CENTRAL BANK OF KENYA

REPORT AND FINANCIAL STATEMENTS

AT

30 JUNE 2012

CENTRAL BANK OF KENYA

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012

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CENTRAL BANK OF KENYA

BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2012

BOARD OF DIRECTORS

Prof. Njuguna Ndung'u	Governor
Dr. Hezron Nyangito	Deputy Governor- Retired on October 24, 2011
Dr. Haron Sirima	Deputy Governor- Appointed on October 24, 2011 and retired from the Board on May 2, 2012
Mr. Joseph K. Kinyua	Permanent Secretary, Treasury- Member
Dr. William O.Ogara	Member
Dr. Mbui Wagacha	Member
Ms. Vivienne Y. Apopo	Member
Ms. Florence K. Muindi	Member
Mr. John G. Msafari	Member

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	Governor
Dr. Hezron Nyangito	Deputy Governor-Retired on October 24, 2011
Dr. Haron Sirima	Deputy Governor-Appointed on October 24, 2011
Mr. Kennedy K. Abuga	Director – Governors' Office and Board Secretary
Mr. Aggrey J.K. Bett	Director – Finance & IMS Department
Mr. Fredrick Pere	Director – Banking Supervision Department
Prof. Kinandu Muragu	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	Director – Internal Audit Department
Mr. Charles Koori	Director – Research Department
Mr. Cassian J. Nyanjwa	Director – Department of Estates, Supplies and Transport
Mr. James T. Lopoyetum	Director – Currency Operations and Branch Administration Department
Mr. Gerald Nyaoma	Director – Financial Markets Department
Mr. Peter K. Rotich	Director – Human Resources and Administration Department
Mr. Mark Lesiit	Director – Banking & Risk Management Department -Appointed on April 3, 2012
Mr. Jackson M. Kitili	Director – Banking & Risk Management Department -Transferred on April 3, 2012

REGISTERED OFFICE

Central Bank of Kenya Building
Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya

BRANCHES AND CURRENCY CENTERS

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

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

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

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

Kenya School of Monetary Studies
Thika Road
P.O. Box 65041
00200 Nairobi, Kenya

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

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

BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2012 (CONTINUED)

AUDITORS	**MAIN LAWYERS**
KPMG Kenya	Oraro and Co. Advocates
Lonrho House, 16th Floor	ACK Garden House
Standard Street	1st Ngong Avenue
P.O. Box 40612	P.O. Box 51236
00100 Nairobi, Kenya	00200 Nairobi, Kenya

CENTRAL BANK OF KENYA

DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2012

The directors submit their report together with the audited financial statements for the year ended 30 June 2012, which shows the state of affairs of the Bank.

1. Incorporation

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

2. Principal activities

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

3. Results

3.1 Financial results

The financial results for the year are set out on page 10. During the year under review, total operating income registered amounted to KShs 12,497m (2011 - KShs 8,099m). The overall income adjusted for gain on valuation of leasehold land and buildings and loss on revaluation of foreign currency reserves is KShs (5,084m). The overall income for 2011 was KShs 49, 485m, including a foreign currency revaluation gain of KShs 38,934m. Total expenditure on the other hand amounted to KShs 13,240m comprising operating expenses amounting to KShs 7,674m, monetary policy expenses of KShs 880m and impairment loss on financial assets of KShs 4,686m. The comparative expenditure for 2011 is KShs 8,560m consisting of operating expenses amounting to KShs 8,531m and monetary policy expenses of KShs 29m. As a result, the Bank recorded a net loss of KShs 18,324m including unrealized foreign currency revaluation loss amounting to KShs 28,238m. The comparative position for 2011 is a net surplus of KShs 40,925 million including a foreign currency revaluation gain of KShs 38,934m. The foreign currency revaluation losses recorded in 2012 were accumulated as the Kenya Shilling gained value against major convertible currencies, particularly towards the last quarter of 2011 in comparison with values prevailing on June 30, 2011. Without the translation losses and the gain on revaluation of non-current assets, the operating net surplus in 2012 would be KShs 2,384m which is much higher than the KShs 622m recorded in 2011owing to higher than normal income in 2012 from higher lending to Government and commercial banks that amounted to KShs 5,596m against KShs 1,043m in 2011 due to shortfalls in Government revenue and tight liquidity in the market earlier on in the year 2012. This lending all took place at unprecedented higher Central Bank Rate (CBR) that was at 18% for a considerable period. Higher than expected income derived from foreign currency sales in the wake of depreciating local currency in the last quarter of 2011 also contributed to the higher income in 2012. However, this favourable income performance was moderated by monetary policy expenses that went up from KShs 29m in 2011 to KShs 880m by the year end in June 2012 as a result of the monetary policy steps taken to stabilize the local currency in the later part of 2011.Overall, the financial performance of the Bank has over the last two years been about 60% lower than normal owing to the effects of the sluggish World economy which has adversely affected the Bank's foreign currency investment income.

3.2 Financial position

The financial position for the year is set out on page 11.The assets of the Bank increased by KShs 63,454m or 14% from KShs.446,616m reported as at June 30, 2011 to KShs 510,070m as at June 30, 2012 mainly due to build-up of foreign currency reserves as a result of both inflows from IMF's Extended Credit Facility (ECF tranches) and net purchases of foreign currency by the Bank. There was also an increase of about KShs 9.9b from bills and bonds discounted by the Bank from the market and an increase of KShs 8.9 billion in property and equipment arising from revaluation of non-current assets and additions to work in progress. This was moderated by the foreign currency revaluation losses occasioned by the strengthening of the Kenya Shilling that shrunk the shilling value of foreign assets during the period and balances of overnight lending to commercial banks that had decreased by KShs 19.8b at year end.

Liabilities on the other hand increased due to a rise in deposits of commercial banks by 18% and Repo instruments for monetary policy interventions that went up from nil in 2011 to KShs 35,672m by year end in 2012 owing Shilling stabilization measures taken during the year. IMF account balances and currency in circulation also went up by 24% and 8% owing to inflows to the Bank from IMF's Extended Credit Facility and normal growth of demand for cash in the economy. The deficit of KShs 18,324m registered during the period under review arising from foreign currency revaluation loss amounting to KShs 28,238m posted to General Reserves reduced these increases in liabilities.

4. Dividend

The Board of Directors recommends a dividend of KShs 1.5 billion to be paid to the Treasury (2011: Nil).

5. 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.

6. Auditors

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

BY ORDER OF THE BOARD

K. K. Abuga
BOARD SECRETARY

Date: 28 September 2012

CENTRAL BANK OF KENYA

STATEMENT OF DIRECTORS' RESPONSIBILITY

The Directors are responsible for the preparation and presentation of the financial statements of Central Bank of Kenya set out on pages 10 to 64 which comprise the statement of financial position as at 30 June 2012, and the statement of comprehensive income, statement of changes in equity and statement of cashflows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

The Directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Central Bank 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 operating results.

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

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

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 28 September 2012 and were signed on its behalf by:

Governor

Director

CENTRAL BANK OF KENYA

STATEMENT OF CORPORATE GOVERNANCE

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

Board of Directors

Section 11 of the CBK Act Cap 491 provides that the Board of Directors shall be composed of a Chairperson, a Governor, The Permanent Secretary to the 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 2nd 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 Permanent 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 hold office for more than two terms.

Currently 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.

Board meetings

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.

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 after every two months basis and as necessary. Its responsibilities are to:

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

Monetary Policy Committee (MPC)

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

The Committee is currently made up of the following:

- The Governor who is also the Chairman-internal member
- The Deputy Governor who is the Deputy Chairman-internal member
- Permanent Secretary to the Treasury or his representative who shall be non-voting member
- Professor T. C. Ryan-external member appointed by Minister for Finance
- Mrs. Sheila S.M.R. M'Mbijjewe-external member appointed by Minister for Finance
- Prof. Francis M. Mwega-external member appointed by Minister for Finance
- Mrs. Farida Abdul-external member appointed by Minister for Finance
- Mr. Charles Koori- internal member appointed by Governor
- Mr. John K. Birech-internal member appointed by Governor

Human Resources Committee

Members of this Committee include Ms. Florence K. Muindi as the Chairperson, Dr. William Otiende Ogara, Mr. John Gerin Msafari and Ms. Vivienne Yeda Apopo. Governor and the Deputy Governor attend the meetings as and when necessary. The Committee meets once every two months and when need arises to review human resource policies and make suitable recommendations to the Board.

Financial Stability and Investment Committee

Members of this Committee are Ms. Vivienne Yeda Apopo as the Chairperson, Dr. William Otiende Ogara, Dr. Mbui Wagacha and Deputy Governor. 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.

Management Structure

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

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

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial 2011/2012 is disclosed in Note 32(iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for the staff loans.

STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

Code of Ethics

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

Internal Controls

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

Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget 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.

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.

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 website of the bank.

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

We have audited the financial statements of Central Bank of Kenya set out on pages 10 to 64 which comprise the statement of financial position at 30 June 2012, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 30 June 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of Kenya Act.

KPMG Kenya

Date: 28 September 2012

CENTRAL BANK OF KENYA

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2012

	Note	2012 KShs'million	2011 KShs'million
Interest income	4	8,308	4,303
Interest expense	5	(888)	(30)
Net interest income		7,420	4,273
Fee and commission income	6	3,000	3,003
Foreign exchange (loss)/gain	7	(25,111)	40,017
Other operating income	8	1,189	793
Operating income		(13,502)	48,086
Operating expenses	9	(12,352)	(8,530)
(Loss)/profit for the year		(25,854)	39,556
Other comprehensive income			
Fair value on valuation of leasehold land	28	1,489	-
Revaluation surplus	29	6,041	1,369
Total comprehensive income		(18,324)	40,925

The notes set out on pages 14 to 64 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2012

	Note	2012 KShs' million	Restated 2011 KShs' million	Restated 2010 KShs' million
ASSETS				
Balances due from banking institutions and gold holdings	10	437,961	368,835	284,682
Funds held with International Monetary Fund (IMF)	11	2,200	2,731	26,272
Items in the course of collection	12	333	409	316
Advances to banks	13	9,973	49	31
Loans and advances	14	10,817	30,642	20,674
Other assets	15	2,224	5,385	4,802
Retirement benefit asset	16	2,193	1,897	1,894
Property and equipment	17	12,083	3,117	1,296
Prepaid operating lease rentals	18	-	-	-
Intangible assets	19	1,412	1,171	853
Due from Government of Kenya	20	30,874	32,380	33,102
TOTAL ASSETS		510,070	446,616	373,922
LIABILITIES				
Currency in circulation	21	159,216	147,718	125,024
Deposits	22	160,642	135,792	143,228
Amounts due to International Monetary Fund (IMF)	11	101,868	81,829	63,276
Investments by Banks	23	35,673	-	-
Other liabilities	24	1,755	9,447	9,474
Dividends payable	25	-	2,641	2,641
Accruals	26	149	98	113
TOTAL LIABILITIES		459,303	377,525	343,756
EQUITY AND RESERVES				
Share capital	27	5,000	5,000	5,000
General reserve fund	28	36,857	62,722	23,166
Revaluation reserve	29	7,410	1,369	-
Proposed dividend	30	1,500	-	2,000
TOTAL EQUITY AND RESERVES		50,767	69,091	30,166
TOTAL LIABILITIES AND EQUITY		510,070	446,616	373,922

The financial statements were approved by the Board of Directors for issue on 28 September 2012 and signed on its behalf by:

Governor

Director

The notes set out on pages 14 to 64 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2012

2011:	Note	Share capital KShs million	General Reserve Fund KShs million	Revaluation reserve KShs million	Proposed dividend KShs million	Total KShs million
At 1 July 2010		5,000	23,166	-	2,000	30,166
Comprehensive income for the year						
Profit for the year	28	-	39,556	-	-	39,556
Other comprehensive income for the year						
Revaluation surplus	29	-	-	1,369	-	1,369
Total comprehensive income for the year		-	39,556	1,369	-	40,925
Transactions with owners recorded directly in equity						
2010 dividends paid		-	-	-	(2,000)	(2,000)
Proposed dividends		-	-	-	-	-
Total contributions by and distribution to the owners		-	-	-	(2,000)	(2,000)
At 30 June 2011		5,000	62,722	1,369	-	69,091
2012:						
At 1 July 2011		5,000	62,722	1,369	-	69,091
Comprehensive income for the year						
Loss for the year	28	-	(25,854)	-	-	(25,854)
Other comprehensive income for the year						
Fair value on valuation of leasehold land	28	-	1,489	-	-	1,489
Revaluation surplus	29	-	-	6,041	-	6,041
Total comprehensive income for the year		-	(24,365)	6,041	-	(18,324)
Transactions with owners recorded directly in equity						
Proposed dividends		-	(1,500)	-	1,500	-
As at 30 June 2012		5,000	36,857	7,410	1,500	50,767

The notes set out on pages 14 to 64 form an integral part of these financial statements.

CENTRAL BANK OF KENYA

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 2012

	Note	2012 KShs'million	2011 KShs'million
Operating activities			
Net cash generated by operating activities	31(a)	80,324	24,966
Investing activities			
Receipts of government loan		1,506	722
Purchase of property and equipment		(1,624)	(1,523)
Purchase of intangible assets		(319)	(334)
Proceeds from disposal of property and equipment		5	1
Net cash used in investing activities		(432)	(1,134)
Financing activities			
Dividends paid		(2,641)	(2,000)
Proceeds from International Monetary Fund – SDR accounts		20,039	23,541
Net cash inflow from financing activities		17,398	21,541
Net increase in cash and cash equivalents		97,290	45,373
Cash and cash equivalents at beginning of year		362,750	277,360
Exchange rate effects		(25,111)	40,017
Cash and cash equivalents at end of year	31(b)	434,929	362,750

The notes set out on pages 14 to 64 form an integral part of these financial statements

CENTRAL BANK OF KENYA

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

1. REPORTING ENTITY

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

(i) Statement of compliance

The financial statements are prepared in accordance with and comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(ii) Basis of measurement

The financial statements are prepared under the historical cost convention except for certain investments such as retirement benefit assets and property and equipment which are measured at fair value.

(iii) Form of presentation

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

(iv) Significant accounting judgement and estimates

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the directors' best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of preparation (continued)

(v) Functional and presentation currency

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

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

(vi) Change in accounting policy

During the year, the bank amended its accounting policy on leasehold land and property to comply with International Accounting Standards number 17 (Leases) with respect to valuation of leasehold land and properties. The accounting policy was changed to carry leasehold land and properties at valuation rather than cost. The effect of changes in accounting policy is outlined in note 38 of the financial statements.

(b) Revenue recognition

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

(i) Interest income and expenses

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

(ii) Fees and commission income

Fees and commission income, which arise mainly from sale of government securities on behalf of the government by the Bank, are recognised when the corresponding services are provided.

(c) Translation of foreign currencies

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

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

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Currency printing and minting expenses

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the profit or loss from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition. The life span of each bank note denomination is as described in note (3 (c)) below.

(e) Employee benefits

(i) Retirement benefits

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

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

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

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

Where the calculation results in a benefit to the Bank, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reduction in future contributions to the plan.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Employee benefits (continued)

(i) Retirement benefits - continued

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

(ii) Other employee benefits

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

(f) Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditure that is directly attributable to the acquisition of the asset. Items of property and equipment are depreciated on a straight-line basis in the income statement over the estimated useful lives of the assets at the following rates:

Building improvements	Twenty years
Motor vehicles & Computer equipment	Four years
Currency Processing Equipment	Ten years
Other Office Equipment	Five years
Furniture, Fixtures & Fittings	Ten years

The estimated useful lives of items of property and equipment were revised from Ten years and Two years for Buildings and Property & Equipment respectively with effect from July 1, 2011 to the useful lives stated above.

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

Subsequent expenditures are capitalized only when it is probable that the future economic benefits will flow to the Bank. Expenditure incurred to replace a component of item of property and equipment is accounted for separately and capitalized while the major replaced component is derecognised.

All other expenditure items which do not meet the recognition criteria are recognised in profit or loss as expenses as they are incurred.

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

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Intangible assets

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

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

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The amortisation expense on intangible assets with finite lives is recognised in the Statement of Comprehensive Income.

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 - Five years

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted when deemed appropriate.

(h) Impairment of non-financial assets

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

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

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

(i) Financial instruments

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

(i) Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, which is the date that the Bank becomes a party to the contractual provisions of the instrument.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(ii) Recognition and initial measurement

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

(iii) Classification and measurement

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

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

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

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

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Financial instruments (continued)

(iii) Classification and measurement - continued

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

Other liabilities
Other liabilities are measured at amortised cost, which approximates fair value due to the short term nature thereof.

Cash and cash equivalents
Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of up to 3 months from the date of issue. Cash and cash equivalents are carried at amortised cost in the statement of financial position..

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

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

(iv) Derecognition

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) **Financial instruments (continued)**

(iv) Derecognition - continued

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

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

(v) Gains and losses on subsequent measurement

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

(vi) Offsetting

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

(vii) Impairment of financial assets

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

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

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

2. **SIGNIFICANT ACCOUNTING POLICIES (Continued)**

(i) **Financial instruments (continued)**

(vii) Impairment of financial assets - continued

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

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

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

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

(j) **Amounts repayable under Repurchase Agreements (REPOs)**

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

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

When the Bank mops money from commercial banks, it creates a liability in its financial statements and secures this borrowing (liability) by assigning part of the securitized debt owing from Government to the Bank to the commercial banks it has mopped from. The Bank freezes the money mopped and pays interest at market rates on the money. The money mopped stays until maturity (4 to 7 days).

Similarly the Bank also lends money to commercial banks (reverse repo). In this process, the Bank creates an asset in its financial statements and takes a security from the borrowing bank usually in form of Treasury Bills or Bonds. The Bank earns interest on this lending. The injected money stays with the borrowing bank until maturity (4 to 7 days).

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Amounts repayable under Repurchase Agreements (REPOs) (continued)

(i) The Bank treats reverse REPOs as collateralized loans for accounting purposes. In this case, a reverse REPO is recognised as a secured advance and is shown separately as Advance to Banks while repurchase agreements are shown as a liability in the books of bank.
(ii) REPOs continue to be recognised in the statement of financial position and are measured in accordance with policies for non-trading investment.
(iii) The difference between sales and repurchase price is treated as interest expenditure and is recognised in the profit or loss.

The Bank also accepts, for monetary policy purposes, term deposits from commercial banks on a voluntary basis at market terms for periods of 14, 21 and 28 days. This is a relatively new monetary instrument that the Bank uses in addition to REPO and is similar to REPO only that it is not secured.

(k) Currency in circulation

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

(l) Deposits

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

Cash Ratio Deposits are taken from commercial banks for liquidity management (monetary policy purposes) of the Bank in accordance with the Banking Act and are interest free. Cash Ratio Reserves is a monetary policy instrument used to manage liquidity. The deposits earn no interest to commercial banks and the Bank does not trade on these deposits in any way. The deposits are currently computed at 5.25% of each commercial bank's deposits it has taken from the public. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

(m) Provisions

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

(n) Leasing

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(n) Leasing (continued)

(i) Bank as a lessee

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

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

(ii) Bank as a lessor

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

(o) Dividends

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

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

(p) Commitments on behalf of Treasury

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) **Comparative**

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

(r) **New standards and interpretations not yet adopted**

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2012, and have not been applied in preparing these financial statements as follows:

Standard/Interpretation		Effective date
IAS 12 amendment	*Deferred tax: Recovery of Underlying Assets*	Annual periods beginning on or after 1 January 2012
IAS 1 amendment	*Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*	Annual periods beginning on or after 1 July 2012
IFRS 10	*Consolidated Financial Statements*	Annual periods beginning on or after 1 January 2013
IFRS 11	*Joint Arrangements*	Annual periods beginning on or after 1 January 2013
IFRS 12	*Disclosure of Interests in Other Entities*	Annual periods beginning on or after 1 January 2013
IFRS 13	*Fair Value Measurement*	Annual periods beginning on or after 1 January 2013
IAS 19 amended 2011	*Employee Benefits*	Annual periods beginning on or after 1 January 2013
IAS 27	*Separate Financial Statements (2011)*	Annual periods beginning on or after 1 January 2013
IAS 28	*Investments in Associates and Joint Ventures (2011)*	Annual periods beginning on or after 1 January 2013
IFRIC 20	*Stripping Costs in the Production Phase of a Surface Mine*	Annual periods beginning on or after 1 January 2013
IFRS 1 amendment	*Government Loan*	Annual periods beginning on or after 1 January 2013
IFRS 7 amendment	*Disclosures: Offsetting Financial Assets and Financial Liabilities*	Annual periods beginning on or after 1 January 2013
IAS 32 amendment	*Offsetting Financial Assets and Financial Liabilities*	Annual periods beginning on or after 1 January 2014
IFRS 9	*Financial Instruments*	Annual periods beginning on or after 1 January 2015

The Bank will adopt the above standards, interpretations and amendments on their effective dates.

The Bank does not intend to early adopt any of the above amendments, standards and interpretations.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

(a) Impairment losses on loans, advances and receivables

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

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

(b) 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 2(f) and 2(g) above. Land and Buildings were revalued in the current year. The basis of valuation and assumptions used are disclosed in Note 17 and 18.

(c) Useful life of currency

Banknotes printing expenses for each denomination which include ordering, printing, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to the income statement from the deferred costs account over the useful period (life span) of each banknote denomination. The deferred amount is recognised as prepayment and represents un-issued banknotes (currency) stock. Previously the costs were expensed upon delivery and payment of currency stock. Cost of coins minted is expensed in full on delivery in the year of purchase/acquisition.

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

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

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

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

(d) Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

All financial instruments are initially recognised at fair value, which is normally the transaction price. In certain circumstances, the initial fair value may be based on a valuation technique which may lead to the recognition of profits or losses at the time of initial recognition. However, these profits or losses can only be recognised when the valuation technique used is based solely on observable market inputs.

Subsequent to initial recognition, some of the bank's financial instruments are carried at fair value, with changes in fair value either reported within profit or loss or within other comprehensive income until the instrument is sold or becomes impaired.

The fair values of quoted financial instruments in active markets are based on current prices. If the market for a financial instrument is not active including for unlisted securities, the bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Where representative prices are unreliable because of illiquid markets, the determination of fair value may require estimation of certain parameters, which are calibrated against industry standards and observable market data, or the use of valuation models that are based on observable market data.

The fair value for the majority of the Bank's financial instruments is based on observable market prices or derived from observable market parameters.

(e) 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 16 for assumptions used.

		2012	2011
4	**INTEREST INCOME**	**KShs million**	**KShs million**
	Cash and cash equivalents (Note 4a)	32	42
	Held to maturity investments (Note 4b)	1,194	1,513
	Loans and advances (Note 4c)	6,778	2,393
	Held for trading investments (Note 4d)	304	355
		8,308	4,303
(a)	**Interest income from cash and cash equivalents**		
	Income from IMF	32	42
U8(b)	**Interest income from held to maturity investments**		
	Interest on Sterling Pound term deposits	441	547
	Interest on US Dollar term deposits	185	339
	Interest on Euro term deposits	568	627
		1,194	1,513
	The weighted average interest rates for term deposits were:		
	US Dollar	0.17%	0.21%
	UK Sterling Pounds	0.40%	0.70%
	Euro	0.18%	1.18%
(c)	**Interest income from loans and advances**		
	Interest on loan due from Government Debt	929	958
	Interest on Government overdraft	3,664	890
	Interest on staff loans	103	271
	Interest on reverse REPOs	1,403	36
	Interest on local commercial banks overnight loans	521	115
	Interest on foreign commercial banks overnight loans	8	2
	Other interest income	150	121
		6,778	2,393
(d)	**Interest income from held for trading investments**		
	Interest income – World Bank RAMP	304	355

The Bank has engaged the services of Reserve Asset Management Programme (RAMP) which is the investment arm of the World Bank to assist in building capacity in foreign reserves management. The Bank has availed US$300 million (2011 - US$300 million) for the Programme.

4 INTEREST INCOME (Continued)

	2012	2011

(c) Additional disclosure on income by source

	KShs million	KShs million
Foreign investments earnings	1,539	1,913
Local investments earnings	6,666	2,298
Other interest earnings	103	92
	8,308	4,303

5 INTEREST EXPENSE

Interest on monetary policy issues/ REPOs	880	29
Interest paid to IMF	8	1
	888	30

6 FEE AND COMMISSION INCOME

Commission on sale of Government securities	3,000	3,000
Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	-	3
	3,000	3,003

The Bank earns from the Government a commission of 1.5% of amounts raised for its agency role in the issuance of Treasury bills and bonds. The commission income is limited to KShs 3 billion as per an agreement between the Bank and Treasury effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

7 FOREIGN EXCHANGE (LOSS) / GAIN

	2012 KShs million	2011 KShs million
Foreign exchange dealing profit (Note 7a)	3,116	991
Foreign Bonds Pending Receivables	11	92
Foreign exchange translation (loss)/gain (Note 7b)	(28,238)	38,934
	(25,111)	40,017

(a) Foreign exchange dealing profit

Gains on sale of foreign exchange to Government	3,116	989
Foreign exchange dealing profit on commercial banks	-	2
	3,116	991

(b) Foreign exchange translation (loss)/gain

Revaluation (loss)/gain on current accounts	(24,164)	533
Revaluation (loss)/gain on foreign deposits	(9,997)	45,482
Revaluation gain/(loss) on IMF accounts	9,080	(9,924)
Revaluation of RAMP securities	(3,158)	2,824
Others-Revaluation gains on Gold Holdings	1	19
	(28,238)	38,934

7 FOREIGN EXCHANGE (LOSS)/GAIN (Continued)

Exchange rates	2012	2011
US Dollar	84.10	89.70
GBP	131.18	144.3
Euro	105.78	130.0

	2012	2011
Foreign currency investment mix		
US Dollar	63%+ /-5%	45%+ /-5%
GBP Sterling Pound	14%+/-5%	30%+/-5%
Euro	23%+/-5%	25%+/-5%
	100%	100%

8 OTHER OPERATING INCOME

	2012 KShs million	2011 KShs million
Actuarial gain on retirement benefit obligations	296	3
Miscellaneous income	206	153
Licence fees from Commercial Banks and bureaus	181	182
Penalties Commercial banks and Forex Bureaus	34	48
Rent received	1	1
KSMS other operating income-hospitality services and tuition fee	444	405
Profit on disposal of property and equipment	27	1
	1,189	793

9 OPERATING EXPENSES

	2012 KShs million	2011 KShs million
Staff costs (Note 9(a))	4,134	3,992
Currency expenses (Note 9(b))	1,216	1,766
Property maintenance expenses (Note 9(c))	765	654
Depreciation on property and equipment (Note 17)	191	1,070
Amortisation on intangible assets (Note 19)	78	13
Other expenses (Note 9(d))	1,275	1,029
Impairment loss on financial asset	4,686	-
Auditors' remuneration	6	5
Banking expenses	1	1
	12,352	8,530

(a) Staff costs

	2012	2011
Personnel emoluments	3,669	3,417
Medical benefit	229	210
Other Staff costs	198	358
Directors' expenses	38	7
	4,134	3,992

9 OPERATING EXPENSES (Continued)

	2012 KShs million	2011 KShs million
(b) Currency expenses		
Notes production	1,200	1,162
Coins production	7	584
Notes issue	7	10
Coin Issue	2	5
Agency Centres	-	5
	1,216	1,766
(c) Property maintenance expenses		
Maintenance of property	359	288
Security of premises	258	234
Property renovation	30	28
Electricity	76	60
Other	42	44
	765	654
(d) Other expenses		
Transport and travelling	161	179
Office expenses	199	165
Postal service expense	131	121
Legal and professional fees	102	100
Other administrative expenses	682	464
	1,275	1,029

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2012 KShs million	2011 KShs million
Cash and cash equivalents (Note 10(a))	60,008	14,058
Held for trading investments (Note 10(b))	42,612	37,734
Held to maturity investments (Note 10(c))	335,267	316,967
Gold holdings	74	76
	437,961	368,835

(a) Cash and cash equivalents

	2012	2011
Special project accounts	12,878	5,846
Current account	39,031	2,640
Domestic forex currency cheque clearing	8,099	5,572
	60,008	14,058

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

	2012 KShs million	2011 KShs million
(b) Held for trading		
US Dollar deposits	8	36
Fixed income securities	42,525	37,612
Accrued interest	79	86
	42,612	37,734
(c) Held to maturity investments		
Term deposits (Note 10 (c)(i))	335,219	316,719
Accrued interest on term deposits	48	248
	335,267	316,967
(i) Term deposits		
Dollar deposits	187,543	118,853
Sterling Pound deposits	68,873	94,548
Euro deposits	78,803	103,318
	335,219	316,719

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

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

	2012		2011	
	SDR Million	KShs Million	SDR' Million	KShs Million
Assets- Funds held at IMF				
IMF balances (SDR asset account)	17	2,200	19	2,731
Liabilities- Amounts due to IMF				
International Monetary Fund Account No. 1	21	2,711	20	2,886
International Monetary Fund Account No. 2	-	1	-	1
International Monetary Fund – PRGF Account	521	66,183	328	47,042
IMF-SDR Allocation account	260	32,972	223	31,900
International Monetary Fund loans to Government of Kenya	-	-	-	-
	802	101,868	571	81,829
Security at 30 June	249	32,550	241	32,550

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

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

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

Kenya's quota in IMF and SDRs allocations amounting to SDR 271.4 million and SDR 259.6 million respectively. The quota of SDR 271.4 million has not been accounted for in the financial statements of the Bank.

12 ITEMS IN THE COURSE OF COLLECTION

	2012 KShs million	2011 KShs million
Items in the course of collection	333	409

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

13 ADVANCES TO BANKS

	2012 KShs million	2011 KShs million
Treasury Bonds Discounted	3,298	32
Treasury Bills Discounted	6,578	16
Accrued interest	97	1
	9,973	49

For monetary policy operations, the Bank lends money to commercial banks through reverse Repo for short durations of up to 7 days only. These advances are secured against government securities of any maturity. To promote liquidity, the Bank also buys securities on discount basis from commercial banks. The securities so discounted and held are of varying maturities.

14 LOANS AND ADVANCES

	2012 KShs million	2011 KShs million
Overnight Lending to commercial banks	-	19,873
Irrecoverable amount from banks under liquidation	3,706	3,706
Government overdraft account (see below and Note 32)	7,257	7,571
Loan from IMF to the Government of Kenya (Note 32)	-	(3)
Advances to employees	3,577	3,220
	14,540	34,367
Allowance for loan impairment (banks & staff)	(3,723)	(3,725)
Net advances as at 30 June	10,817	30,642

14 LOANS AND ADVANCES (Continued)

	2012 KShs million	2011 KShs million
Movement in the loan impairment allowance is as follows:		
At start of the year	(3,725)	(3,784)
Additional impairment allowance made during the year	-	(1)
Recoveries during the year	2	60
At end of the year	(3,723)	(3,725)

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 KShs 25,373,202,658.35 based on the Government financial statements for 2009/2010, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 22,926,066,860.60 based on the Government financial statements for 2008/2009. The Government overdraft attracts an interest at the CBR rate determined by the Bank which varies from time to time according to the monetary policy stance in place.

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty in order to prevent a loss of confidence spreading through the financial system as a whole. Commercial banks did not utilise this facility in the year under review (2011: KShs 19.8million). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

15. OTHER ASSETS

	2012 KShs million	2011 KShs million
Prepayments and sundry debtors	250	2,374
Deferred currency expenses	1,659	2,796
Other	5,001	215
	6,910	5,385
Provision for impairment losses	(4,686)	-
	2,224	5,385

The policy of the Bank is to expense banknotes costs over a predetermined useful life of the notes upon issue of the banknotes into circulation.

16 RETIREMENT BENEFIT ASSET

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund. The defined benefit plan is funded by the Bank and the employees of the Bank. The retirement benefit asset is recognised in the financial statements of the Bank up to a limit as described in the accounting policy.

The amounts recognised in the statement of financial position are determined on the basis of an actuarial review carried out as at 30 June.

CENTRAL BANK OF KENYA

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2012 (CONTINUED)

16 RETIREMENT BENEFIT ASSET (Continued)

	2012 KShs million	2011 KShs million
Present value of funded obligations	12,673	12,137
Fair value of plan assets	(17,103)	(15,872)
Present value of net asset	(4,430)	(3,735)
Unrecognised actuarial gain	2,237	1,838
Balance at 30 June	(2,193)	(1,897)

The amounts recognised in profit or loss are as follows:

	2012	2011
Current service costs	565	601
Interest costs	1,071	1,022
Expected return on plan assets	(1,492)	(1,334)
Net actuarial gains recognised	24	-
Past service cost	625	-
Adjustment for previous year values	(724)	58
Total expenses included in operating expenses	69	347

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

	2012	2011
Net liability at start of period	(1,897)	(1,894)
Net expense recognised in the profit or loss	69	347
Employer contributions	(365)	(350)
Net liability at end of period	(2,193)	(1,897)
Actual return on plan assets	608	1,173

The principal actuarial assumptions at the reporting date were:

	2012	2011
Discount rate (p.a.)	12.5%	9%
Salary increase (p.a.)	10.5%	7%
Expected return on plan assets (p.a.)	12.5%	9%
Future pension increases	3%	0%

Historical information	2012 KShs million	2011 KShs million	2010 KShs million	2009 KShs million	2008 KShs million
Fair value of plan assets	17,102	15,872	14,868	11,678	12,136
Present value of funded obligations	(12,673)	(12,137)	(11,550)	(9,582)	(10,496)
Retirement benefit asset	4,429	3,735	3,318	2,096	1,640

17 PROPERTY AND EQUIPMENT

30 June 2012	Freehold land and buildings KShs million	Leasehold land and buildings KShs million	Work in progress KShs million	Motor vehicles KShs million	Furniture and equipment KShs million	Total KShs million
Cost						
At beginning of year (Restated)	1,010	-	325	263	5,444	7,042
Transfers from prepaid operating lease rentals (Note 18)	-	300	-	-	-	300
Additions	25	-	971	95	533	1,624
On revaluation	5,057	1,455	-	-	-	6,512
Disposals	-	-	-	(55)	(2)	(57)
At end of the year	6,092	1,755	1,296	303	5,975	15,421
Accumulated depreciation and impairment losses						
At start of the year	986	-	-	214	2,993	4,193
Transfers from prepaid operating lease rentals (Note 18)	-	32	-	-	-	32
Charge for the year	19	6	-	24	142	191
On revaluation	(986)	(32)	-	-	-	(1,018)
On disposal	-	-	-	(58)	(2)	(60)
At end of the year	19	6	-	180	3,133	3,338
Net carrying value						
At 30 June 2012	6,073	1,749	1,296	123	2,842	12,083

17 PROPERTY AND EQUIPMENT (Continued)

30 June 2011	Land and buildings KShs million	Leasehold land and buildings KShs million	Motor vehicles KShs million	Furniture and equipment KShs million	Total KShs million
Cost					
At beginning of year	1,086	-	217	4,220	5,523
Transfers from Prepaid operating lease rentals (Note 18)		300			300
Additions	249		48	1,225	1,522
Disposals	-	-	(2)	(1)	(3)
At end of the year	1,335	300	263	5,444	7,342
Accumulated depreciation and impairment losses					
At start of the year	964	-	187	3,348	4,499
Transfers from Prepaid operating lease rentals (Note 18)	-	28	-	-	28
Charge for the year	22	4	29	1,015	1,070
On revaluation	-	-	-	(1,369)	(1,369)
On disposal	-	-	(2)	(1)	(3)
At end of the year	986	32	214	2,993	4,225
Net carrying value					
At 30 June 2011	349	268	49	2,451	3,117
30 June 2010:					
Cost					
At start of year	988	-	196	3,813	4,997
Transfers from prepaid operating lease rentals (Note 18)	-	300	-	-	300
Reclassification to intangible asset	-	-	-	(115)	(115)
At 30 June 2009 as restated	988	300	196	3,698	5,182
Additions	98	-	30	522	650
Disposals	-	-	(9)	-	(9)
At end of the year	1,086	300	217	4,220	5,823
Accumulated depreciation and impairment losses					
At beginning of the year	954	-	175	2,834	3,963
Transfers from Prepaid operating lease rentals (Note 18)	-	25	-	-	25
Charge for the year	10	3	21	514	548
On disposal	-	-	(9)	-	(9)
At end of the year	964	28	187	3,348	4,527
Net carrying value					
At 30 June 2010	122	272	30	872	1,296

17 PROPERTY AND EQUIPMENT (Continued)

Property and Equipment were revalued by internal professional valuers 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.

  The valuation methods used were:

  (i) Contractors cost basis

  Under this method, the Bank has used the cost per square foot/ metre and multiply the square foot/metre cost by the structure square footages/metres for a value estimate. The cost per square foot/metre is derived from the current construction costs prevailing in the market and include professional fees, depreciation etc. This method estimated what it would cost to optimally develop the property taking cognisance of the plot size, plot ratio and coverage and permitted plot user ratios under the local authority bylaws, physical planning requirements. The estimated cost includes among others, value of land, cost of all the buildings, site works, professional fees, statutory fees (council approval fees, NEMA, etc).

  As stated above the unit costs can also be derived from an analysis of actual costs. The commercial properties i.e. the Bank's offices are specialized in that there is insufficient market data to value them using some form of comparison (for instance, currency operations, vaults etc) so contractors cost are used as basis of valuation.

  (ii) Investment cost basis valuation

  Although the Bank properties (residential) are owner occupied, prevailing rental values of similar properties were adopted. In this method annual rent less outgoings and capitalized / added element of land value were used to arrive at a value.

  The bank also used comparables of capital values of comparable properties within the same location.

18 PREPAID OPERATING LEASE RENTALS

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

	2012 KShs million	Restated 2011 KShs million	Restated 2010 KShs million
Cost			
At 30 June	300	300	300
Additions	-	-	-
At year end	300	300	300
Amortisation			
At 1 July and end of the year	32	28	25
Net carrying value at end of the year	268	272	275
Transfer to property, plant & equipment (Note 17)	(268)	(272)	(275)
At end of year – as restated	-	-	-

19 INTANGIBLE ASSETS

2012:	Software	Work-in-Progress	Total
Cost			
At the start of the year	236	1,157	1,393
Additions	11	308	319
Transfer from work in progress	1,465	(1,465)	-
At end of the year	1,712	-	1,712
Accumulated amortisation and impairment losses			
At the start of the year	222	-	222
Amortisation for the year	78	-	78
At end of the year	300	-	300
Net carrying value at end of the year	1,412	-	1,412
2011:			
Cost			
At the start of the year	220	842	1,062
Additions	19	315	334
Impairment loss	(3)	-	(3)
At end of the year	236	1,157	1,393
Accumulated amortisation and impairment losses			
At the start of the year	209	-	209
Amortisation for the year	13	-	13
At end of the year	222	-	222
Net carrying value at end of the year	14	1,157	1,171

19 INTANGIBLE ASSETS (Continued)

The costs of software and hardware implemented during the year under System of Integrated Management, Banking and Accounting (SIMBA) Project were fully capitalised during the year.

20 DUE FROM GOVERNMENT OF KENYA

	2012 KShs million	2011 KShs million
At start of the year	32,380	33,102
Accrued interest receivable	875	716
Receipts during the year	(2,381)	(1,438)
At end of the year	**30,874**	**32,380**

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 KShs 1.11 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at fair value. The Directors have assessed the loan for impairment and the amount of the impairment is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate of 3% per annum. The assessment has indicates that the loan is not impaired.

21 CURRENCY IN CIRCULATION

	2012 KShs million	2011 KShs million
Kenya bank notes	154,325	143,022
Kenya coins	4,885	4,690
Commemorative coins	6	6
	159,216	147,718
Balance at the beginning of the year	147,718	125,024
Deposits by banks	(385,210)	(317,596)
Withdrawals by banks	396,708	340,290
Balance at the end of the year	**159,216**	**147,718**

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

Banknotes: 1,000/=, 500/=, 200/=, 100/= and 50/=.
Coins: 40/=, 20/=, 10/=, 5/=, 1/=, /50, /10 and /05.

22 DEPOSITS

	2012 KShs million	2011 KShs million
Local commercial banks (Note 22 a)	97,790	72,731
Local banks forex settlement accounts (Note 22 b)	7,541	5,129
External banks forex settlement accounts	40	310
Other public entities and project accounts	17,587	10,830
Government of Kenya (Note 22 c)	37,684	46,792
	160,642	135,792

(a) Local commercial banks

Clearing accounts and cash reserve ratio	97,790	72,731

The cash reserve ratio is a statutory ratio for monetary policy. Commercial Banks and Non-Bank Financial Institutions (NBFI's) are required to hold at the Central Bank of Kenya a prescribed percentage of their total deposits. The ratio is, depending on monetary policy stance, revised from time to time and is currently standing at 5.25%. The statutory deposits are determined from commercial banks monthly returns submitted to Central Bank of Kenya on or before the tenth day of every month. The banking institutions are required to maintain balances at the Central Bank equivalent to the cash reserve requirement of 5.25% based on monthly averages, but should not fall below 3% at any time. Currently there are 43 licensed commercial banks and 1 mortgage finance company.

(b) Local banks forex settlement accounts

	2012 KShs million	2011 KShs million
Euro	1,178	930
Dollar	5,553	3,698
Sterling Pound	810	501
	7,541	5,129

(c) Government of Kenya

Paymaster General	16,243	20,791
Treasury Funding Account	11,198	17,207
The Exchequer Account	2,672	1,223
Others	7,571	7,571
	37,684	46,792

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

23 INVESTMENTS BY BANKS

	2012 KShs million	2011 KShs million
Term Auction Deposits	22,064	-
Repos sold to Banks	13,609	-
At end of the year	35,673	-

Investments by banks are due to mopping up of excess liquidity in the market which is managed through issue of securities at a discount and term deposits which attract interest from commercial banks

24 OTHER LIABILITIES

	2012 KShs million	2011 KShs million
Impersonal accounts	204	4,095
Sundry creditors	751	3,285
Bonds pending payables	214	1,536
Refundable deposits	586	531
	1,755	9,447

25 DIVIDENDS PAYABLE

Dividends payable	-	2,641
The movement in dividends payable is as follows:		
Balance at 1 July	2,641	2,641
Dividends approved in the year	-	-
Paid during the year	(2,641)	-
Funds earmarked for an on-going project	-	2,641

26 ACCRUALS

Leave accrual	101	75
Gratuity to staff members	48	23
	149	98

27 SHARE CAPITAL

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

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

28 GENERAL RESERVE FUND

The general reserve fund is a fund into which at least 10% of the net annual profits of the Bank are transferred at the end of each financial year. This is after allowing for expenses for operation and after allowance has been made for bad and doubtful debts, depreciation of assets, contribution to staff benefit fund, and such other contingencies and provisions as the Bank deems appropriate. The Bank utilises funds accumulated in this account to pay for acquisition of assets, pay dividends once declared by the Board of Directors, increase paid up capital when necessary and to absorb any negative external shocks. The movement during this year is as follows:

	2012 KShs million	2011 KShs million
At 1 July	62,722	23,166
(Loss)/profit for the year	(25,854)	39,556
Fair value on leasehold land	1,489	-
Proposed dividends	(1,500)	-
As at 30 June	36,857	62,722

29 REVALUATION RESERVE

Revaluation reserves arise from the periodic revaluation of land and buildings. Buildings were revalued by internal professional valuers on an open market basis as per fixed asset policy and as part of harmonisation initiatives within the region partner states Central Banks and the resulting revaluation surplus has been included in the revaluation reserve. The movement during the year is as follows:

	2012 KShs million	2011 KShs million
At 1 July	1,369	-
Revaluation surplus in the year	6,041	1,369
As at 30 June	7,410	1,369

30 DIVIDENDS

The Board of Directors recommends payment of a dividend of KShs 1.5 billion (2011: Nil).

31 NOTES TO THE CASH FLOW STATEMENT

(a) Reconciliation of net (loss)/profit before tax to cash flow from operating activities

	2012	Restated 2011
Cash flows from operating activities	**KShs million**	**KShs million**
Net (loss)/profit for the year	(25,854)	39,556
Adjustments for:		
Depreciation of property and equipment	191	1,070
Amortization of intangible assets	78	13
Impairment loss on intangible assets	-	3
Exchange rate loss /(gains)effects	25,111	(40,017)
Gain on disposal of property and equipment	(2)	(1)
Surplus in defined benefit scheme	(296)	(4)
Operating (loss)/profit before working capital changes	(771)	620
Net increase in loans and advances	19,825	(9,968)
Decrease in balance with International Monetary Fund	531	18,553
(Increase)/decrease in Project accounts	(7,038)	1,205
Decrease in accrued interest on balances due from banking institutions	161	16
Decrease/(increase) in items in the course of collection	76	(93)
Increase/(decrease) in deposits	24,850	(7,436)
Decrease/(increase) in other assets	3,161	(583)
Increase in currency in circulation	11,498	22,694
Increase in Investment by banks	35,672	-
Decrease in other liabilities and accruals	(7,641)	(42)
Net cash generated by operations	80,324	24,966

(b) Cash and cash equivalents

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

	2012 KShs million	2011 KShs million
Term deposits	335,219	316,679
Current accounts	39,032	2,640
Domestic forex cheques clearing	8,098	5,572
Travellers Cheques	-	-
Gold holdings	74	76
	382,423	324,967
Advances to Banks	9,973	49
Investments with RAMP	42,533	37,734
	434,929	362,750

32 RELATED PARTY TRANSACTIONS

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

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 14) include advances to employees that as at 30 June 2012 amounted to KShs 3,577 million (2011: KShs 3,220 million). The advances are at preferential rates of interest determined by the Bank.

		2012 KShs million	2011 KShs million
(ii)	**Loans to executive directors**		
	At start of the year	3	6
	Loans advanced during the year	3	-
	Loan repayments	(3)	(3)
	At end of the year	3	3
(iii)	**Loans to key management personnel**		
	At start of the year	62	39
	Loans advanced during the year	22	57
	Loan repayments	(33)	(34)
	At end of the year	51	62
(iv)	**Directors' emoluments:**		
	Fees to non executive directors	16	7
	Other remuneration to executive directors	53	50
		69	57
(v)	**Remuneration to senior management**	164	172
(vi)	**Post –employment pension**	2	2

(vii) Government of Kenya

Transactions entered into with the Government include:

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

32 RELATED PARTY TRANSACTIONS (Continued)

(vii) *Government of Kenya - continued*

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

	2012 KShs million	2011 KShs million
Due from Government of Kenya (Note 20)	30,874	32,380
Overdraft account (Note 14)	7,257	7,571
Loan from IMF to the Government of Kenya (Note 14)	-	(3)
Government of Kenya deposits (Note 22)	37,684	46,792

(viii) *Deposit Protection Fund Board*

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

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was KShs 14 million (2011: KShs 86million).

(ix) *Kenya School of Monetary Studies*

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

33 RISK MANAGEMENT

(a) Structure and Reporting

The Board of Directors is responsible for the overall risk management approach and for approving the risk management policy and strategies. Other organs that monitor the assessment and management of risks within the Bank include:

(i) Audit Committee of the Board

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

(ii) Bank Risk Management Committee

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

33 RISK MANAGEMENT (Continued)

(a) Structure and Reporting (continued)

(iii) Internal Audit Department (IA)

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

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

(b) Strategy in using financial instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate 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.

33 RISK MANAGEMENT (Continued)

(c) **Risks facing the Bank**

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

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

(i) Financial risks

Credit risk

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

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

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

33 **RISK MANAGEMENT (Continued)**

(c) **Risks facing the Bank (continued)**

(i) Financial risks - continued

Credit risk - continued

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

	2012 KShs million	2011 KShs million
Individually impaired:		
Staff loans	42	49
Other financial asset	4,686	-
Banks in liquidation	3,706	3,766
	8,434	3,815
Allowance for impairment	(8,411)	(3,784)
	23	31
Loans past due but not impaired:		
Past due up to 30 days	30,874	32,380
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	-	-
	30,874	32,380
Loans neither past due nor impaired:		
Staff loans and advances	3,534	3,171
Overnight lending to commercial banks	-	19,873
Goverment Overdraft	7,257	7,571
	10,791	30,615

The Bank undertakes its operations in the Republic of Kenya. An analysis of the Bank's financial assets and financial liabilities by geographical area is given below:
The bank's exposure to credit risk is analysed as follows:

	2012 KShs Millions	2011 KShs Millions
Financial assets		
Republic of Kenya	9,973	49
United Kingdom	58,785	75,503
Rest of Europe	114,876	82,717
United states of America	59,192	209,025
Rest of the World	148,445	40
	391,271	367,334
Financial liabilities		
Republic of Kenya	295,241	217,621

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk

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

As at 30 June 2012	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.21-1.18%	424,956	127	-	12,878	437,961
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,200	-	2,200
Items in the course of collection	-	-	-	-	333	333
Advances to Banks	-	9,973	-	-	-	9,973
Loans and advances	3%	93	333	10,391	-	10,817
Other assets	-	-	-	-	2,224	2,224
Property, plant and equipment	-	-	-	-	12,083	12,083
Intangible assets	-	-	-	-	1,412	1,412
Retirement benefit assets	-	-	-	-	2,193	2,193
Due from Government of Kenya	3%	875	1,110	28,889	-	30,874
Total assets		435,897	1,570	41,480	31,123	510,070

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Interest risk - continued

As at 30 June 2012	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Liabilities and equity						
Currency in circulation	-	-	-	-	159,216	159,216
Deposits	-	-	-	-	160,642	160,642
Amounts due to International Monetary Fund	-	-	-	-	101,868	101,868
Investments by Banks	-	-	-	-	35,673	35,673
Other liabilities	-	-	-	-	1,755	1,755
Provisions	-	-	-	-	149	149
Dividends payable	-	-	-	-	-	-
Equity and reserves	-	-	-	-	50,767	50,767
Total liabilities and equity		-	-	-	510,070	510,070
Interest sensitivity gap 2012		435,897	1,570	41,480	478,947	-

33 **RISK MANAGEMENT (Continued)**

(c) **Risks facing the Bank (continued)**

(i) Financial risks - continued

As at 30 June 2011	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Assets						
Balances due from banking institutions and gold holdings	0.21-1.18%	362,655	334	-	5,846	368,835
Funds held at International Monetary Fund (SDR Account)	0-0.5%	-	-	2,731	-	2,731
Items in the course of collection	-	-	-	-	409	409
Advances to Banks	-	49	-	-	-	49
Loans and advances	3%	19,984	333	10,325	-	30,642
Other assets	-	-	-	-	5,385	5,385
Property, plant and equipment	-	-	-	-	3,117	3,117
Retirement benefit asset	-	-	-	-	1,897	1,897
Intangible assets	-	-	-	-	1,171	1,171
Due from Government of Kenya	3%	1,271	1,110	29,999	-	32,380
Total assets		383,959	1,777	43,055	17,825	446,616
Liabilities and equity						
Currency in circulation	-	-	-	-	147,718	147,718
Deposits	-	-	-	-	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	-	81,829	81,829
Other liabilities	-	-	-	-	9,447	9,447
Provisions	-	-	-	-	98	98
Dividends payable	-	-	-	-	2,641	2,641
Equity and reserves	-	-	-	-	69,091	69,091
Total liabilities and equity		-	-	-	446,616	446,616
Interest sensitivity gap 2011		383,959	1,777	43,055	446,616	-

33 **RISK MANAGEMENT (Continued)**

(c) **Risks facing the Bank (continued)**

(i) Financial risks - continued

Sensitivity analysis on interest rate risk

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

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 33(c). The sensitivity computations assume that financial assets maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2012 KShs million	2011 KShs million
Effect on profit before tax of a +10% change in interest rates	630	621
Effect on profit before tax of a -10% change in interest rates	(630)	(621)

Foreign currency exchange rate risk

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

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

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

USD: 58 - 68%
GDP: 09 - 19%
EUR: 18 - 28%
CHF: 00 - 5%

The net foreign currency position of the Bank as of 30 June 2012 and 2011 is summarized below. The table presented below provides the Bank's financial assets, and financial liabilities, at carrying amounts, categorized by currency.

33 **RISK MANAGEMENT (Continued)**

(c) **Risks facing the Bank (continued)**

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

The various currencies to which the Bank is exposed at 30 June 2012 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	285,886	69,844	81,792	-	-	365	437,887
Special Drawing Rights	-	-	-	2,200	-	-	2,200
Gold holdings	-	-	-	-	74	-	74
Total financial assets	285,886	69,844	81,792	2,200	74	365	440,161
Liabilities							
Balances due to IMF	-	-	-	101,868	-	-	101,868
Local Banks forex settlements	5,553	810	1,178	-	-	-	7,541
Local bank guarantees	376	-	-	-	-	-	376
Bonds pending payables	214	-	-	-	-	-	214
Forex bureaux deposits	210	-	-	-	-	-	210
Total financial liabilities	6,353	810	1,178	101,868	-	-	110,209
Net statement of financial position at 30 June 2012	279,533	69,034	80,614	(99,668)	74	365	329,952

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Foreign currency exchange rate risk - continued

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

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

Sensitivity analysis on currency risk

Currency risk is the risk of loss resulting from changes in exchange rates. The Bank bases its analysis on the interest sensitivity gap (Note 33). 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.

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

	2012 KShs million	2011 KShs million
Effect on profit before tax of a +7% change in exchange rates	23,096	19,778
Effect on profit before tax of a -7% change in exchange rates	(23,096)	(19,778)

Liquidity risk

Liquidity risk is defined as not having sufficient cash to meet the commitments that are due or being compelled to convert assets into cash at a price lower than their fair value. The choice of the types of instruments to invest the reserves in is part of liquidity risk management. The available instruments are governed by Section 26 of the Central Bank of Kenya Act which specifies the eligible instruments in which the Bank can invest its reserves including; gold, demand or time deposits and convertible and marketable securities of or, guaranteed by foreign governments or international financial institutions.

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

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(i) Financial risks - continued

Liquidity risk - continued

The table below analyses financial liabilities into relevant maturity groupings based on the remaining period at 30 June 2012 to the contractual maturity date.

LIABILITIES	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	159,216	159,216
Deposits	147,764	-	12,878	-	-	160,642
Amounts due to International Monetary Fund	-	-	-	-	101,868	101,868
Other liabilities	-	-	1,755	-	-	1,755
Accruals		-	149	-	-	149
Investment by banks	-	35,672	-	-	-	35,672
TOTAL FINANCIAL LIABILITIES	147,764	35,672	14,782	-	261,084	459,302
Liquidity gap 2012	(147,764)	(35,672)	(14,782)	-	(261,084)	(459,302)

33 **RISK MANAGEMENT (Continued)**

(c) **Risks facing the Bank (continued)**

(i) Financial risks - continued

Liquidity risk - continued

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

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

33 RISK MANAGEMENT (Continued)

(c) Risks facing the Bank (continued)

(ii) Non-financial risks

Operational risk

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

The assessment of risks in terms of their effects and probabilities of occurrence and the adequacy, effectiveness and efficiency of the controls established to mitigate the risks is done through audits and risk assessments conducted by the Risk Management Department Division.

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 for its staff as an effort to improve its human resource requirements.

Legal risk

Legal risks arise from any uncertainty of enforceability, whether through legal or judicial processes, of the obligations of the Bank's clients and counter parties. These are the risks that the Bank may not be complying fully with the relevant laws and legislations. The Bank aims at minimizing such uncertainties through continuous consultations with all relevant parties. In mitigating these types of the risks, the Bank ensures that all business agreements are subjected to extensive legal reviews before contracting.

Reputation risk

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

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

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

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

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

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

30 June 2012:	Held for trading KShs million	Held-to-maturity KShs million	Loans and receivables KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Financial assets						
Balances due from banking institutions and Gold holdings	42,612	335,637	60,082	-	438,331	438,331
Funds held at International Monetary Fund	-	-	2,200	-	2,200	2,200
Items in the course of collection	-	-	333	-	333	333
Advances to Banks	-	-	9,973	-	9,973	9,973
Loans and advances	-	-	10,817	-	10,817	10,817
Other assets	-	-	2,224	-	2,224	2,224
Due from Government of Kenya	-	-	30,874	-	30,874	30,874
Total financial assets	42,612	335,637	116,503	-	494,752	494,752
Financial liabilities						
Currency in circulation	-	-	-	159,216	159,216	159,216
Deposits	-	-	-	160,642	160,642	160,642
Amounts due to International Monetary Fund	-	-	-	101,868	101,868	101,868
Investment by banks	-	-	-	35,672	35,672	35,672
Other liabilities and provisions	-	-	-	1,755	1,755	1,755
Total financial liabilities	-	-	-	459,153	459,153	459,153

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

30 June 2011:	Held for trading KShs million	Held-to-maturity KShs million	Loans and receivables KShs million	Other amortised cost KShs million	Total carrying amount KShs million	Fair value KShs million
Financial assets						
Balances due from banking institutions and Gold holdings	37,734	316,967	14,134	-	368,835	368,835
Funds held at International Monetary Fund	-	-	2,731	-	2,731	2,731
Items in the course of collection	-	-	409	-	409	409
Advances to Banks	-	-	49	-	49	49
Loans and advances	-	-	30,642	-	30,642	30,642
Other assets	-	-	5,385	-	5,385	5,385
Due from Government of Kenya	-	-	32,380	-	32,380	32,380
Total financial assets	37,734	316,967	85,730	-	440,431	440,431
Financial liabilities						
Currency in circulation	-	-	-	147,718	147,718	147,718
Deposits	-	-	-	135,792	135,792	135,792
Amounts due to International Monetary Fund	-	-	-	81,829	81,829	81,829
Other liabilities and provisions	-	-	-	9,545	9,545	9,545
Total financial liabilities	-	-	-	374,884	374,884	374,884

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

Valuation hierarchy

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

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

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2012:

30 June 2012:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Total KShs million**
Assets				
Balances due from banking institutions and Gold holdings	42,612	-	-	42,612
Staff loans and advances	-	3,577	-	3,577
Total assets	42,612	3,577	-	46,189

30 June 2011:	**Level 1 KShs million**	**Level 2 KShs million**	**Level 3 KShs million**	**Total KShs million**
Assets				
Balances due from banking institutions and Gold holdings	37,734	-	-	37,734
Staff loans and advances	-	3,220	-	3,220
Total assets	37,734	3,220	-	40,954

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

The effective interest rates for the principal financial assets and financial liabilities at 30 June 2012 and 2011 were in the following ranges:

	2012	2011
Financial assets		
Government securities	6.00%	6.00%
Deposits with overseas correspondent banks:		
- current accounts		
- term deposits (USD)	0.17%	0.21%
- term deposits (Sterling Pounds)	0.40%	0.71%
- term deposits (Euro)F	0.18%	1.18%
Loans and advances:		
- commercial banks	6.50%	6.50%
- Government of Kenya	3.0%	3.0%
- employees	3.0%	3.0%
Financial liabilities	0.0%	0.0%
- deposits	0.36%	0.36%

35 CONTINGENCIES

The Bank is party to various legal proceedings with potential liability of KShs 266.5 million as at 30 June 2012 (2011- KShs 266.5 million). Having regard to all circumstances and the legal advice received, the directors are of the opinion that these legal proceedings will not give rise to liabilities.

36 COMMITMENTS	2012 KShs million	2011 KShs million
Capital: Authorised and not contracted for		
Office furniture	-	1
Office equipment	24	26
Computer equipment	10	27
Computer equipment - SIMBA Software	12	4
Fixtures & fittings	5	1
Motor vehicles	-	31
Other	2	64
	53	154

37 TAXES

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

38 RESTATEMENT OF PRIOR YEAR BALANCE SHEETS

During the year, the bank amended its accounting policy on leasehold land and property to comply with International Accounting Standards number 17 (Leases) with respect to valuation of leasehold land and properties. The accounting policy was changed to carry leasehold land and properties at valuation rather than cost. The balance sheets as at 30 June 2011 and 2010 have been restated to present the changes noted above. The effect of the restatement is shown in Notes 17 and 18 of these financial statements.