CENTRAL BANK OF KENYA

ANNUAL REPORT

AND

FINANCIAL STATEMENTS

30 JUNE 2008

ERNST & YOUNG

CENTRAL BANK OF KENYA
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2008

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BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2008

DIRECTORS

Prof.Njuguna Ndungu	-	Governor and Chairman
Mrs Jacinta W. Mwatela	-	Deputy Governor and Deputy Chairman
Mr Joseph K. Kinyua	-	Permanent Secretary-Treasury, Member
Mr Joseph K. Waiguru	-	Member
Dr. William O. Ogara	-	Member
Mr. Nicholas A. Nesbitt	-	Member
Ms Agnes Wanjiru	-	Member
Ms Wanza Kioko	-	Member

SENIOR MANAGEMENT

Prof. Njuguna Ndungu	-	Governor
Mrs Jacinta W. Mwatela	-	Deputy Governor
Mr Kennedy K. Abuga	-	Director –Governors office & Board Secretary–appointed on 7 April,2008
Mr John M. Gikonyo	-	Director –Governors office & Board Secretary-Retired on 1 April, 2008
Mr Aggrey J.K. Bett	-	Director – Finance, Resource Planning and Strategy Management
Mr Jones M. Nzomo	-	Director – Human Resources and Services Department
Ms Rose Detho	-	Director – Banking Supervision Department
Ms Elizabeth C. A. Omolo	-	Executive Director – Kenya School of Monetary Studies-Retired on 30 June, 2008
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies –appointed on 30 June, 2008
Mr William Nyagaka	-	Director – Internal Audit & Risk Management- appointed on 17 April, 2008
Mr Nicholas M.Kiritu	-	Director – Internal Audit & Risk Management- Retired on 30 November, 2007.
Mr Nicholas N. B. T. Korir	-	Director –Research Department
Mr Daniel M.Chege	-	Director – Currency Operations and Branch Administration
Mr Gerald Nyaoma	-	Director – Banking Department
Mr Jackson M. Kitili	-	Director – Monetary Operations & Debt Management
Mr. Charles Maranga	-	Director- Human Resources (Performance Management System)-Retired on 30 June, 2008

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

BRANCHES

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Nkrumah Road
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80100 Mombasa, Kenya

Kisumu
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Jomo Kenyatta Highway
PO Box 4
40100 Kisumu, Kenya

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Kiptagich House
Uganda Road
PO Box 2710
30100 Eldoret, Kenya

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

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

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

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2008

The directors submit their report together with the audited financial statements for the year ended 30 June 2008, which shows the state of affairs of the Bank.

1. INCORPORATION

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

2. PRINCIPAL ACTIVITIES

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

3. FINANCIAL PERFORMANCE

3.1 Financial Results

The results for the year set out on page 10 show that the Bank recorded a profit of KShs 8,995 million against a loss of KShs 386 million in the previous year. This substantial improvement from the previous year is attributable mainly to a substantial reduction in foreign exchange translation losses which dropped to KShs 1.3 billion in the year from KShs 9.8 billion in the previous year. Contributing to this performance also are foreign interest earnings which was KShs 1,991 million (24%) higher than the previous year due to higher levels of foreign currency reserves available for investing in the year at interest rates that were also higher than the previous year. Operating expenses were also lower by KShs 441 million (8%) mainly due to currency printing expenses which were lower by 68% owing to the shifting of planned deliveries of banknotes for 20007/2008 to year 2008/2009. There were savings also on other operating expenses such as depreciation and property maintenance as a result of delayed procurements and cancellation of scheduled maintenance works.

The above positive revenue and expenditure performances were tempered by commission on sale of Government securities that was nearly 40% lower than the previous year due to the capping of this commission by Government to a maximum of KShs 3.0 billion during the year under review. Monetary policy (Mop Up) expenses also went up by 69% during the year due to the need to mop up undesirable liquidity generated by economic and political activities during 2007 and part of 2008. Slight increases in staff costs and other operating expenses also impacted negatively on the profit.

3.2 Financial Position

The financial position of the Bank is set out in the Balance Sheet shown on page 11. During the year, total assets of the Bank increased by KShs 51,687 million (23%). This increase is attributed mainly to an increase of KShs 42,608 million (24%) in balances due from international banking institutions and gold holdings (foreign currency reserves), items in the course of collection and investments in government securities amounting to KShs 2,296 million and KShs 8,535 million respectively.

During the year, the Bank built up its foreign currency reserves by KShs 42 billion (24%) mainly through purchases and foreign investment earnings. The increase of KShs 8,535 million in investment in government securities represents the magnitude of discounting of these investments by the public at Central Bank compared to the previous year.

On the other hand, total liabilities increased by KShs 42,692 million (20%). This was attributed mainly to increases in deposits of commercial banks of KShs 39,802 million (44%), IMF loans to the Bank of KShs 3,957 million (25%) and currency in circulation of KShs 9,951 million (11%). General Reserves Fund increased by KShs 8,995 million (11%) being the net profit for the year. The Board of Directors has recommended the payment of a dividend of KShs 4 billion and KShs 3.5 billion of general reserves has been utilised to increase the paid up capital to KShs 5 billion subsequent to the year end.

4. DIVIDEND

The Board of Directors recommend payment of a dividend of KShs 4 billion for the year ended 30 June 2008 (2007: nil).

5. DIRECTORS

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

6. AUDITORS

The auditors, Ernst & Young, were appointed in 2007 in line with the Public Procurement and Disposal Act, 2005 for a period of three years.

By order of the Board

K. K. Abuga
BOARD SECRETARY

………………………… 2008

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITIES
ON THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2008

We, the directors, certify that:

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

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

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

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

5. The directors are of the opinion that the financial statements for the year ended 30 June 2008 fairly present the financial position and operating results of the Bank.

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

Signed on behalf of the Board of Directors by:-

Governor	**Director**
---------------------------------2008	--------------------------2008

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE

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

Board of Directors

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

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

Board Meetings

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

Monetary Policy Committee (MPC)

Section 4D of the CBK (amendment) Act 2008 establishes the Monetary Policy Committee (MPC) which replaces the Monetary Policy Advisory Committee (MPAC). According to the CBK Act, the Monetary Policy Committee of the Central Bank is responsible for formulating monetary policy. The Committee consists of the following members:-
a) The Governor, who is the chairman;
b) The Deputy Governor, who is the deputy chairman;
c) Two members appointed by the Governor from among the staff;
d) Four other members who have knowledge, experience and expertise in matters relating to finance, banking and fiscal and monetary policy, appointed by the Minister for Finance.

The Minister for Finance appointed the four external members of the Committee through *The Kenya Gazette Notice* Number 3771. They will hold office for a period of three (3) years with effect from 1st May 2008. The four members are:

(1) Rose W. Ngugi (Dr)
(2) Sheila M'Mbijjewe
(3) Terry Ryan (Prof) and
(4) Wycliffe Mukulu.

Of the two members appointed from within the Bank, one has the executive responsibility within the Bank for monetary policy analysis; and the other has the responsibility within the Bank for monetary policy operations.

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

Audit Committee

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

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

Human Resources Committee

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

Management Structure

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

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

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial year 2007/2008 is disclosed in note 28 (iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid monthly and are eligible for the staff loans.

Code of Ethics

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

Internal Controls

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

Authorisations

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

Internal Audit

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

Transparency

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

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Central Bank of Kenya, as set out on pages 10 to 43 which comprise the balance sheet as at 30 June 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the state of financial affairs of the Bank as at 30 June 2008 and of the profit and cash flows for the year then ended in accordance with the International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

Report on other matters

We also report to you, based on our audit, that:

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

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

iii) The Bank's income statement and balance sheet are in agreement with the books of account.

Nairobi

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CENTRAL BANK OF KENYA
INCOME STATEMENT
FOR THE YEAR ENDED 30 JUNE 2008

	Note	2008 KShs million	2007 KShs million
Interest income	2	12,108	9,872
Interest expense	3	(1,716)	(1,016)
Net interest income		**10,392**	**8,856**
Fee and commission income	4	3,156	5,243
Net foreign exchange gain/ (loss)	5	54	(9,337)
Other operating income	6	421	321
		14,023	**5,083**
Operating expenses	7	(5,028)	(5,469)
Profit/ (loss) for the year		8,995	(386)
Dividends:			
Proposed dividend for the year	8	4,000	-

CENTRAL BANK OF KENYA
BALANCE SHEET
AS AT 30 JUNE 2008

ASSETS	Note	2008 KShs million	2007 KShs million
Balances due from banking institutions and Gold holdings	9	223,486	180,878
International Monetary Fund	10	206	5
Items in the course of collection	11	2,885	589
Investment in government securities	12	8,539	4
Loans and advances	13	3,460	3,742
Other assets	14	1,244	1,562
Retirement benefit asset	15	55	240
Property and equipment	16	568	591
Prepaid operating lease rentals	17	278	282
Intangible assets	18	18	49
Due from Government of Kenya	19	34,439	35,549
TOTAL ASSETS		275,178	223,491
LIABILITIES			
Currency in circulation	20	99,750	89,799
Deposits	21	131,141	91,339
International Monetary Fund	10	19,697	15,740
Amounts repayable under repurchase agreements	22	1,807	15,626
Other liabilities	23	4,529	1,728
TOTAL LIABILITIES		256,924	214,232
EQUITY AND RESERVES			
Share capital	24	1,500	1,500
General reserve fund	25	12,754	7,759
Proposed dividend	8	4,000	-
TOTAL EQUITY AND RESERVES		18,254	9,259
TOTAL LIABILITIES AND EQUITY		275,178	223,491

The financial statements were approved by the Board of Directors for issue on -----------------2008 and signed on its behalf by:

____________________ ____________________
Governor **Director**

CENTRAL BANK OF KENYA
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2008

	Share capital KShs million	General reserve fund KShs million	Proposed dividend KShs million	Total KShs million
Year ended 30 June 2007				
Balance at start of the year	1,500	8,145	2,000	11,645
Loss for the year	-	(386)	-	(386)
2006 dividends paid	-	-	(2,000)	(2,000)
Balance at end of the year	1,500	7,759	-	9,259
Year ended 30 June 2008				
Balance at start of the year	1,500	7,759	-	9,259
Profit for the year	-	8,995	-	8,995
Proposed dividend	-	(4,000)	4,000	-
Balance at end of the year	1,500	12,754	4,000	18,254

CENTRAL BANK OF KENYA
CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 2008

	Note	2008 KShs million	2007 KShs million
Operating activities			
Net cash generated from/(absorbed by) operating activities	27 (a)	39,214	(2,826)
Investing activities			
Receipts of government loan		1,110	-
Purchase of property and equipment		(120)	(151)
Purchase of intangible assets		-	(55)
Proceeds from disposal of property and equipment		81	6
Proceeds in International Monetary Fund -SDR accounts		(201)	8
Net cash from /(used in) investing activities		870	(192)
Financing activities			
Dividends paid		-	(2,000)
Currency in circulation		9,951	13,592
Net cash from financing activities		9,951	11,592
Net increase in cash and cash equivalents		50,035	8,574
Cash and cash equivalents at start of year		175,265	166,691
Cash and cash equivalents at end of year	27 (b)	225,300	175,265

1. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation of financial statements

(i) Basis of preparation

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

(ii) Form of presentation

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

(iii) Changes in accounting policies

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

IFRS 7 Financial Instruments: Disclosures
This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Bank's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

IAS 1 Presentation of Financial Statements
This amendment requires the Bank to make new disclosures to enable users of the financial statements to evaluate the Bank's objectives, policies and processes for managing capital.

(iv) Standards, Amendments and Interpretations Effective In 2008 but not Relevant

The following standards, amendments and interpretations are mandatory for accounting periods beginning on 1 April 2007 but are not relevant to the Bank's operations:

- IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (effective from 1 March 2007);
- IFRIC 12, Service Concession Agreements (effective from 1 January 2008).
- IFRIC 14, IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction (effective from 1 January 2008)

(v) Standards, Amendments and Interpretations that have been issued and are not yet Effective for the Bank's Operations

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

- IFRS 2, Amendments to IFRS 2 Share-based Payment - Vesting Conditions and Cancellations (effective from 1 January 2009)
- IFRS 3, Business Combinations (effective from 1 July 2009)
- IFRS 8, Operating Segments (effective from 1 January 2009)
- IAS 1, Presentation of Financial Statements amendment (effective from 1 January 2009)
- IAS 23 Borrowing Costs (effective from 1 January 2009)
- IAS 27, Consolidated and Separate Financial Statements (effective from 1 July 2009)
- IAS 32, Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation (effective from 1 January 2009)
- IFRIC 13, Customer Loyalty Programmes (effective from 1 July 2008)

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

(b) Significant accounting judgements and estimates

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

(i) Impairment losses on loans and advances

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

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

(b) Significant accounting judgement and estimates (continued)

(ii) Pensions

The cost of the defined benefit pension plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. See note 15 for assumptions used.

(iii) Property, equipment and intangible assets

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

(iv) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values.

(c) Revenue recognition

Income is recognised in the period in which it is earned.

(i) Interest income and expenses

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

(ii) Fees and commission income

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

(d) Translation in foreign currencies

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

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

(e) Currency printing and minting expenses

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

(f) Employee benefits

(i) Retirement benefits

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund scheme administered by Trustees and funded by the Bank. Deposit Protection Fund Board, a related party, reimburses the Bank the costs of contributions relating to staff seconded to it by the Bank.

The Bank's net obligation in respect to the plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine the present value and the fair value of any plan assets is deducted. The calculation is performed by a qualified actuary using the Projected Unit Credit Method.

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

The Bank also makes contributions to a statutory pension scheme, the National Social Security Fund (NSSF). Contributions to the scheme are determined by local statute and are shared between the employer and employee. The Bank's contributions in respect of retirement benefit costs are charged to the income statement in the year to which they relate.

(ii) Other employee benefits

The Bank provides free medical treatment to staff and their dependants. The cost is charged to the income statement.

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

(g) Property and equipment

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

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

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

The asset's residual values , useful lives and methods of depreciation are reviewed, and adjusted if appropriate at each financial year end.

(h) Intangible assets

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

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The useful life is reviewed at least at each financial year end. The amortisation expense on intangible assets is recognised in the income statement. Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software	50%

(i) Impairment of other assets

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

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

(j) Financial Instruments

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

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

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

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

(j) Financial Instruments (continued)

(1) Loans, advances and receivables

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

As the lender of last resort, the Bank may grant loans or advances for fixed periods not exceeding six months to commercial banks that pledge Government securities specified by the Bank.

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

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

(2) Held to maturity

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

(3) Financial liabilities

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

(j) Financial Instruments (continued)

(iv) Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all of the risks and rewards of ownership.
The gains and losses on investments held to maturity and loans and receivables are recognized in the income statement when the investments are derecognized.

(v) Gains and losses on subsequent measurement

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

(vii) Offsetting

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

(viii) Impairment of financial assets

Loans are stated at outstanding amount less provision for impairment.

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

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

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

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

(k) Amounts Repayable under Repurchase Agreements (REPOs)

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

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

(l) Currency in circulation

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

(m) Dividends

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

(n) Provisions

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

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

(o) Offsetting of financial assets and liabilities

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

(p) Leasing

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

(p) Leasing(continued)

(a) Bank as a lessee

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

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Bank will obtain ownership by the end of the lease term.

Operating lease payments are not recognised in the balance sheet. Any rentals payable are accounted for on a straight-line basis over the lease term and included in 'Other operating expenses'.

(b) Bank as a lessor

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

(q) Other assets

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

(r) Other liabilities

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

(s) Cash and cash equivalents

Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of upto 3 months from the date of issue. Gold holdings is measured at the closing market price at the end of the year.

		2008 KShs million	2007 KShs million
2	**INTEREST INCOME**		
	Foreign investments earnings	10,431	8,440
	Local investments earnings	1,604	1,363
	Other interest earnings	73	69
		12,108	9,872
3	**INTEREST EXPENSE**		
	Interest on monetary policy issues	1,640	968
	Interest paid to IMF	76	48
		1,716	1,016
4	**FEES AND COMMISSION INCOME**		
	Commission on sale of government securities	3,152	5,236
	Special projects agency fees	4	7
		3,156	5,243
5	**NET FOREIGN EXCHANGE GAIN/(LOSS)**		
	Gains on sale of foreign exchange	1,319	508
	Foreign exchange translation loss	(1,265)	(9,845)
		54	(9,337)
6	**OTHER OPERATING INCOME**		
	Rent received	16	17
	Proceeds from disposal of property and equipment	81	6
	Tuition fees and other charges	33	43
	Hospitality services	159	156
	Miscellaneous income	132	99
		421	321
7	**OPERATING EXPENSES**		
	Currency printing expenses	403	1,248
	Depreciation on property and equipment	144	254
	Property maintenance expenses	519	388
	Auditors' remuneration	4	4
	Banking expenses	4	4
	Operating lease rentals	3	3
	Amortisation on intangible assets	31	19
	Staff costs	3,261	2,956
	Other expenses	659	593
		5,028	5,469

8 DIVIDENDS

The Board of Directors recommend payment of a dividend of KShs 4 billion for the year ended 30 June 2008. (2007: Nil).

9 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2008 KShs million	2007 KShs million
Current accounts	4,423	2,333
Term deposits	210,866	171,262
Domestic forex currency cheque clearing	1,438	1,641
Forex travellers cheques	6	5
Cash and cash equivalents	216,733	175,241
Accrued interest on foreign investments	2,274	1,132
Total own resources	219,007	176,373
Special project accounts	4,451	4,485
	223,458	180,858
Gold holdings	28	20
	223,486	180,878

The Gold Holdings held amounted to 474 volume in Troy Ounces (2007- 474).

10 INTERNATIONAL MONETARY FUND

Special Drawing Rights (SDR) is an internal reserve asset credited by the IMF and allocated to member countries in order to increase international liquidity. The SDR is defined in terms of a basket of currency and its value is determined as the weighted sum of exchange rates of few currencies such as US dollars, Sterling Pound, Euro and the Yen.

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.

	2008		2007	
	SDR 000'	KShs million	SDR 000'	KShs million
IMF balances (SDR Account)	**2**	**206**	**0.5**	**5**
International Monetary Fund Account No. 1	20	2,134	20	2,042
International Monetary Fund Account No. 2	-	-	-	1
International Monetary Fund–PRGF Account	122	16,510	122	12,287
International Monetary Fund On-lent to Government of Kenya	10	1,053	14	1,410
	152	**19,697**	**156**	**15,740**
On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and en cashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository. Security at 30 June	**246**	**24,015**	**243**	**24,947**

11 ITEMS IN THE COURSE OF COLLECTION

	2008 KShs million	2007 KShs million
Items in the course of collection	2,885	589

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

12 INVESTMENT IN GOVERNMENT SECURITIES

	2008 KShs million	2007 KShs million
Reverse REPOS Treasury Bonds	7,042	-
Treasury Bills and Treasury Bonds discounted	1,497	4
	8,539	4

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

13 LOANS AND ADVANCES

	2008 KShs million	2007 KShs million
Advances to banks under liquidation	8,337	8,259
Government overdraft account (see below and Note 28)	-	42
Advances to employees (Note 28)	2,422	2,312
IMF funds on-lent to the Government (Note 28)	1,053	1,410
	11,812	12,023
Provision for loan impairment	(8,352)	(8,281)
Net advances as at 30 June	3,460	3,742

Movement in the provision for loan impairment is as follows:

	2008	2007
At start of the year	(8,281)	(8,281)
Additional provisions made in the year	(78)	(2)
Recoveries in the year	7	2
At end of the year	(8,352)	(8,281)

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest audited financial statements. The limit stands at KShs 14,818,521,441 based on the Government financial statements for 2005/2006 which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 13,268,817,798 based on the Government financial statements for 2004/2005.

14 OTHER ASSETS

	2008 KShs million	2007 KShs million
Prepayments	966	1,290
Advances	278	272
	1,244	1,562

15 RETIREMENT BENEFIT ASSET

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

The amounts recognised in the balance sheet are determined on the basis of an actuarial review carried out by Alexander Forbes Financial Services as at 30 June 2008.

	2008 KShs million	2007 KShs million
Present value of funded obligations	(10,496)	(9,416)
Fair value of plan assets	12,136	10,774
Present value of net asset	1,640	1,358
Unrecognised actuarial gain	(1,585)	(1,118)
Asset in the balance sheet	55	240

The amounts recognised in the income statement are as follows:

	2008	2007
Current service costs	532	498
Interest costs	847	738
Expected return on plan assets	(955)	(845)
Net actuarial gains recognised in the year	(5)	-
Total expenses included in operating expenses	419	391

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

	2008	2007
Net expense recognised in the income statement	419	391
Employer contributions	(234)	(237)
Movement in the asset recognised in the balance sheet	(185)	(154)
Actual return on plan assets	**1,679**	**1,451**

The principal actuarial assumptions at the balance sheet date were:

	2008	2007
Discount rate (p.a)	9%	9%
Salary increase (p.a)	7%	7%
Expected return on plan assets (p.a)	9%	9%
Future pension increases	0%	0%

16 PROPERTY AND EQUIPMENT

	Land and buildings KShs million	Motor vehicles KShs million	Furniture and equipment KShs million	Total KShs million
30 JUNE 2008				
Cost				
At start of year	1,004	184	3,065	4,253
Additions	-	54	66	120
Disposals	(17)	(23)	(1)	(41)
At end of the year	987	215	3,130	4,332
Depreciation				
At start of the year	942	157	2,563	3,662
Charge for the year	9	34	100	143
Eliminated on disposal	(17)	(23)	(1)	(41)
At end of the year	934	168	2,662	3,764
Net book value At 30 June 2008	53	47	468	568
30 JUNE 2007				
Cost				
At start of year	1,004	205	2,824	4,033
Additions	-	-	151	151
Adjustments	-	-	90	90
Disposals	-	(21)	-	(21)
At end of the year	1,004	184	3,065	4,253
Depreciation				
At start of the year	921	141	2,277	3,339
Charge for the year	21	37	196	254
Adjustments	-	-	90	90
Eliminated on disposal	-	(21)	-	(21)
At end of the year	942	157	2,563	3,662
Net book value At 30 June 2007	62	27	502	591

In 2007, the Bank carried out a physical verification of its property and equipment. As a result computer equipment previously written off from the books were reinstated in the general ledger. These amounted to KShs 90 million and had been fully depreciated.

17 PREPAID OPERATING LEASE RENTALS

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

	2008 KShs million	2007 KShs million
Cost		
At 30 June	300	300
Amortisation		
At 1 July 2007 and 2006	18	15
Amortisation for the year	4	3
At end of the year	22	18
Net carrying value at end of the year	278	282

18 INTANGIBLE ASSETS

	2008 KShs million	2007 KShs million
Cost		
At 1 July 2007 and 2006	179	125
Additions	1	55
At end of the year	180	180
Amortisation		
At 1 July 2007 and 2006	131	112
Amortisation for the year	31	19
At end of the year	162	131
Net carrying value at end of the year	18	49

19 DUE FROM GOVERNMENT OF KENYA

Loans due from the Government

	2008 KShs million	2007 KShs million
At start of the year	35,549	35,549
Receipts during the year	(1,110)	-
At end of the year	34,439	35,549

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

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

20 CURRENCY IN CIRCULATION

	2008 KShs million	2007 KShs million
Kenya notes	95,993	86,310
Kenya coins	3,752	3,484
Commemorative coins	5	5
	99,750	89,799

21 DEPOSITS

Banks -Kenya	53,868	39,441
-External	21	25
Local Banks forex settlement accounts	1,239	1,444
Non-bank financial institutions	-	119
Other public entities and project accounts	8,506	9,244
Government of Kenya	67,507	41,066
	131,141	91,339

22 AMOUNTS REPAYABLE UNDER REPURCHASE AGREEMENTS

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

23 OTHER LIABILITIES

	2008 KShs million	2007 KShs million
Impersonal accounts	3,467	991
Sundry creditors	728	513
Refundable deposits	234	187
Development deposits	100	37
	4,529	**1,728**

24 SHARE CAPITAL

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

Subsequent to the year end, the Board in consultation with the Minister for Finance has approved to increase the paid up capital to KShs 5 billion by capitalising KShs 3.5 billion from the general reserve fund.

25 GENERAL RESERVE FUND

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

26 CAPITAL MANAGEMENT

Capital includes the share capital and the general reserve fund.

	2008 KShs million	2007 KShs million
Share capital	1,500	1,500
General reserve fund	16,754	7,759
	18,254	**9,259**

Movements in equity capital during the year are explained in the Statement of Changes in Equity on page 12.

The Bank is not subject to any regulatory requirements concerning the level of capital it must maintain, although the Central Bank Act sets out how the statutory annual net profit for the year shall be allocated. The principal source of capital increase is through retention of the undistributed element of the profit. The Bank is not a not-for-profit organization, nor does it seek profit maximization. Instead it seeks to make a profit commensurate with normal market returns in areas where it conducts normal commercial operations.

Capital is not actively managed and the relatively low risk nature of most of the Bank's activities means that it is not capital intensive. Its purpose is to cover unexpected losses. The most significant unexpected losses are likely to arise out of support operations and the Bank's role as lender of last resort or from losses on the foreign exchange reserves should the Kenya shilling appreciate significantly against other world currencies.

27 NOTES TO THE CASH FLOW STATEMENT

(a) Cashflows from operating activities

	2008 KShs million	2007 KShs million
Net profit /(loss) for the year	8,995	(386)
Adjustments for:		
Depreciation of property and equipment	143	254
Amortisation of prepaid operating leases	4	3
Amortisation of intangible assets	31	19
Decrease in defined benefit scheme asset	185	154
Gain on disposal of property and equipment	(81)	(6)
Operating profit before working capital changes	**9,277**	**38**
Net decrease in loans and advances	282	5,541
Decrease in amounts repayable under repurchase agreements	(13,819)	(7,716)
Increase/(decrease) in deposits	39,802	(9,479)
Increase in balance with International Monetary Fund	3,957	2,152
Increase in project accounts	34	899
Increase in accrued interest on balances due from banking institutions	(1,142)	(222)
Increase in items in the course of collection	(2,296)	(52)
Decrease in other assets	318	5,289
Increase in other liabilities	2,801	724
Net cash generated from/(absorbed by) operations	**39,214**	**(2,826)**

27 NOTES TO THE CASH FLOW STATEMENT (continued)

(b) Cash and cash equivalents

	2008 KShs million	2007 KShs million
Cash and cash equivalents included in the cash flow statement comprise the following:		
Term deposits	210,866	171,262
Current accounts	4,423	2,333
Domestic forex cheques clearing	1,438	1,641
Travellers Cheques	6	5
Gold holdings	28	20
	216761	175,261
Investment in Government securities	8,539	4
	225,300	**175,265**

28 RELATED PARTY TRANSACTIONS

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

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 13) include advances to employees that as at 30 June 2008 amounted to KShs 2,422 million (2007: KShs 2,312 million). The advances are at preferential rates of interest determined by the Bank.

	2008 KShs million	2007 KShs million
(ii) Loans to executive directors		
At start of the year	2	6
Loans advanced during the year	-	14
Loan repayments	(1)	(18)
At end of the year	1	2
(iii) Loans to key management personnel		
At start of the year	22	30
Loans advanced during the year	34	8
Loan repayments	(23)	(16)
At end of the year	33	22
(iv) Directors' emoluments:		
Fees to non executive directors	13	13
Other remuneration to executive directors	35	26
	48	39
(v) Key management personnel remuneration:		
Remuneration to senior management	134	109

28 RELATED PARTY TRANSACTIONS(continued)

(vi) Government of Kenya

Transactions entered into with the Government include:

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

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

	2008 KShs million	2007 KShs million
Due from Government of Kenya (Note 19)	34,439	35,549
Overdraft account (Note 13)	-	42
IMF funds on-lent to the Government (Note 10)	1,053	1,410
Government of Kenya deposits (Note 21)	67,507	41,066
Investments in GOK Securities (Note 12)	8,539	4

(vii) Deposit Protection Fund Board

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

The balance outstanding from The Deposit Protection Fund Board and included in other assets as at year end was KShs 15 million (2007: KShs 23 million).

(viii) Kenya School of Monetary Studies

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

29 RISK MANAGEMENT

i) Structure and Reporting

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

a) Audit Committee of the Board

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

29 RISK MANAGEMENT (continued)

Bank Risk Management Committee

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

b) Internal Audit and Risk Management Department (IARM)

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

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

ii) Strategy in Using Financial Instruments

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

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

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

29 RISK MANAGEMENT(continued)

iii) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course of executing its operations:
Financial Risks include:
1) Credit risk
2) Market risk
   - Interest risk
   - Foreign currency exchange risk
3) Liquidity risk

Non financial Risks include:
4) Operational risk
5) Human resource risk
6) Legal risk
7) Reputational risk

Financial Risk
a) Credit risk

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

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

To minimize the sovereign risk exposure, the eligible banks are distributed among 10 countries under the following set criteria; long-term credit rating of A+, short-term credit rating of F1, composite rating of B and BIS capital adequacy ratio of 8%.
The Bank undertakes its operations in the Republic of Kenya. An analysis of the Bank's assets and liabilities by geographical area is given below:

	2008/2007	**2007/2006**
	KShs Millions	KShs Millions
Assets		
Republic of Kenya	51,612	43,047
United Kingdom	124,291	112,097
Rest of Europe	95,413	65,474
United States of America	3,338	2,857
Rest of the World	524	16
	275,178	**223,491**
Liabilities		
Republic of Kenya	**275,178**	**223,491**

b) Interest risk

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

	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non- interest bearing KShs million	Total KShs million
Assets					
Balances due from banking institutions and gold holdings	219,035	-	-	4,451	223,486
International Monetary Fund(SDR Account)	206	-	-	-	206
Items in the course of collection	-	-	-	2,885	2,885
Investment in government securities	8,539	-	-	-	8,539
Loans and advances	74	933	2,453	-	3,460
Other assets	-	-	-	1,244	1,244
Property, plant and equipment	-	-	-	568	568
Prepaid leasehold land	-	-	-	278	278
Intangible assets	-	-	-	18	18
Retirement benefit asset	-	-	-	55	55
Due from Government of Kenya	-	1,110	33,329	-	34,439
Total assets	227,854	2,043	35,782	9,499	275,178
Liabilities and equity					
Currency in circulation	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	131,141
International Monetary Fund	-	-	-	19,697	19,697
Amounts repayable under repurchase agreements	1,807	-	-	-	1,807
Other liabilities	-	-	-	4,529	4,529
Equity and reserves	-	-	-	18,254	18,254
Total liabilities and equity	132,948	-	-	142,230	275,178
Interest sensitivity gap 2008	**94,906**	**2,043**	**35,782**	**(132,731)**	**-**
Total Assets	176,476	2,044	37,173	7,798	223,491
Total liabilities and equity	106,971	-	-	116,520	223,491
Interest sensitivity gap 2007	**69,505**	**2,044**	**37,173**	**(108,722)**	**-**

c) Market risk

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

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

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

USD: 30 - 40%
GDP: 45 - 55%
EUR: 10 - 20%
CHF: 0 - 5%

The net foreign currency position of the Bank as of 30 June 2008 and 2007 is summarized below. The table presented below provides the Bank's assets, and liabilities, at carrying amounts, categorized by currency:

c) Market risk (continued)

The various currencies to which the Bank is exposed at 30 June 2008 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	73,789	108,802	40,326	-	-	541	223,458
Special Drawing Rights	-	-	-	206	-	-	206
Gold holdings	-	-	-	-	28	-	28
Total assets	73,789	108,802	40,326	206	28	541	223,692
Liabilities							
Balances due to IMF	-	-	-	19,697	-	-	19,697
Commissions for EEC Development Fund	-	100	-	-	-	-	100
Forex bureaux deposits	1,112	123	161	-	-	-	1,396
Total liabilities	1,112	223	161	19,697	-	-	21,193
Net balance sheet position 2008	**72,677**	**108,579**	**40,165**	**(19,491)**	**28**	**541**	**202,499**
As at 30 June 2007							
Total assets	90,458	69,003	21,365	5	20	32	180,883
Total liabilities	1,227	145	290	15,740	-	-	17,402
Net balance sheet position 2007	89,231	68,858	21,075	(15,735)	20	32	163,481

d) Liquidity risk

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

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

e) Liquidity risk (continued)

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at 30 June 2008 to the contractual maturity date.

ASSETS	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Balances due from banking institutions and gold holdings	12,798	210,660	-	-	28	223,486
International Monetary Fund(SDR Account)	206	-	-	-	-	206
Loans and advances	41	118	701	1,772	828	3,460
Investments in government securities	-	8,539	-	-	-	8,539
Items in the course of collection	2,885	-	-	-	-	2,885
Other assets	-	1,244	-	-	-	1,244
Property, plant and equipment	-	148	366	54	-	568
Prepaid leasehold land	-	1	3	14	260	278
Intangible assets	-	9	9	-	-	18
Retirement benefit asset	-	-	-	-	55	55
Due from Government of Kenya	-	-	1,110	4,440	28,889	34,439
TOTAL ASSETS	15,930	220,719	2,189	6,280	30,060	275,178
LIABILITIES						
Currency in circulation	-	-	-	-	99,750	99,750
Deposits	131,141	-	-	-	-	131,141
International Monetary Fund	-	-	413	1,535	17,749	19,697
Amounts repayable under repurchase agreements	-	1,807	-	-	-	1,807
Other liabilities	-	4,529	-	-	-	4,529
Equity and reserves	-	-	-	-	18,254	18,254
TOTAL LIABILITIES AND EQUITY	131,141	6,336	413	1,535	135,753	275,178
Liquidity gap 2008	**(115,211)**	**214,383**	**1,776**	**4,745**	**(105,693)**	**-**
Total assets	10,246	173,103	1,096	7,429	31,617	223,491
Total liabilities and equity	91,345	17,348	413	1,535	112,850	223,491
Liquidity gap as at 30 June 2007	**(81,099)**	**155,755**	**683**	**5,894**	**(81,233)**	**-**

Non Financial Risk

f) Operational risk

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

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

g) Human Resource Risk

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

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

h) Legal Risk

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

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

i) Reputational Risk

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

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

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

30 SENSITIVITY ANALYSIS

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

30 SENSITIVITY ANALYSIS (continued)

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

	2008 KShs million	2007 KShs million
Effect on profit before tax of a +13% change in interest rates	1,339	1,081
Effect on profit before tax of a -13% change in interest rates	(1,339)	(1,081)

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

	2008 KShs million	2007 KShs million
Effect on profit before tax of a +7% change in exchange rates	488	410
Effect on profit before tax of a -7% change in exchange rates	(488)	(410)

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

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

The effective interest rates for the principal financial assets and liabilities at 30 June 2008 and 2007 were in the following ranges:

	2008	2007
Assets		
Government securities	6.64%	6.64%
Deposits with overseas correspondent banks		
- current accounts	0.0%	0.0%
- term deposits (USD)	3.22%	5.29%
- term deposits (Pounds Sterling)	5.68%	5.65%
- term deposits (Euro)	4.54%	4.10%
Loans and advances - Commercial banks	8.50%	8.50%
- Government of Kenya	8.50%	8.50%
- Employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%

Liabilities -Customer deposits	0%	0%

32 CONTINGENCIES

Pending legal suits

The Bank is party to various legal proceedings with potential liability of KShs 2.427 billion at 30 June 2008. Having regard to the legal advice received, and in all circumstances, the directors are of the opinion that these legal proceedings will not give rise to liabilities.

33 EVENTS AFTER BALANCE SHEET DATE

In 1993, the Bank created a charge for KShs 2.5 billion over the Grand Regency Hotel, a property owned by Uhuru Highway Development Limited, to secure a debt owing from Exchange Bank Ltd. The debt arose out of inter-bank transactions between Exchange Bank Ltd and the Bank during the period 1992 and 1993. During the year, the Bank sold its security for US$ 45 million in satisfaction of the KShs 2.5 billion debt. The sale was completed in July 2008.

To address public interest and anxiety in the matter, in July, 2008 H. E. the President appointed a Commission of Inquiry to, inter alia, investigate the circumstances surrounding the sale of the Hotel. The Commission was yet to complete its work and submit a report of its findings to the President by the time the audit of the Bank's financial statements for year 2007/2008 was completed. Owing to these uncertainties, the down payment (10% or $4.5 million) of the sale price received during the year has been treated as part of the balances due from banking institutions in Note 9 and other liabilities in Note 23. The balance (90% or $40.5 million) that was received in July 2008 has been similarly treated in the Bank's books subsequent to year end.

34 COMMITMENTS

	2008 KShs million	2007 KShs million
Contracted for	-	10

Capital commitments contracted for in the previous year relates to currency disintegration and briquetting system for Kisumu and Eldoret bank notes and sorting system.

OPERATING LEASE COMMITMENTS

AS LESSEE:

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

	2008 KShs million	2007 KShs million
One year	12	11
Between two and five years	7	7
Over five years	139	140
	158	**158**

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

35 EMPLOYEES

The average number of employees during the year was 1,230 (2007: 1,255).

36 TAXATION

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

37 COMPARATIVES

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