

REPUBLIC OF KENYA



KENYA NATIONAL AUDIT OFFICE

**REPORT OF
THE
AUDITOR-GENERAL**

ON

**THE FINANCIAL STATEMENTS OF
CENTRAL BANK OF KENYA FOR THE
YEAR ENDED 30 JUNE 2013**



CENTRAL BANK OF KENYA



ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2013



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Board of Directors

Dr Mbui Wagacha	Interim Chairperson – Elected on 11 February 2013
Prof Njuguna Ndung'u	Governor
Dr Kamau Thugge	Principal Secretary, Treasury Appointed on 7 June 2013
Mr Joseph K. Kinyua	Permanent Secretary, Treasury Retired on 7 June 2013
Dr William O. Ogara	
Ms Vivienne Y. Apopo	
Ms Florence K. Muindi	
Mr John G. Msafari	

Senior Management

Prof Njuguna Ndung'u	Governor
Dr Haron Sirima	Deputy Governor
Mr Kennedy K. Abuga	Director – Governors' Office and Board Secretary
Mr Aggrey J.K. Bett	Director – Special Projects - Appointed 5 November 2012
Mr Fredrick Pere	Director – Bank 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. Lopyetum	Director – Currency Operations and Branch Administration Department - Resigned 26 June 2013
Mr Paul K. Wanyagi	Ag .Director – Currency Operations and Branch Administration Department - Appointed 12 July 2013
Mr Gerald Nyaoma	Director – Financial Markets Department
Mr Peter K. Rotich	Director – Finance & IMS Department - Appointed 5 November 2012
Mr Mark Lesiit	Director – Banking & Risk Management Department
Ms Mary Waceke	Director – Human Resources and Administration Department - Appointed 3 June 2013

Registered office and principal place of business

Central Bank of Kenya Building
Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya
Tel. (+254) (02)2860000

Branches

Mombasa Branch	Kisumu Branch	Eldoret Branch
Central Bank of Kenya Building	Central Bank of Kenya Building	Kiptagich House
Nkrumah Road	Jomo Kenyatta Highway	Uganda Road
P.O.Box 86372	P.O.Box 4	P.O.Box 2710
80100 Mombasa	40100 Kisumu	30100 Eldoret

Currency centres

Nyeri Currency Centre	Meru Currency Centre	Nakuru Currency Centre
Kenya Commercial Bank Building	Co-operative Bank Building	Central Bank of Kenya Building
Kenyatta Street	Njuri Ncheke Street	George Morara Street
P.O.Box 840	P.O.Box 2171	P.O.Box 14094
10100 Nyeri	60200 Meru	20100 Nakuru

Subsidiary

Kenya School of Monetary Studies
Off Thika Road
Mathare North Road
P.O.Box 65041
00618 Nairobi

Main Lawyers

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

Auditor

PricewaterhouseCoopers
Certified Public Accountants
PwC Tower, Chiromo Road
P.O. Box 43963 – 00100 GPO
Nairobi

On behalf of:-
Auditor General
Anniversary Towers
P.O. Box 30084 – 00100 GPO
Nairobi

1. 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 Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act provides that the Board of Directors shall be composed of a Chairperson, a Governor, The Principal Secretary to the National Treasury, who is a non-voting member and five Non-Executive Directors. Previously, all the Board members were appointed by the President. With effect from 2 May 2012 however, the Act was amended and now requires that the President appoints the Governor after the conduct of a competitive process and following the approval of Parliament. The proposed procedure for appointing the Chairperson, although not yet enacted, is intended to be similar to the appointment procedure applicable to the Governor. Other than the Principal Secretary to the Treasury who is ex-officio, all the non-executive Directors of the Board are appointed by the President of the Republic of Kenya. All the Board members are appointed for terms of four years each and are eligible for reappointment provided that no Board Member holds office for more than two terms.

There are five Non-Executive Directors namely Dr Mbui Wagacha, Mr John Gerin Msafari, Ms Vivienne Yeda Apopo and Ms Florence Kagendo Muindi who are all serving their first term and Dr William Otiende Ogara who 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.

The Board meets once every two months 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 the responsibility given to the Governor by the Act. It, however, retains responsibility for determining the policy of the Bank.

The Members of the Board as at 30 June 2013 and their attendance of the 5 meetings held in the year were as follows:

No	Name	Position	Discipline	Date of appointment	Nationality	Meetings attended
1	Dr Mbui Wagacha	Interim Chairperson	Economist	14 March 2011	Kenyan	5
2	Prof Njuguna Ndungu	Governor, Member	Economist	14 March 2011	Kenyan	5
3	Dr William Otiende Ogara	Member	Professional Accountant	14 March 2011	Kenyan	5
4	Mr. John Gerin Msafari	Member	Business management	1 June 2011	Kenyan	5
5	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	14 March 2011	Kenyan	4
6	Ms Florence Kagendo Muindi	Member	Human Resource	1 June 2011	Kenyan	5
7	Principal Secretary/ National Treasury	Executive Officer	Economist	Permanent	Kenyan	2

The remuneration paid to the Directors for services rendered during the financial 2013/2012 is disclosed in Note 29 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 staff loans.

1. Statement of Corporate Governance (continued)

1.2. 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 once every two months and as necessary. The Terms of Reference for the Audit Committee cover five major areas, namely, Internal Control, Financial Reporting, Risk management, Internal Audit and External Audit.

The Audit Committee's mandate under **Internal Control** covers evaluation of control culture; the adequacy of the internal control systems and compliance with International Financial Reporting Standards in preparation of financial statements; the overall effectiveness of the internal control and risk management frameworks; and review of the effectiveness of the system for monitoring compliance with laws and regulations.

The mandate relating to **Financial Reporting** requires the Audit Committee to review significant accounting and reporting issues and their impact on the financial reports and ensure current financial risk areas are being managed appropriately. The Committee also ensures the adequacy of the financial reporting process and reviews the Bank's monthly management accounts and annual financial statements before approval by the Board and release.

With regard to **External Audit**, the Audit Committee reviews the external auditors' proposed audit scope, approach and audit deliverables; and review draft accounts before submission to the External Auditors for audit.

The Committee's mandate on **Internal Audit** covers review of the activities and resources of the Internal Audit function; effectiveness, standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditors' findings and recommendations. The Audit Committee reports to the Board of Directors standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditors' findings and recommendations. The Audit Committee reports to the Board of Directors on approach and audit deliverables; and review draft accounts before submission to the External Auditors for audit.

The Members of the Audit Committee as at 30 June 2013 and their attendance of the 15 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Dr William Otiende Ogara	Chairman	Professional Accountant	Kenyan	15
2	Mr John Gerin Msafari	Member	Business management	Kenyan	15
3	Ms Florence Muindi	Member	Human resource	Kenyan	8
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	7
5	Dr Mbui Wagacha	Member	Economist	Kenyan	5

1.3 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.

1. Statement of Corporate Governance (continued)

1.3 Monetary Policy Committee (MPC) (continued)

The Members of the MPC as at 30 June 2013 and their attendance of the 6 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Prof Njuguna Ndungu	Chairman	Economist	Kenyan	6
2	Dr Haron Sirima	Vice Chairman	Economist	Kenyan	6
3	Principal Secretary/ National Treasury	Member	Economist	Kenyan	6
4	Prof Francis Mwegu	Member	Economist	Kenyan	6
5	Prof Terry C. Ryan	Member	Economist	Kenyan	6
6	Mrs Sheila Mbijewe	Member	Finance	Kenyan	6
7	Mrs Farida Abdul	Member	Economist	Kenyan	6
8	Mr Charles Koori	Internal-Member	Economist	Kenyan	6
9	Mr John K. Birech	Internal-Member	Economist	Kenyan	6

1.4 Human Resources Committee

The Committee meets once every two months and when need arises to review human resource policies and make suitable recommendations to the Board. The Governor and the Deputy Governor attend the meetings as and when necessary.

The Members of the Human Resources as at 30 June 2013 and their attendance of the 8 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Florence K. Muindi	Chairperson	Human Resource	Kenyan	8
2	Dr William Otiende Ogara	Member	Finance	Kenyan	8
3	Mr John Gerin Msafari	Member	Business management	Kenyan	8
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	2

1.5 Financial Stability and Investment Committee

The Committee meets regularly and as and when need arises to review financial stability issues and foreign reserves management and Investments policies and make suitable recommendations to the Board.

Members of this Committee who served during the year are as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Vivienne Yeda Apopo	Chairperson	Lawyer and banker	Kenyan	5
2	Dr William Otiende Ogara	Member	Finance	Kenyan	5
3	Dr Mbui Wagacha	Member	Economist	Kenyan	5

1.6 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.

1. Statement of Corporate Governance (continued)

1.7 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.

1.8 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.

1.9 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 and a procurement plan that is prepared and approved by the Board before commencement of the financial year. The Board of Directors receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

1.10 Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. Risk Management Unit is a separate function under Banking Department and is responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit Department and Risk Management are availed to the Audit Committee of the Board.

1.11 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 are also placed in the Bank's website.

2 Financial Performance

The Bank's financial performance is affected by monetary policy undertaken, money supply, interest rates and exchange rate. The Bank's financial performance is presented on page 11 of these financial statements.

During the financial year ended 30 June 2013, the Bank's net interest income after impairment charge was Shs 1,912 million (2012: Shs 7,422 million). The decline is due to monetary policy undertaken in the year due to mop-up of excess liquidity in the economy. The reduction was further compounded by the low interest rates recorded on the foreign denominated deposits and investments.

The Bank's unrealized foreign exchange gains were Shs 5,623 million (loss 2012: Shs 27,993 million) due to favourable movements in major foreign exchange rates.

Trading income mainly generated from sale of foreign currency reduced to Shs 1,699 million (2012: Shs 2,902 million). The decrease in trading income is due to favourable movements in major foreign exchange rates.

Administrative expenses decreased to Shs 9,325 million (2012: Shs 12,058 million) as a result of the one off provision of Shs 4,686 million recorded in 2012. The one off provision posted in 2012 was offset by increases in staff expenses at Shs 3,483 million (2012: Shs 2,908 million) as the Bank introduced a defined contribution retirement benefit scheme. Currency costs increased to Shs 2,396 million (2012: Shs 1,216 million) as the Bank makes investments in the new generation currency to comply with Constitutional requirements. Administrative expenses were further reduced by actuarial gain of Shs 600 million (loss 2012: Shs 69 million) from revaluation of the Retirement Benefit Asset.

The Bank revalues its leasehold land and buildings every three years. The last valuation was in 2012 which resulted in gains of Shs 7,498 million.

The outcome of the Bank's operations was a net surplus of Shs 3,652 million (deficit 2012: Shs 18,356 million) that has been added to the general reserve fund.

The financial position for the year is set out on page 12. The Bank's assets increased to Shs 590,389 million (2012: Shs 509,498 million) fostered by favorable exchange rates compared to the previous year. Excess liquidity mop-up activities resulted in a decrease in advances to banks to Shs 351 million (2012: Shs 9,973 million).

Liabilities on the other hand increased to Shs 537,470 million (2012: Shs 458,731 million) due to higher liquidity as evidenced by higher deposits from banks and government at Shs 191,671 million (2012: 160,642 million) and currency in circulation at Shs 183,047 million (2012: Shs 159,216 million). The Bank instituted excess liquidity mop-up monetary policy measures resulting in investments by banks of Shs 41,589 million (2012: Shs 35,368 million). The increase was further fostered by favorable exchange rates compared to the previous year.

The directors submit their report together with the audited financial statements for the year ended 30 June 2013, which shows the state of affairs of Central Bank of Kenya (the "Bank").

Incorporation

The Bank is incorporated under Article 231 of the Constitution of Kenya, 2010.

Principal activities

The Bank is established and administered under the Constitution of Kenya, 2010 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.

Results and dividend

The surplus for the year of Shs 3,652 million (deficit 2012: Shs 25,854 million) has been added to the general reserve fund. The directors do not recommend the payment of a dividend. (2012: Shs 1.5 billion).

Board of Directors

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

Auditors

The Bank is audited by the Auditor General in accordance with Section 12 of the Public Audit Act and the Central Bank of Kenya Act.

By order of the Board


C.K. Abuga
BOARD SECRETARY

23rd September 2013

Central Bank of Kenya
Statement of Directors' Responsibility
For the year ended 30 June 2013

The directors are responsible for the preparation of financial statements for each financial year that give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the Bank's surplus. The directors also ensure that the Bank keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Bank. They are also responsible for safeguarding the assets of the Bank.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable estimates, in conformity with International Financial Reporting Standards and the requirements of the Central Bank of Kenya 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 surplus in accordance with International Financial Reporting Standards. The directors further accept responsibility for the maintenance of accounting records that may be relied upon in the preparation of financial statements, as well as designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement.

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



Governor

23rd September 2013



Director



REPUBLIC OF KENYA

Telephone: +254 20-342330
Fax: +254-20-311482
E-mail: cag@kenyaweb.com

P.O. Box 30084-00100
NAIROBI



KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2013.

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Central Bank of Kenya set out on pages 11 to 47, which comprise the consolidated statement of financial position as at 30 June 2013, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information have been audited on my behalf by PricewaterhouseCoopers, auditors appointed under Section 39 of the Public Audit Act, 2003 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 13 of the Public Audit Act, 2003.

Auditor-General's Responsibility

My responsibility is to express an independent opinion on the financial statements based on the audit and report in accordance with the provisions of Section 15(2) of the Public Audit Act, 2003 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. The audit was conducted in accordance with



International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

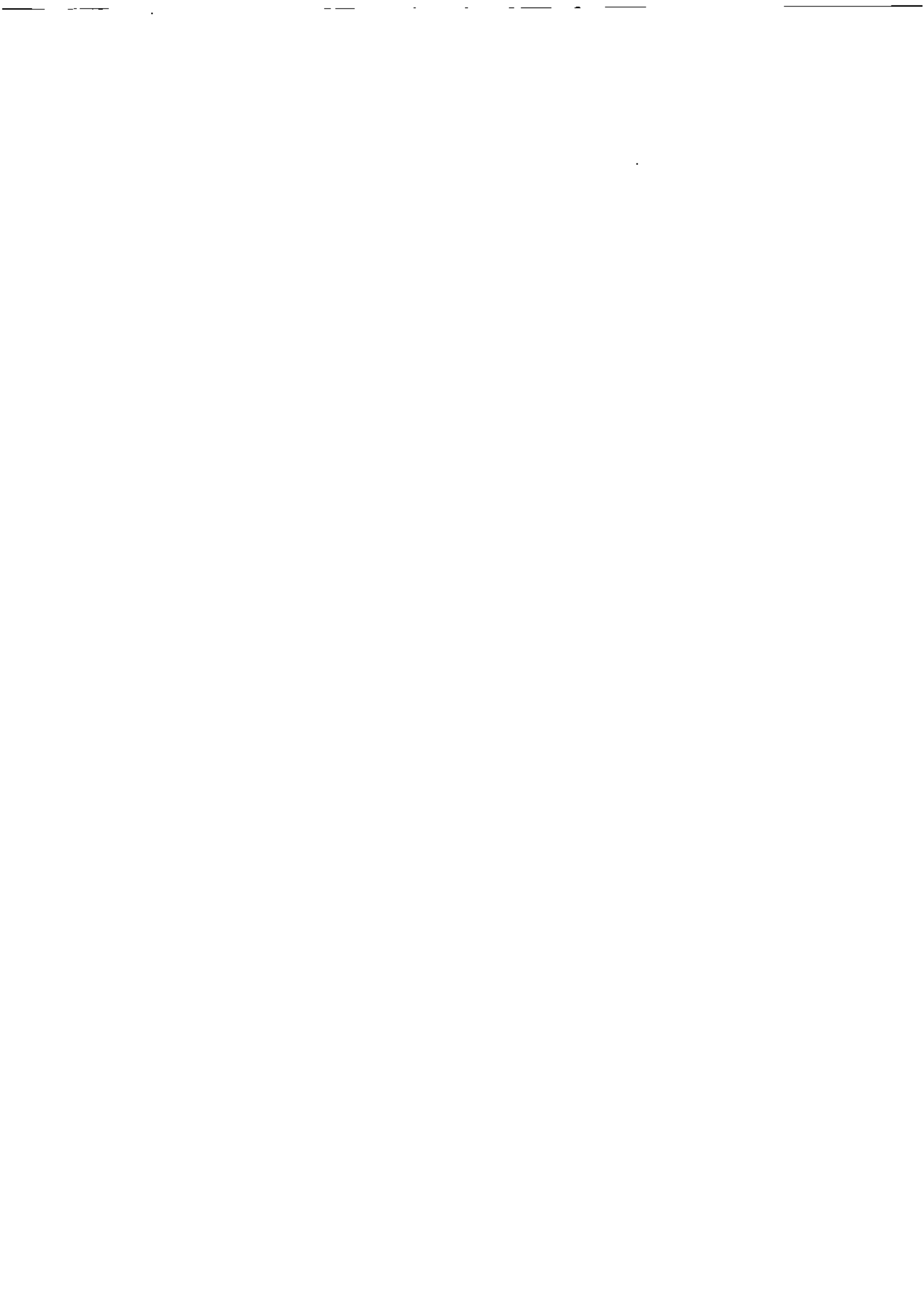
In my opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 30 June 2013, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Central Bank Act, Cap 491 of the Laws of Kenya.



Edward R.O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

26 September 2013



Consolidated statement of comprehensive income

	Notes	Year ended 30 June	
		2013 Shs' million	2012 Shs' million
Interest income	4	5,904	8,308
Interest expense	5	(4,037)	(888)
Net interest income		1,867	7,420
Decrease in loan impairment	16	45	2
Net interest income after loan impairment charges		1,912	7,422
Fees and commission income	2(q)	3,000	3,000
Net trading income	6	1,699	2,902
Other income	7	798	893
Operating income/(loss)		7,409	14,217
Operating expenses	8	(9,325)	(12,058)
Operating (deficit)/surplus before unrealised gains/(losses)		(1,916)	2,159
Unrealized gains and losses:			
Foreign exchange gain/(loss)		5,623	(27,993)
Fair value loss on financial assets held for trading		(55)	(20)
Surplus/(deficit) for the year		3,652	(25,854)
Other comprehensive income			
Fair value gain on land and buildings		-	7,498
Total comprehensive income for the year		3,652	(18,356)

The notes on pages 15 to 47 are an integral part of these financial statements.



Consolidated statement of financial position

	Notes	As at 30 June	
		2013 Shs' million	2012 Restated Shs' million
Assets			
Balances due from banking institutions- Local	10	55,200	60,008
Advances to banks	15	351	9,973
Balances due from banking institutions- Foreign	12	395,493	335,275
Funds held with International Monetary Fund (IMF)	14(a)	2,694	2,200
Loans and advances	16	2,645	3,560
Financial assets at fair value through profit or loss	11	77,929	42,678
Investments securities – Available-for-sale	13	6	-
Other assets	17	4,119	2,557
Property and equipment	19	12,052	11,651
Intangible assets	20	973	1,272
Retirement benefit asset	18	2,967	2,193
Due from Government of Kenya	21	35,960	38,131
Total assets		590,389	509,498
Liabilities			
Currency in circulation	22	183,047	159,216
Deposits from banks and government	23	191,671	160,642
Due to International Monetary Fund (IMF)	14(b)	118,568	101,868
Investments by banks	24	41,589	35,673
Other liabilities	25	2,595	1,332
Total liabilities		537,470	458,731
Equity and reserves			
Share capital	26	5,000	5,000
General reserve fund		39,020	35,368
Revaluation reserve		8,899	8,899
Proposed dividend		-	1,500
Total equity		52,919	50,767
Total equity and liabilities		590,389	509,498

The financial statements on pages 11 to 47 were authorised for issue by the Board of Directors on 23 September 2013 and signed on its behalf by:

Governor

Director

The notes on pages 15 to 47 are an integral part of these financial statements.



Consolidated statement of changes in equity

	Share capital Shs' million	Accumulated surplus Shs' million	Revaluation reserve Shs' million	Proposed dividend Shs' million	Total Shs' million
Balance at 1 July 2011	5,000	62,722	1,401	-	69,123
Deficit for the year	-	(25,854)	-	-	(25,854)
Other comprehensive income: Fair value on valuation of leasehold land	-	-	7,498	-	7,498
Total comprehensive income for the year	-	(25,854)	7,498	-	(18,356)
Transactions with owners					
Proposed dividends	-	(1,500)	-	1,500	-
Balance at 30 June 2012	5,000	35,368	8,999	1,500	50,767
Balance at 1 July 2012	5,000	35,368	8,999	1,500	50,767
Surplus for the year	-	3,652	-	-	3,652
Other comprehensive income	-	-	-	-	-
Total comprehensive income for the year	-	3,652	-	-	3,652
Transactions with owners					
Dividends paid	-	-	-	(1,500)	(1,500)
Balance at 30 June 2013	5,000	39,020	8,999	-	52,919

The notes on pages 15 to 47 are an integral part of these financial statements.

The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.

Consolidated statement of cash flows

	Notes	Year ended 30 June	
		2013 Shs' million	2012 Shs' million
Net cash generated from operating activities	27	65,029	61,786
Cash flows from investing activities			
Purchase of property plant and equipment	19	(1,230)	(1,924)
Purchase of intangible assets	20	(46)	(319)
Proceeds from disposal of property and equipment		11	5
Net (purchase)/sale of financial assets			
- held for trading		(30,173)	(19,630)
- held to maturity		(7,331)	(7,211)
- available-for-sale		(6)	-
- funds held with International Monetary Fund (IMF)		(494)	531
Net cash used in investing activities		(39,269)	(28,548)
Cash flows from financing activities			
Proceeds from due to International Monetary Fund (IMF)		16,700	15,353
Dividends paid		(1,500)	(2,641)
Net cash from financing activities		15,200	12,712
Increase in cash and cash equivalents		40,960	45,950
Cash and cash equivalents at start of year		367,466	321,516
Cash and cash equivalents at end of year	28	408,426	367,466

The notes on pages 15 to 47 are an integral part of these financial statements.

Notes

1 General information

Central Bank of Kenya (the "Bank") is established by and derives its authority and accountability from the Central Bank of Kenya Act Cap 491 of the Laws of Kenya (the "CBK Act"). The Bank is wholly owned by the Government of Kenya and is domiciled in Kenya. The Bank acts as banker, advisor and agent of the Government of Kenya.

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below. The financial statements are presented in Kenya Shillings (Shs), rounded to the nearest million.

Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

Amendment to IAS 1, 'Presentation of Financial Statements' as regards presentation of other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The application of this amendment will not have a material impact on the Bank's financial statements.

There are no other IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on 1 July 2012 that would be expected to have a material impact on the Bank.

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 July 2012, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except the following:

Standard	Title	Applicable for financial years beginning on/after
IFRS 9	Financial instruments	1 January 2015
IFRS 10	Consolidated financial statements	1 January 2013
IFRS 12	Disclosure of interests in other entities	1 January 2013
IAS 19 (R)	Employee benefits	1 January 2013
IFRS 13	Fair value measurement	1 January 2013

Notes (continued)

2 Summary of significant accounting policies (continued)

Changes in accounting policy and disclosures (continued)

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank (continued)

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. Issued in November 2009 and October 2011, it replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The directors are yet to assess IFRS 9's full impact and intend to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015.

IFRS 10, 'Consolidated financial statements' - is a new standard that replaces the consolidation requirements in SIC-12 Consolidation—Special Purpose Entities and IAS 27 Consolidated and Separate Financial Statements. The standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

The revised definition of control focuses on the need to have both power and variable returns before control is present. The Bank will need to consider the new guidance.

IFRS 12, 'Disclosure of Interests in other entities'- includes the disclosure requirements for all forms of interests in other entities, including interests in subsidiaries, associates, joint arrangements, special purpose entities and other off balance sheet vehicles. The Bank is yet to assess IFRS 12's full impact.

IAS 19 (Revised), 'Employee benefits', was amended in June 2011. The impact on the Bank will be to immediately recognise all past service costs and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit asset. The adoption of the standard will result in a significant increase in the retirement benefits asset on the Bank's statement of financial position when the unrecognised actuarial gains are recognised on 1 July 2013.

IFRS 13, 'Fair value measurement', aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The application of IFRS 13 may enhance fair value disclosures in certain circumstances.

Other amendments and interpretations to standards became mandatory for the year beginning after 1 July 2012 but had no significant effect on the Bank's financial statements.

Notes (continued)

2 Summary of significant accounting policies (continued)

(b) Consolidation

Kenya School of Monetary Studies is a subsidiary to the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(c) Functional currency and translation of foreign currencies

i. Functional and presentation currency

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

ii. Transactions and balances

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.

(d) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in investments by banks.

Securities purchased under agreements to resell ('reverse repos') are recorded as advances to banks. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

The Bank from time to time mops up money from the financial market ('repos') or injects money into the market ('reverse repos') with maturities of 4-7 days. The Bank engages in these transactions with commercial banks only. These have been disclosed in the financial statements as 'advances to banks' and 'investments by banks'.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities

i. Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

This category comprises two sub-categories; financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 'Fair value loss on financial assets held for trading'. Interest income and expense and dividend income and expenses on financial assets held for trading are included in 'interest income' and 'interest expense' respectively.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which generally below the prevailing market interest rates. Loans issued at non market rates are initially be measured at fair value (by discounting the related cash flows using market rates of interest) and subsequently carried at amortised cost. The difference between the fair value of the loans and the carrying amount at inception is treated as a long term employee benefit and is accounted for as a deferred cost. The resulting loan adjustment account is released to interest income over the loan period in line with the unwinding of the discount, while the deferred cost is expensed to staff costs as the services are rendered to the Bank over the period of the loan.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

i. Financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value remeasurements are included in other comprehensive income.

ii. Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and government and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

iii. Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

iv. De-recognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2013	2012
				Shs' million.	Shs' million.
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	26,263	25,765
			Fixed income securities	51,608	16,839
		Designated at initial recognition	Gold holdings	58	74
	Loans and receivables	Loans and advances to banks		-	-
		Loans and advances to staff		2,645	3,560
		Due from Government	Government loan	28,960	30,874
			Overdraft facility to Government	7,000	7,257
		Investment in debt securities	Term deposits	395,493	335,275
	Available-for-sale	Investment securities	SWIFT shares	6	-
	Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Term auction deposits	30,983
Cash reserve ratio and current account deposits				113,647	105,371
Repurchase agreements				10,606	13,609
Deposits from Government institutions			78,024	55,271	

vi. Impairment of financial assets

a. Loans and receivables

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount, and for a collateralised loan, after taking into account any value of the security which has been realised.

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

vi. Impairment of financial assets (continued)

b. Available for sale financial assets

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

If any such evidence exists for available-for-sale financial assets, impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

vii. Offsetting financial instruments

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

(f) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

(g) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are stated at valuation less accumulated depreciation. Valuations are carried out every three years.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is de-recognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Leasehold land	Over the period of the lease
Buildings	20 years
Motor vehicles	4 years
Furniture and equipment	5-10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'other income' in profit or loss. When revalued assets are sold, the amounts included in other reserves are transferred to the general reserve.

Notes (continued)

2 Summary of significant accounting policies (continued)

(h) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

- i. It is technically feasible to complete the software product so that it will be available for use;
- ii. management intends to complete the software product and use or sell it;
 - there is an ability to use or sell the software product;
 - it can be demonstrated how the software product will generate probable future economic benefits;
 - adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- iii. the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

(i) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(j) Employee benefits

The Bank operates a defined benefit and defined contribution pension schemes. The schemes are funded through payments to trustee-administered funds on a monthly basis.

On the defined contribution scheme, the Bank pays fixed contributions to the scheme. The payments are charged to the profit or loss in the year to which they relate. The Bank has no further payment obligation once the contributions have been paid.

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on age, years of service and compensation.

Notes (continued)

2 Summary of significant accounting policies (continued)

(j) Employee benefits (continued)

The assets of the scheme are held by the Bank in an independent trustee administered fund. The asset recognised in the statement of financial position in respect of the defined benefit pension scheme is the fair value of the scheme's assets less the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of Kenya treasury bonds that have terms to maturity approximating to the terms of the related pension liability.

The asset recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to profit or loss over the employees' expected average remaining working lives.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The Bank and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme.

A defined contribution plan is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit or loss account in the year in which they fall due.

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

(k) Income tax

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.

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation at a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(m) Dividend payable

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 on ordinary shares are charged to equity in the period in which they are declared.

(n) Share capital

Ordinary shares are classified as 'share capital' in equity.

(o) Leases

Bank as lessee

The leases entered into by the Bank are primarily operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Bank as lessor

The group leases certain property, plant and equipment where it does not transfer substantially all the risks and benefits of ownership of the assets. The operating leases generate rental income which is recorded in the income statement on a straight-line basis over the period of the lease.

(p) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Notes (continued)

2 Summary of significant accounting policies (continued)

(q) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

The Bank earns from the Government a commission of 1.5% of amounts raised through its agency role in the issuance of Treasury bills and bonds. The annual commission income is limited to Shs 3 billion as per the 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.

(r) Commitments on behalf of the Kenya Government and National Treasury

The Bank issues Treasury Bonds and Bills on behalf of the National Treasury. Commitments arising on such transactions on behalf of Kenya Government and National Treasury are not included in these financial statements as the Bank is involved in such transactions only as agent.

(s) Currency in circulation

Notes and coins in circulation are measured at cost. Currency in circulation represents the nominal value of all bank notes and coins held by the public and commercial banks.

(t) Inventories

The Bank's inventory is comprised of new currency not issued. Inventories are stated at the sum of the production costs. Cost is determined using the first-in, first-out (FIFO) method.

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.

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

Shs 1,000	2 years
Shs 500	2 years
Shs 200	2 years

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

(u) Loan due from the Government of Kenya

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 the Bank's lending to Government of Kenya to 5% of Government of Kenya 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 the loan at Shs 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 loan and receivables and is measured at amortised cost.

Notes (continued)

2 Summary of significant accounting policies (continued)

(v) Funds held at/ 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.

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

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository. The security issued is in part payment of Kenya's quota of IMF shares.

(w) Comparatives

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

Notes (continued)

3 Critical accounting estimates and judgements in applying accounting policies

(i) Critical estimates in applying the entity's accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

i. Post-retirement benefits

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 18 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

ii. Loans and advances

Critical estimates are made by the management in determining the recoverable amount of impaired loans and receivables.

iii. Fair value of financial assets

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques.

iv. Property and equipment

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers.

(ii) Critical judgements in applying the entity's accounting policies

In the process of applying the Bank's accounting policies, management has made judgements in determining:

- the classification of financial assets and leases
- whether assets are impaired.

Notes (continued)

	2013 Shs' million	2012 Shs' million
4 Interest income		
Cash and cash equivalents	–	32
Financial assets - held to maturity	1,150	1,194
Loans and advances	4,479	6,778
Financial assets - held for trading	275	304
	<u>5,904</u>	<u>8,308</u>
Interest income from loans and advances comprises:		
Loan due from Government Debt	892	929
Government overdraft	2,960	3,664
Staff loans	113	103
Reverse repos	368	1,403
Local commercial banks overnight loans	6	521
Foreign commercial banks overnight loans	29	8
Other interest income	111	150
	<u>4,479</u>	<u>6,778</u>
5 Interest expense		
Interest on monetary policy issues – investments by banks	4,033	880
Interest paid to IMF	4	8
	<u>4,037</u>	<u>888</u>
6 Net trading income		
Net gain on sale of foreign exchange currencies	1,772	3,116
Net loss on held for trading financial assets trading	(73)	(214)
	<u>1,699</u>	<u>2,902</u>
7 Other income		
Licence fees from commercial banks and foreign exchange bureaux	218	181
Penalties from commercial banks and foreign exchange bureaux	17	34
Rent income	2	1
Kenya School of Monetary Studies operating income-hospitality services and tuition fee	416	444
Gain on disposal of property and equipment	11	27
Miscellaneous income	134	206
	<u>798</u>	<u>893</u>

Notes (continued)

8 Operating expenses	2013 Shs' million	2012 Shs' million
Employee benefit expenses (Note 9)	3,566	3,838
Currency production expenses	2,396	1,216
Property maintenance and utility expenses	903	765
Depreciation (Note 19)	823	191
Amortisation (Note 20)	345	78
Provision for impairment loss on other assets (Note 17)	153	4,686
Auditors' remuneration	6	6
Banking expenses	-	1
Loss on financial assets at fair value through profit or loss	16	2
Transport and travelling	178	161
Office expenses	190	199
Postal service expense	136	131
Legal and professional fees	112	102
Other administrative expenses	501	682
	9,325	12,058
9 Employee benefits expense		
Wages and salaries	3,483	2,908
Medical expenses	168	229
Other staff costs	447	563
Directors' emoluments (Note 29)	68	69
Net cost on retirement benefit obligations (defined benefit) (Note 18)	(600)	69
	3,566	3,838
10 Balances due from banking institutions - Local		
Current accounts	31,995	39,031
Special project accounts	13,240	12,878
Domestic foreign currency cheque clearing	9,965	8,099
	55,200	60,008
All balances due from banking institutions -- local are recoverable within one year		
11 Financial assets at fair value through profit or loss		
a. Designated at initial recognition		
Gold holdings	58	74
Movements in gold holdings are due to mark to market movements.		
b. Held for trading		
Fixed income securities	51,608	16,839
Fixed income securities under World Bank RAMP	26,263	25,765
	77,871	42,604
	77,929	42,678

Notes (continued)

12 Balances due from banking institutions- Foreign	2013 Shs' million	2012 Shs' million
Foreign denominated term deposits	395,347	335,227
Accrued interest on term deposits	146	48
	395,493	335,275

All balances due from banking institutions – foreign are recoverable within one year.

13 Investments securities – Available-for-sale		
Unlisted equity securities	6	-
	6	-
At start of year	-	-
Additions	6	-
	6	-
At end of year	6	-
	6	-

The fair value of the investment in unlisted company is estimated as being equivalent to the purchase price. The investment in Available for sale securities is recoverable after a year.

14 Funds held at/ due to International Monetary Fund (IMF)	2013 SDR million	2013 Shs' million	2012 SDR million	2012 Shs' million
(a) Assets				
IMF balances (SDR asset account)	16	2,694	17	2,200
	16	2,694	17	2,200
(b) Liabilities				
International Monetary Fund Account No. 1	19	2,531	21	2,711
International Monetary Fund Account No. 2	-	1	-	1
International Monetary Fund – PRGF Account	634	82,493	521	66,183
IMF-SDR Allocation account	260	33,543	260	32,973
	913	118,568	802	101,868

The National Treasury is the Government of Kenya's Fiscal Agent. Commitments arising on transactions between IMF, Kenya Government and National Treasury are not included in these financial statements as the Bank is not the Government's fiscal agent.

Kenya's quota in IMF of SDR 271.4 million (2012: SDR 271.4 million) and allocations of SDR 258.3 million (2012: 259.6 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government fiscal agent.

Notes (continued)

15 Advances to banks	2013 Shs' million	2012 Shs' million
Treasury bonds discounted	333	3,298
Treasury bills discounted	8	6,578
Accrued interest	10	97
	<u>351</u>	<u>9,973</u>

All advances to banks are recoverable within one year

16 Loans and advances		
Due from banks under liquidation	3,656	3,706
Advances to employees	2,667	3,577
	<u>6,323</u>	<u>7,283</u>
Allowance for impairment	(3,678)	(3,723)
	<u>2,645</u>	<u>3,560</u>
Net advances		
	<u>2,645</u>	<u>3,560</u>
Movement in the loan impairment allowance is as follows:		
At start of year	3,723	3,725
Decrease in impairment allowance	(45)	(2)
	<u>3,678</u>	<u>3,723</u>
At end of year		
	<u>3,678</u>	<u>3,723</u>

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. Commercial banks did not utilise this facility in the year under review (2012: Nil). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

17 Other assets	2013 Shs' million	2012 Shs' million
Prepayments	115	250
Deferred currency expenses	3,477	1,659
Sundry debtors	5,212	5,001
Items in the course of collection	154	333
	<u>8,958</u>	<u>7,243</u>
Provision for impairment	(4,839)	(4,686)
	<u>4,119</u>	<u>2,557</u>
All other assets balances are recoverable within one year		
	<u>4,119</u>	<u>2,557</u>
Movement in the impairment allowance is as follows:		
At start of year	4,686	-
Increase in impairment allowance	153	4,686
	<u>4,839</u>	<u>4,686</u>
At end of year		
	<u>4,839</u>	<u>4,686</u>

Notes (continued)

18 Retirement benefit asset	2013 Shs' million	2012 Shs' million
Present value of funded obligations	13,065	12,673
Fair value of plan assets	(21,173)	(17,103)
	<hr/>	<hr/>
Present value of net asset	(8,108)	(4,430)
Unrecognised actuarial gains	5,141	2,237
	<hr/>	<hr/>
	(2,967)	(2,193)
	<hr/>	<hr/>
The amounts recognised in statement of comprehensive income are as		
Current service costs	311	565
Interest costs	1,707	1,071
Expected return on plan assets	(2,358)	(1,492)
Net actuarial (gains)/losses recognised	(79)	24
Past service costs	-	625
Adjustment for previous year values	(181)	(724)
	<hr/>	<hr/>
Total expenses included in employee benefits expense (Note 9)	(600)	69
	<hr/>	<hr/>
Movements in the net defined benefit asset recognised are as follows:		
At start of year	2,193	1,897
Net income/(expense) recognised in the profit or loss (Note 9)	600	(69)
Employer contributions	174	365
	<hr/>	<hr/>
At end of year	2,967	2,193
	<hr/>	<hr/>
Actual return on plan assets	4,082	608
	<hr/>	<hr/>
Movements in the plan assets are as follows:		
At start of year	17,103	15,872
Expected return on scheme assets	2,358	1,492
Actuarial gain	2,087	565
Employer contributions (Note 9)	174	365
Employee contributions	60	-
Benefits expenses paid	(428)	(467)
Adjustment for previous year values	(181)	(724)
	<hr/>	<hr/>
At end of year	21,173	17,103
	<hr/>	<hr/>
Movements in the plan benefit obligation are as follows:		
At start of year	12,673	12,137
Current service cost net of employees' contributions	311	565
Interest cost	1,707	1,072
Employee contributions	60	-
Actuarial gain	(1,258)	(1,259)
Past service cost	-	625
Benefits paid	(428)	(467)
	<hr/>	<hr/>
At end of year	13,065	12,673
	<hr/>	<hr/>

Notes (continued)

18 Retirement benefit asset (continued)

The principal actuarial assumptions at the reporting date were:

Discount rate (p.a.)	13.7%	12.5%
Salary increase (p.a.)	13.7%	10.5%
Expected return on plan assets (p.a.)	11.7%	12.5%
Future pension increases	3.0%	3.0%

Historical information	2013 Shs' million	2012 Shs' million	2011 Shs' million	2010 Shs' million	2009 Shs' million
Fair value of plan assets	21,173	17,103	15,872	14,868	11,678
Present value of funded obligations	(13,065)	(12,673)	(12,137)	(11,550)	(9,582)
Retirement benefit asset	8,108	4,430	3,735	3,318	2,096
Unrecognised actuarial gains	(5,141)	(2,237)	(1,838)	(1,424)	(671)
	2,967	2,193	1,897	1,894	1,425

Plan assets are distributed as follows:

	2013 Shs' million	2012 Shs' million
Quoted shares	39%	32%
Investment in properties	13%	16%
Government of Kenya Treasury bills and bonds	27%	43%
Commercial paper and corporate bonds	6%	7%
Offshore investments	8%	-
Fixed and term deposits	7%	3%
	100%	100%

19 Property and equipment

Year ended 30 June 2012	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor Vehicles Shs' million	Furniture and Equipment Shs' million	Total Shs' million
Cost or valuation						
At start of year	1,010	300	325	263	5,444	7,342
Additions	25	-	869	102	196	1,192
On revaluation	5,057	1,455	-	-	-	6,512
Disposals	-	-	-	(55)	(2)	(57)
At end of the year	6,092	1,755	1,194	310	5,638	14,989
Accumulated depreciation						
At start of year	986	300	-	214	2,993	4,493
Charge for the year	19	6	-	24	142	191
On revaluation	(986)	(300)	-	-	-	(1,286)
On disposal	-	-	-	(58)	(2)	(60)
At end of the year	19	6	-	180	3,133	3,338
Net carrying value*	6,073	1,749	1,194	130	2,505	11,651

Notes (continued)

19 Property and equipment (continued)

Year ended 30 June 2013

Cost or valuation

At start of year	6,092	1,755	1,194	310	5,638	14,989
Additions	-	-	819	63	348	1,230
Disposals	-	-	-	(21)	(2)	(23)
At end of year	6,092	1,755	2,013	352	5,984	16,196

Accumulated depreciation

At start of year	19	6	-	180	3,133	3,338
Adjustments	-	-	-	2	4	6
Charge for the year	303	33	-	50	437	823
On disposal	-	-	-	(21)	(2)	(23)
At end of the year	322	39	-	211	3,572	4,144

Net carrying value	5,770	1,716	2,013	141	2,412	12,052
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The net book value of freehold land, leasehold land and buildings had they not been revalued would be immaterial.

*Opening net carrying value

	Shs' million
Net carrying value as previously stated	12,083
Prior year adjustment	(432)
Net carrying value as restated	<u>11,651</u>

The prior year adjustment relates to correction of errors in capitalisation of property and equipment items in FY 2012 and thus a third balance sheet is not presented.

Property and Equipment were revalued by internal professional valuers in the prior year on an open market basis and the revaluation has been included in the revaluation reserve.

The methods and significant assumptions applied in arriving at the revalued amounts are as follows:

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property based on the going rentals for similar properties within the same location.
- The Bank has taken into account comparables values of similar properties (plot, construction standards, design, (lay out), size, location, – current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

Notes (continued)

20 Intangible assets

	Software Shs' million	Work-in- Progress Shs' million	Total Shs' million
Year ended 30 June 2012			
Cost			
At start of year	236	1,157	1,393
Additions	11	168	179
Transfer from work in progress	1,325	(1,325)	-
At end of the year	1,572	-	1,572
Accumulated amortisation			
At the start of the year	222	-	222
Amortisation for the year	78	-	78
At end of the year	300	-	300
Net carrying value*	1,272	-	1,272
Year ended 30 June 2013			
Cost			
At start of year	1,572	-	1,572
Additions	46	-	46
At end of the year	1,618	-	1,618
Accumulated amortisation			
At start of year	300	-	300
Amortisation for the year	345	-	345
At end of the year	645	-	645
Net carrying value	973	-	973
*Opening net carrying value			Shs' million
Net carrying value as previously stated			1,412
Prior year adjustment			(140)
Net carrying value as restated			1,272

The adjustment relates to correction of errors in capitalisation of intangible assets items in FY 2012 and thus a third balance sheet is not presented.

Notes (continued)

21 Due from Government of Kenya	2013 Shs' million	2012 Shs' million
Overdraft	7,000	7,257
Government loan	28,960	30,874
	<u>35,960</u>	<u>38,131</u>

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit stands at Shs 34,186,643,828 (2012: Shs 25,373,202,658) based on the Government financial statements for 2010/2011 (2012: 2009/2010), which are the latest audited financial statements at the date of approval of these financial statements.

22 Currency in circulation	2013 Shs' million	2012 Shs' million
Kenya bank notes	177,488	154,325
Kenya coins	5,553	4,885
Commemorative coins	6	6
	<u>183,047</u>	<u>159,216</u>
Movement in the account was:		
At start of year	159,216	147,718
Deposits by banks	(403,689)	(385,210)
Withdrawals by banks	427,520	396,708
	<u>183,047</u>	<u>159,216</u>

23 Deposits		
Local commercial banks clearing accounts and cash ratio reserve	104,366	97,790
Local banks foreign exchange settlement accounts	9,248	7,541
External banks foreign exchange settlement accounts	33	40
Other public entities and project accounts	19,954	17,587
Government of Kenya	58,070	37,684
	<u>191,671</u>	<u>160,642</u>

24 Investment by banks		
Term auction deposits	30,983	22,064
Repos sold to commercial banks	10,606	13,609
	<u>41,589</u>	<u>35,673</u>

Notes (continued)

25 Other liabilities	2013 Shs' million	2012 Shs' million
Impersonal accounts	248	204
Sundry creditors*	926	179
Bonds pending payables	620	214
Refundable deposits	677	586
Leave accrual	76	101
Gratuity to staff members	48	48
	2,595	1,332

*The sundry creditors balance as at 30 June 2012 has been restated to correct errors in the capitalisation of property and equipment and intangible assets as below. The errors relate to FY 2012 and thus a third balance sheet is not presented.

	Shs' million
As previously stated	751
Prior year adjustment on property and equipment (Note 19)	(432)
Prior year adjustment on intangible assets (Note 20)	(140)
	179
As restated	179

26 Share capital	Authorised share capital Shs' million	Ordinary shares Shs' million
Balance at 1 July 2011, 30 June 2012 and 30 June 2013	5,000	5,000

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

27 Cash generated from operations	2013 Shs' million	2012 Shs' million
Reconciliation of net surplus /(deficit) to cash flows from operations		
Surplus/(deficit) for the year	3,652	(25,854)
Adjustments for:		
Depreciation (Note 19)	823	191
Amortisation (Note 20)	345	78
Gain on disposal of property and equipment	(11)	(2)
Net interest income	(1,867)	(7,420)
Net cost on defined benefit asset (Note 9)	(600)	(69)
Interest received	5,893	8,223
Interest paid	(4,026)	(803)
Changes in working capital:		
Loans and advances	915	19,825
Other assets	(1,562)	3,237
Currency in circulation	23,831	11,498
Deposits	31,029	24,850
Other liabilities	691	(7,641)
Investments by banks	5,916	35,673
	65,029	61,786

Notes (continued)

28 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include:

	2013 Shs' million	2012 Shs' million
Balances due from banking institutions - Local (Note 10)	55,200	60,008
Balances due from banking institutions- Foreign	347,349	294,462
Financial assets - held for trading	5,526	3,023
Advances to banks (Note 15)	351	9,973
	<u>408,426</u>	<u>367,466</u>

29 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 (a corporation established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institutions. It is managed by a Board comprising the Governor of the Central Bank of Kenya as the Chairman.)

The main transactions include ordinary banking facilities to government ministries included in Note 23 and lending to government of Kenya included in Note 21.

(i) Loans

The Bank extends loan facilities to the Governor and the Deputy Governor and other key management personnel. The advances are at preferential rates of interest determined by the Bank.

	2013 Shs' million	2012 Shs' million
Loans to executive directors		
At start of the year	6	3
Loans advanced during the year	11	6
Loan repayments	(4)	(3)
	<u>13</u>	<u>6</u>
Loans to key management personnel		
At start of the year	87	76
Loans advanced during the year	20	44
Loan repayments	(30)	(33)
	<u>77</u>	<u>87</u>

Notes (continued)

29 Related party transactions (continued)	2013 Shs' million	2012 Shs' million
(ii) Directors' emoluments:		
Fees to non executive directors	15	16
Other remuneration to executive directors	53	53
	68	69
(iii) Remuneration to senior management	172	164
(iv) Post-employment pension to senior management	11	5
(v) Government of Kenya		
Due from Government of Kenya (Note 21)	35,960	38,131

Transactions entered into with the Government include:

- i. Banking services;
- ii. Management of issue and redemption of securities at a commission and;
- iii. Foreign currency denominated debt settlement and other remittances at a fee.

(vi) Deposit Protection Fund Board

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

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was Shs 20 million (2012: Shs 14million).

(vii) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank and has been consolidated in these financial statements.

30 Financial risk management objectives and policies

The Group's activities expose it to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign currency exchange rates and interest rates. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

Risk management is carried out by the finance department under policies approved by the Board of Directors. Other organs that monitor the assessment and management of risks within the Bank include: Board Audit Committee, Internal Audit Department and Risk Management Unit.

Notes (continued)

30 Financial risk management objectives and policies (continued)

(a) 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 volatilities. 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.

Governed by 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.

(b) 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. Credit risk

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets. The Bank has no significant concentrations of credit risk except for the lending to the Government of Kenya.

Management of the credit risk is through the choice of depository banks. The Bank's choice of depository banks is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A), short-term credit rating (AA), composite rating and capital adequacy.

The amount that best represents the Group's maximum exposure to credit risk is per the statement of financial position.

The Bank does not grade the credit quality of these assets. None of the balances have had their terms renegotiated. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Provisions of Shs 83 million (2012: Nil) have been recorded due to impaired balances to related parties.

Notes (continued)

30 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

The following amounts in loans and advances and other assets are neither past due nor impaired or individually impaired. All other financial instruments operate within their contractual terms.

	Neither past due nor impaired 2013 Shs' million	Individually impaired 2013 Shs' million	Neither past due nor impaired 2012 Shs' million	Individually impaired 2012 Shs' million
Advances to employees	2,646	22	3,560	67
Due from banks under liquidation	-	3,656	-	3,656
Sundry debtors	4,004	4,839	2,307	4,686
	6,650	8,617	5,867	8,409
Allowance for impairment				
- other assets (Note 17)	-	(4,839)	-	(4,686)
- loans and advances (Note 16)	-	(3,678)	-	(3,723)
	6,650	(8,517)	5,867	(8,409)
	6,650	-	5,867	-

There were no past due but not impaired balances as at 30 June 2013 (2012: Nil).

ii. Market risk

The Group takes on exposure to market risks, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios.

Market risks arising from trading and non-trading activities are concentrated in Bank Treasury and are monitored by management with oversight from the Monetary Policy Committee.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with commercial banks or the market.

Non-trading portfolios primarily arise from the interest rate management of the Bank's investment and monetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and World Bank RAMP financial assets.

Interest rate risk

The Bank's interest rate risk arises from interest bearing investments, loans and advances to commercial banks and investments by banks. Borrowings issued at variable rates expose the Bank to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the Bank to fair value interest rate risk.

The tables below summarise the Bank's financial assets and liabilities and analyses them into the earlier of contractual maturity or repricing.

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

As at 30 June 2013	1 – 3 months			3-12 months		1 - 5 years		Over 5 years		Non-interest		Total
	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Bearing	Shs' million	
Assets												
Balances due from banking institutions - Local	-	-	-	-	-	-	-	-	-	55,200	-	55,200
Advances to banks	351	-	-	-	-	-	-	-	-	-	-	351
Financial assets at fair value	5,526	12,602	33,581	25,623	-	-	-	-	-	597	-	77,929
Balances due from banking institutions - Foreign	347,349	42,471	-	-	-	-	-	-	-	5,673	-	395,493
Funds held with International Monetary Fund (IMF)	-	-	-	-	-	-	-	-	-	2,694	-	2,694
Investments securities – Available-for-sale	-	-	-	-	-	-	-	-	-	6	-	6
Loans and advances	2	37	824	1,782	-	-	-	-	-	-	-	2,645
Other assets	-	-	-	-	-	-	-	-	-	4,004	-	4,004
Due from Government of Kenya	73	1,110	1,110	33,667	-	-	-	-	-	-	-	35,960
Total financial assets	353,301	56,220	35,515	61,072	61,072	68,174	574,282					
Liabilities												
Deposits from banks and government	-	-	-	-	-	-	-	-	-	191,671	-	191,671
Due to International Monetary Fund (IMF)	-	-	-	-	-	-	-	-	-	118,568	-	118,568
Investments by banks	41,589	-	-	-	-	-	-	-	-	-	-	41,589
Other liabilities	-	-	-	-	-	-	-	-	-	2,595	-	2,595
Total financial liabilities	41,589	-	-	-	-	312,834	354,423					
Interest sensitivity gap	311,712	56,220	35,515	61,072	61,072	(244,660)	219,859					

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

	As at 30 June 2012					Non-interest Bearing Shs' million	Total Shs' million
	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million			
Assets							
Balances due from banking institutions - Local	-	-	-	-	60,008	60,008	
Advances to banks	9,973	-	-	-	-	9,973	
Financial assets at fair value	3,023	6,895	18,372	14,019	369	42,678	
Balances due from banking institutions - Foreign	294,462	36,004	-	-	4,809	335,275	
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,200	2,200	
Loans and advances	3	50	1,109	2,398	-	3,560	
Other assets	-	-	-	-	2,307	2,307	
Due from Government of Kenya	881	1,110	1,110	35,030	-	38,131	
Total financial assets	308,342	44,059	20,591	51,447	69,693	494,132	
Liabilities							
Deposits from banks and government	-	-	-	-	160,642	160,642	
Due to International Monetary Fund (IMF)	-	-	-	-	101,868	101,868	
Investments by banks	35,673	-	-	-	-	35,673	
Other liabilities	-	-	-	-	1,332	1,332	
Total financial liabilities	35,673	-	-	-	263,842	299,515	
Interest sensitivity gap	272,669	44,059	20,591	51,447	(194,149)	194,617	

As at 30 June 2013, an increase/decrease of 10 basis points would have resulted in a decrease/increase in profit of Shs 700 million (2012: Shs 630 million).

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk

Foreign exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Monetary Policy Committee sets limits on the level of exposure by currency which is monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2013. Included in the table are the Bank's financial instruments categorised by currency:

As at 30 June 2013

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs' million	Total Shs' million
Assets						
Balances due from banking institutions - Local	30,243	1,283	43	-	23,631	55,200
Financial assets at fair value	77,929	-	-	-	-	77,929
Balances due from banking institutions - Foreign	279,846	81,997	33,650	-	-	395,493
Funds held with International Monetary Fund (IMF)	-	-	-	2,694	-	2,694
Total financial assets	388,018	83,280	33,693	2,694	23,631	531,316
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	118,568	-	118,568
Deposits from banks and government	8,195	1,161	1,189	-	-	10,545
Total financial liabilities	8,195	1,161	1,189	118,568	-	129,113
Net position	379,823	82,119	32,504	(115,874)	23,631	402,203

Notes (continued)

30 Financial risk management objectives and policies (continued)

ii. Market risk

Foreign exchange risk (continued)

	USD	GBP	EUR	SDR	Others	Total
	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million	Shs' million
As at 30 June 2012						
Assets						
Balances due from banking institutions - Local	33,907	13,542	12,194	-	365	60,008
Financial assets at fair value	42,678	-	-	-	-	42,678
Balances due from banking institutions - Foreign	209,375	56,302	69,598	-	-	335,275
Funds held with International Monetary Fund (IMF)	-	-	-	2,200	-	2,200
Total financial assets	285,960	69,844	81,792	2,200	365	440,161
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	101,868	-	101,868
Deposits from banks and government	6,353	810	1,178	-	-	8,341
Total financial liabilities	6,353	810	1,178	101,868	-	110,209
Net position	279,607	69,034	80,614	(99,668)	365	329,952

As at 30 June 2013, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's profit would have been:

- USD Shs 18,991 million (2012: Shs 13,980 million)
- Euro Shs 1,625 million (2012: Shs 4,031 million)
- British Pound Shs 4,106 million (2012: Shs 3,452 million)
- SDR Shs 5,794 million (2012: Shs 5,093 million)

Notes (continued)

30 Financial risk management objectives and policies (continued)

iii. Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Treasury maintains flexibility in funding by maintaining availability under committed credit lines.

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash flow.

The table below analyses the Bank's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	On demand 1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Total Shs' million
As at 30 June 2013					
Currency in circulation	-	-	-	183,047	183,047
Deposits from banks and government	178,259	13,412	-	-	191,671
Due to International Monetary Fund (IMF)	-	-	-	118,568	118,568
Investments by banks	-	41,631	-	-	41,631
Other liabilities	-	-	2,595	-	2,595
Total financial liabilities	178,259	41,631	16,007	301,615	537,512
As at 30 June 2012					
Currency in circulation	-	-	-	159,216	159,216
Deposits from banks and government	147,764	12,878	-	-	160,642
Due to International Monetary Fund (IMF)	-	-	-	101,868	101,868
Investments by banks	-	35,710	-	-	35,710
Other liabilities	-	-	1,904	-	1,904
Total financial liabilities	147,764	35,710	14,782	261,084	459,340

Notes (continued)

30 Financial risk management objectives and policies (continued)

Fair value of financial instruments

IFRS 7 specifies a fair value hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Bloomberg).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
As at 30 June 2013:				
Financial assets at fair value	77,871	58	-	77,929
Investment securities – Available-for-sale	-	-	6	6
Total assets	77,871	58	6	77,935
As at 30 June 2012:				
Financial assets at fair value	42,604	74	-	42,678
Investment securities – Available-for-sale	-	-	-	-
Total assets	42,604	74	-	42,678

Changes in level 3 instrument are disclosed in Note 13 to the financial statements.

31 Contingent liabilities and commitments

The Bank is party to various legal proceedings with total claims up to Shs 7.3 billion (2012: Shs 267 million). Based on legal advice, the directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2013, the Bank did not have capital commitments (2012: Shs 53 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2013 Shs' million	2012 Shs' million
Not later than 1 year	16	16
Later than 1 year and not later than 5 years	40	66
	66	82

