costs of contributions relating to staff seconded to it by the Bank.

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.

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

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

(ii) Other employee benefits

The Bank provides free medical treatment to staff and their dependants. Contracted staff are eligible to a gratuity based on the employment terms. A provision is made for the estimated liability of such gratuity payable and charged to the income statement. The estimated monetary liability for employees' accrued leave entitlement at the balance sheet date is recognised as an expense accrual.

(f) Property and equipment

Property and equipment are stated at purchase price less accumulated depreciation and impairment losses.

Depreciation is charged to the profit and loss account on a straight-line basis at the following rates:

Building improvements	10%
Motor vehicles, furniture and equipment	50%

The residual value, if not insignificant is reassessed annually.

(g) Financial assets and liabilities

Classification

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.

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

(i) Financial assets at fair value through profit or loss

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 does not currently hold financial assets for trading.

(ii) Loans and advances

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.

(iii) 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's management has the intention and ability to hold to maturity. 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 repurchase and reverse purchase instruments as held to maturity.

(iv) Available for sale

These investments are those intended to be held for an indefinite period of time, which may be sold as part of the Bank's official operations or otherwise. The bank does not currently have any assets classified as available-for-sale.

A financial liability is any liability that is a contractual obligation to deliver cash (or another financial asset) to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity. The bank cannot settle in its own equity instruments.

(g) Financial assets and liabilities (continued)

Recognition and measurement

Loans are recognized when cash is advanced to the borrowers. Purchases and sales of other financial assets are recognized on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are initially recognized at fair value, plus transaction costs for financial assets not carried at fair value through the income statement. Financial assets are derecognized 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. Financial assets that are available for sale and financial assets at fair value through profit or loss are subsequently carried at fair value.

Loans and advances and investments that are held to maturity are carried at amortised cost using the effective interest method, less provision for impairment.

(h) Loans and provisions for loan impairment

Loans are stated at outstanding amount less provision 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, the Bank may make direct advances to the Government for the purpose of offsetting fluctuations between receipts from the budgeted revenue and the payments of the Government. The total amount of advances to the Government outstanding shall not exceed five percent of the gross recurrent revenue of the Government as shown in the Appropriation Accounts for the latest year for which those financial statements have been audited by the Controller and Auditor-General.

The Bank also operates a staff loans scheme for its employees for the provision of facilities such as house and car loans.

The Bank determines the terms and conditions for granting of the above loans with reference to the prevailing market interest rates and may determine different rates for different classes of transactions and maturities.

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

When a loan is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries are credited to the income statement if previously written off.

(i) Dividends

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.

(j) Provisions

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

(k) Offsetting of financial assets and liabilities

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

(l) Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If such condition exists, the asset's recoverable amount is estimated and an impairment loss recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised through the income statement.

(m) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

(n) Receivables

Amounts due from Government of Kenya and other assets are stated at their cost less impairment losses.

(o) Cash and cash equivalents

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

(p) Comparatives

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

	2006 KShs million	2005 KShs million
2 INTEREST INCOME		
Foreign investments earnings	5,372	3,299
Local investments earnings	1,506	1,672
Other interest earnings	65	62
	6,943	**5,033**
3 INTEREST EXPENSE		
Interest on monetary policy issues	991	323
Interest paid to International Monetary Fund	48	40
Interest on customer deposits	-	1
	1,039	**364**
4 FEES AND COMMISSION INCOME		
Commission on sale of government securities	4,967	3,782
Special projects agency fees	1	1
	4,968	**3,783**
5 NET FOREIGN EXCHANGE EXPENSES		
Gains on sale of foreign exchange	378	566
Foreign exchange translation loss	(487)	(3,637)
	(109)	**(3,071)**
6 OTHER OPERATING INCOME		
Rent received	14	15
Profit from disposal of property and equipment	10	9
Tuition fees and other charges	135	125
Miscellaneous income	96	35
	255	**184**
7 OPERATING EXPENSES		
Currency expenses	2,027	1,925
Depreciation	728	609
Property maintenance expenses	371	331
Auditors' remuneration	5	4
Banking expenses	3	4
Operating lease rentals	4	3
Staff costs	2,654	2,130
Other expenses	475	679
	6,267	**5,685**

	2006 KShs million	2005 KShs million

8 STAFF COSTS

The following items are included within staff costs:

	2006 KShs million	2005 KShs million
Retirement benefit costs - defined benefit scheme (Note 15)	334	271

9 IMPAIRMENT LOSSES

	2006 KShs million	2005 KShs million
Losses and write-offs of loans	4	14
Impairment loss on amount due from Government of Kenya (Note 18)	-	4,000
	4	**4,014**

10 DIVIDENDS

The board of directors recommend the payment of Kshs 2 billion dividend in respect of the year ended 30 June 2006 (2005 –Nil).

11 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2006 KShs million	2005 KShs million
Current accounts	2,604	3,059
Term deposits	162,674	109,858
Domestic forex currency cheque clearing	1,386	1,164
Forex travellers cheques	5	2
Gold holdings	21	16
Cash and cash equivalents	166,690	114,099
Accrued interest on foreign investments	910	446
Special Drawing Rights	13	50
Total own resources	167,613	114,595
Special project accounts	5,384	5,162
	172,997	**119,757**

12 INVESTMENT IN GOVERNMENT SECURITIES

	2006 KShs million	2005 KShs million
Treasury bills	**1**	**7**

All the government securities held have a maturity date of within 90 days from the date of acquisition.

13 LOANS AND ADVANCES

	2006 KShs million	2005 KShs million
Advances to banks under liquidation	8,259	8,259
Government overdraft account (see below and Note 27)	5,202	5,225
Advances to employees (Note 27)	2,150	1,998
Overnight Advances to Commercial Banks	5	-
IMF funds on-lent to the Government (Note 27)	1,948	2,221
	17,564	17,703
Provision for loan impairment	(8,281)	(8,289)
Net advances as at 30 June	**9,283**	**9,414**

Movement in the provision for loan impairment is as follows:

	2006 KShs million	2005 KShs million
At start of the year	(8,289)	(8,291)
Additional provisions made in the year	(2)	(13)
Recoveries in the year	10	15
At end of the year	**(8,281)**	**(8,289)**

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest audited financial statements. The limit stands at KShs 11,323,869,438.70 based on the Government financial statements for 2003/2004, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 8,908,699,851 based on the Government financial statements for 2001/2002.

14 OTHER ASSETS

	2007 KShs million	2006 KShs million
Impersonal accounts	4,545	4,545
Sundry debtors and Prepayments	2,306	2,306
	6,851	**6,851**

15 RETIREMENT BENEFIT ASSET

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

The amounts recognised in the balance sheet are determined on the basis of an actuarial review carried out by Alexander Forbes Financial Services Limited as at 30 June 2006.

	2006 KShs million	2005 KShs million
Present value of funded obligations	8,126	7,062
Fair value of plan assets	(9,260)	(8,075)
Present value of net asset	(1,134)	(1,013)
Unrecognised actuarial gain	740	535
Net Retirement Benefit Asset	**(394)**	**(478)**

The amounts recognised in the income statement are as follows:

Current service costs	418	375
Interest costs	641	541
Expected return on plan assets	(725)	(645)
Total expenses included in operating expenses	**334**	**271**

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

Net expense recognised in income statement	334	271
Employer contributions	(250)	(238)
Movement in the asset recognised in the balance sheet	84	33
Actual return on plan assets	**1,235**	**899**

The principal actuarial assumptions at the balance sheet date were:

	2006	2005
Discount rate (p.a)	9%	9%
Salary increase (p.a)	7%	7%
Expected return on plan assets (p.a)	9%	9%
Future pension increases	0%	0%

16 PROPERTY AND EQUIPMENT

	Land and buildings KShs million	Motor vehicles KShs million	Furniture and equipment KShs million	Total KShs million
Cost				
At start of year	1,004	193	2,584	3,781
Adjustments	-	-	247	247
Additions	-	45	196	241
Disposals	-	(33)	(79)	(112)
At end of the year	1,004	205	2,948	4,157
Depreciation				
At start of the year	835	153	1,600	2,588
Adjustments	-	-	247	247
Charge for the year	86	21	621	728
On disposal	-	(33)	(79)	(112)
At end of the year	921	141	2,389	3,451
Net book value				
At 30 June 2006	**83**	**64**	**559**	**706**
At 30 June 2005	**169**	**40**	**984**	**1,193**

17 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:

	2006 KShs million	2005 KShs million
Cost		
At beginning and end of the year	300	300
Amortisation		
At start of the year	11	8
Amortisation charge for the year	4	3
At end of year	15	11
Net carrying value at end of the year	**285**	**289**

18 DUE FROM GOVERNMENT OF KENYA

Revaluation Account		
Gross amount Outstanding at the start of the year	15,642	16,642
Recovered through dividends payable	-	(1,000)
Gross Outstanding at the end of year	15,642	15,642
Impairment provision:		
Balance at the start of the year	(15,642)	(11,642)
Additions in the year	-	(4,000)
Impairment provision at the year end	(15,642)	(15,642)
Net at year end	-	-
Loan due from government		
At start of the year	35,917	36,917
Receipts during the year	(368)	-
Recovered through dividends payable	-	(1,000)
	35,549	**35,917**

The loan due from 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 Cap 491. The loan which stood at KShs 35,549 million at 30 June 2006 bears interest at the rate of 3% per annum from 1 July 2003. The repayment period is 36 years from 1 July 2004.

19 CURRENCY IN CIRCULATION

	2006 KShs million	**2005 KShs million**
Kenya notes	73,089	64,416
Kenya coins	3,113	2,901
Commemorative coins	5	5
	76,207	**67,322**

20 DEPOSITS

Banks – Kenya	31,661	27,127
– External	20	19
Domestic forex cheques clearing	1,159	949
Non-bank financial institutions	119	113
Other public entities and project accounts	8,688	7,914
Government of Kenya	59,178	43,775
	100,824	**79,897**

21 INTERNATIONAL MONETARY FUND

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Central Bank of Kenya (CBK) 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 CBK.

	2006		2005	
	SDRs million	**KShs million**	**SDR's million**	**KShs million**
International Monetary Fund Account no.1	20	2,199	20	2,259
International Monetary Fund Account no.2	-	1	-	1
International Monetary Fund – PRGF Account	87	9,440	94	10,392
International Monetary Fund – On lent to Government of Kenya	18	1,948	20	2,221
	125	**13,588**	**134**	**14,873**
On a custodial basis, CBK holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in the favour of the IMF in its capacity as the IMF's depository.				
Security at 30 June	**238**	**24,947**	**238**	**27,690**

22 AMOUNTS REPAYABLE UNDER REPURCHASE AGREEMENTS

These are securities issued and utilised by the Bank for monetary policy purposes and are shown as a liability to the buyers.

23 OTHER LIABILITIES

	2006 KShs million	2005 KShs million
Sundry creditors	542	564
Refundable deposits	237	258
Development deposits	186	155
Amount pending litigation	32	32
	997	**1,009**

24 SHARE CAPITAL

Authorised share capital	**5,000**	**5,000**
Issued and fully paid	**1,500**	**1,500**

25 GENERAL RESERVE FUND

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

26 NOTES TO THE CASH FLOW STATEMENT

		2006 KShs million	2005 KShs million
(a)	**Cash flows from operating activities**		
	Profit/(loss) for the year	4,747	(4,134)
	Adjustments for:		
	Impairment losses on amount due from Government of Kenya	-	4,000
	Depreciation	728	609
	Amortization of prepaid operating leases	4	3
	Decrease in defined benefit scheme asset	84	33
	Gain on disposal of property and equipment	(10)	(9)
	Operating profit before working capital changes	5,553	502
	Net decrease in loans and advances	131	4,032
	Increase/(Decrease) in amounts repayable under repurchase agreements	18,008	(810)
	Increase in deposits	20,927	4,121
	(Decrease)/Increase in balance with International Monetary Fund	(1,285)	4,243
	(Increase)/Decrease in project accounts	(222)	2,415
	Increase in accrued interest on balances due from banking institutions	(464)	(145)
	Decrease/(Increase) in items in the course of collection	4,931	(846)
	Increase in other assets	(4,041)	(2,368)
	Decrease in other liabilities	(12)	(2)
	Net cash generated by operations	43,526	11,142
(b)	**Cash and cash equivalents**		
	Cash and cash equivalents included in the cash flow statement comprise the following:		
	Term deposits	162,674	109,858
	Current accounts	2,604	3,059
	Domestic forex cheques clearing	1,386	1,164
	Travellers cheques	5	2
	Gold holdings	21	16
		166,690	114,099
	Investment in Government securities	1	7
		166,691	**114,106**

27 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. Unless otherwise stated, all transactions between these entities take place at arm's length.

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 13) include advances to employees that as at 30 June 2006 amounted to KShs 2,150 million (2005 - KShs 1,998 million). The advances are at preferential rates of interest determined by the Bank.

	2006 KShs million	2005 KShs million
(ii) Loans to executive directors		
At start of the year	12	16
Loans advanced during the year	-	6
Loan repayments	(6)	(10)
At end of the year	**6**	**12**
(iii) Director's emoluments		
Fees to non executive directors	9	9
Remuneration to executive directors	41	36

(iv) 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.

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

	2006 KShs million	2005 KShs million
Due from Government of Kenya (Note 18)	35,549	35,917
Overdraft account (Note 13)	5,202	5,225
IMF funds on-lent to the Government (Note 13)	1,948	2,221
Government of Kenya deposits (Note 20)	59,178	43,775
Investments in Government of Kenya securities (Note 12)	1	7

(v) 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 14 million (2005: KShs 4 million).

(vi) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity incorporated under the Companies Act as a company limited by guarantee and is 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.

28 LIQUIDITY RISK

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 30 June 2006 to the contractual maturity date.

ASSETS	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
Balances due from banking institutions and gold holdings	10,310	162,674	-	-	13	172,997
Items in the course of collection	537	-	-	-	-	537
Investments in government securities	-	1	-	-	-	1
Loans and advances	5,207	118	746	1985	1,227	9,283
Other assets	-	6,851	-	-	-	6,851
Property and equipment	-	177	529	-	-	706
Prepaid operating leave rentals	-	1	3	16	265	285
Retirement benefit asset	-	-	-	-	394	394
Due from Government of Kenya	-	-	-	5,000	30,549	35,549
TOTAL ASSETS	16,054	169,822	1,278	7,001	32,448	226,603
LIABILITIES						
Currency in circulation	-	-	-	-	76,207	76,207
Deposits	100,824	-	-	-	-	100,824
International Monetary Fund	-	-	413	1,535	11,640	13,588
Amounts repayable under repurchase agreements	-	23,342	-	-	-	23,342
Other liabilities	-	997	-	-	-	997
Equity and reserves	-	-	-	-	11,645	11,645
TOTAL LIABILITIES AND EQUITY	100,824	24,339	413	1535	99,492	226,603
Liquidity gap at 30 June 2006	**(84,770)**	**145,483**	**865**	**5,466**	**(67,044)**	**-**
As at 30 June 2005:						
Total assets	20,542	113,220	333	6,808	34,430	175,333
Total liabilities and equity	147,219	6,343	413	1,808	19,550	175,333
Liquidity gap at 30 June 2005	**(126,677)**	**106,877**	**(80)**	**5,000**	**14,880**	**-**

29 INTEREST RATE 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 2006	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	167,613	-	-	5,384	172,997
Items in the course of collection	-	-	-	537	537
Investment in government securities	1	-	-	-	1
Loans and advances	5,325	746	3,212	-	9,283
Other assets	-	-	-	6,851	6,851
Property and equipment	-	-	-	706	706
Prepaid operating leave rentals	-	-	-	285	285
Retirement benefit asset	-	-	-	394	394
Due from Government of Kenya	-	1,000	34,549	-	35,549
Total assets	172,939	1,746	37,761	14,157	226,603
Liabilities and equity					
Currency in circulation	-	-	-	76,207	76,207
Deposits	100,824	-	-	-	100,824
International Monetary Fund	-	-	-	13,588	13,588
Amounts repayable under repurchase agreements	23,342	-	-	-	23,342
Other liabilities	-	-	-	997	997
Equity and reserves	-	-	-	11,645	11,645
Total liabilities and equity	124,166	-	-	102,437	226,603
Interest sensitivity gap at 30 June 2006	**48,773**	**1,746**	**37,761**	**(88,280)**	**-**
As at 30 June 2005					
Total assets	112,714	405	39,509	19,086	171,714
Total liabilities and equity	6,144	1,186	6,838	157,546	171,714
Interest sensitivity gap at 30 June 2005	**106,570**	**(781)**	**32,671**	**(138,460)**	**-**

30 CURRENCY RISK

The various currencies to which the bank is exposed at 30 June 2006 are summarised in the below (all expressed in KShs million):

2006	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	87,980	58,568	26,362	-	-	53	172,963
Special Drawing Rights	-	-	-	13	-	-	13
Gold holdings	-	-	-	-	21	-	21
Total assets	87,980	58,568	26,362	13	21	53	172,997
Liabilities							
Balances due to IMF	-	-	-	13,588	-	-	13,588
Commissions for EEC Development Fund	-	186	-	-	-	-	186
Forex bureaux/Banks deposits	973	222	216	-	-	-	1,411
Total liabilities	973	408	216	13,588	-	-	15,185
Net foreign currency position as at June2006	**87,007**	**58,160**	**26,146**	**(13,575)**	**21**	**53**	**157,812**
2005							
Total assets	42,591	46,198	30,867	50	16	35	119,757
Total liabilities	783	342	231	14,873	-	-	16,229
Net foreign currency position at 30 June 2005	**41,808**	**45,856**	**30,636**	**(14,823)**	**16**	**35**	**103,528**

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

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

The effective interest rates for the principal financial assets and liabilities at 30 June 2006 and 2004 were in the following ranges:

	2006	2005
Assets		
Government securities	6.2%	4.9%
Deposits with overseas correspondent banks		
– current accounts	0.0%	0.0%
– term deposits (USD)	5.1%	2.2%
– term deposits (Pounds Sterling)	4.6%	4.8%
– term deposits (Euro)	2.9%	2.0%
Loans and advances – Commercial banks	9.75 %	9.2%
– Government of Kenya	9.75 %	6.2%
– Employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%
Liabilities		
Customer deposits	0%	0%

32 CONTINGENCIES AND COMMITMENTS

Contingencies

The Bank is party to various legal proceedings amounting to KShs 447 million at 30 June 2006 (2005 – KShs 532 million). Having regard to the legal advice received, and in all circumstances, the directors are of the opinion that these legal proceedings will not give rise to liabilities, which in aggregate, would otherwise have material effect on these financial statements.

Commitments	**2006 KShs million**	**2005 KShs million**
Contracted for	163	106
Authorised but not contracted for	-	42

33 TAXATION

No provision for tax is made as Section 7 of the Income Tax Act (Cap.470) 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.