REPUBLIC OF KENYA

OFFICE OF THE AUDITOR-GENERAL

REPORT

OF

THE AUDITOR-GENERAL

ON

THE FINANCIAL STATEMENTS OF CENTRAL BANK OF KENYA

FOR THE YEAR ENDED 30 JUNE 2016

CENTRAL BANK OF KENYA

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2016

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Board of Directors

Mr. Mohammed Nyaoga	Chairman
Dr. Patrick Njoroge	Governor
Dr. Kamau Thugge	Principal Secretary, the National Treasury

Executive Management

Dr. Patrick Njoroge	Governor
Ms. Sheila M'Mbijjewe	Deputy Governor

Heads of Department

Mr. Kennedy Abuga	Director - Governors' Office
Mr. Charles Koori	Director - Research Department
Mr. Gerald Nyaoma	Director - Bank Supervision Department
Mr. Mark Lesiit	Director - Banking, National Payments and Risk Management Department
Ms. Rose Detho	Director - Strategic Management Department
Mr. William Nyagaka	Director - Internal Audit Department
CPA. Peter Rotich	Director – Finance and ICT Department
Mr. John Birech	Acting Director - Financial Markets Department
Ms. Terry Nganga	Acting Director - Human Resource and Administration Department
Mr. Paul Wanyagi	Acting Director – Currency Operations and Branch Administration Department
Eng. Erastus Miriti	Acting Director - Department of Procurement, Logistics and Supplies
Prof. Kinandu Muragu	Executive Director – Kenya School of Monetary Studies

Registered office and principal place of business

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

Branches

Mombasa Branch
Central Bank of Kenya Building
Nkurumah Road
P.O. Box 86372
80100 Mombasa

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

Eldoret Branch
Kiptagich House
Uganda Road
P.O. Box 2710
30100 Eldoret

Currency centres

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

Meru Currency Centre
Co-operative Bank Building
Njuri Ncheke Street
P.O. Box 2171
60200 Meru

Nakuru Currency Centre
Central Bank of Kenya Building
George Morara Street
P.O. Box 14094
20100 Nakuru

Subsidiary

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

Main Lawyers

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

Auditor

Deloitte & Touche
Deloitte Place
Waiyaki way, Muthangari
P.O. Box 40092
00100 Nairobi

On behalf of:-
The Auditor General
Kenya National Audit Office
Anniversary Towers
P.O. Box 30084
00100 Nairobi

1. Statement of Corporate Governance

The Central Bank of Kenya (the "Bank"/"CBK") is established under Article 231 of the Constitution, 2010 and is wholly owned by the Government of Kenya. Under this Article the Central Bank has the responsibility of formulating monetary policy, promoting price stability, issuing currency and performing any other functions conferred on it by an Act of Parliament. Whilst the Constitution grants the Bank authority and autonomy, the Bank is committed to maintaining the highest standards of integrity, accountability, professionalism and business ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act (the "Act") provides that the Board of Directors (the "Board") shall be composed of a Chairperson, a Governor, and the Principal Secretary to the National Treasury who is a non-voting member and five Non-Executive Directors. Previously, all the Board members were appointed directly by the President of the Republic of Kenya, (the "President") without an intermediate vetting process. With effect from 2 May 2012, however, the Act was amended and now requires that the President appoints the Governor after the conduct of a competitive process and following the approval of Parliament. The proposed procedure for appointing the Chairperson is similar to the appointment procedure applicable to the Governor. Other than the Principal Secretary to the National Treasury who is an ex-officio member, all the Non-Executive members of the Board are appointed by the President for terms of four years each and are eligible for reappointment provided that no Board Member holds office for more than two terms. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

The Chairman of the Board of Directors, Mr Mohammed Nyaoga, was appointed on 19th June 2015 through a competitive recruitment process. The independent Non-Executive Board members are yet to be appointed to replace the retired members.

The Board is required to meet once every two months and has a formal schedule of agenda items due for deliberations. The Board Members are given appropriate and timely information to enable them provide and maintain full and effective direction and control over strategic and policy issues of the Bank. 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 approval and oversight of the policies of the Bank.

The Members of the Board (all Kenyan) in the year ended 30 June 2016 are listed in the table below. No meetings were held in the year under review due to lack of quorum.

No	Name	Position	Discipline/Professional Background	Date of Appointment	Meetings Attended
1	Mr. Mohammed Nyaoga	Chairman	Lawyer	Appointed – 19 June 2015	-
2	Dr. Patrick Njoroge	Governor	Economist	Appointed – 19 June 2015	-
3	Principal Secretary/ National Treasury	Ex-Officio	Economist	Permanent Member of the Board	-

The remuneration paid to the Board Directors for services rendered during the financial year 2015/2016 is disclosed in Note 28 to the financial statements. The Non-Executive Board Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Board Directors during the year, while Executive Directors are paid a monthly salary and are eligible for staff loans.

1. Statement of Corporate Governance (continued)

1.2 Monetary Policy Committee (MPC)

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

During the FY2015/16, the MPC formulated monetary policy to achieve and maintain overall inflation within the allowable margin of 2.5 percent on either side of the 5 percent target. Overall month-on-month inflation remained within the Government target range except in December 2015 and January 2016, largely due to high food prices and the impact of the revised Excise taxes implemented from 1st December 2015. The foreign exchange market was volatile at the beginning of the FY2015/16 due to the impact of the devaluation of the Chinese Yuan, and strengthening of the U.S. dollar against most currencies. Nevertheless, the foreign exchange market stabilised since September 2015 supported by a narrower current account deficit due to lower imports of petroleum products, improved earnings from tea and horticulture exports, and strong diaspora remittances. The moderate petroleum product prices coupled with the stability of the Shilling moderated any risks of imported inflation

The CBK held regular meetings with the Chief Executive Officers of banks to discuss the background to MPC decisions, and obtain feedback from the market. The Governor also held regular press conferences to brief the media on the background to MPC decisions and financial sectors developments. The forums have improved the understanding of monetary policy decisions and enhanced the transmission mechanism of monetary policy.

The MPC held 7 meetings in the year ended 30 June 2016 and attendance was as follows:

No	Name	Position	Discipline	Meetings Attended
1	Dr. Patrick Njoroge	Chairman	Economist	7
2	Ms. Sheila M'Mbijjewe	Vice Chairperson	Finance/ Accountancy	7
3	Dr. Haron Sirima≠	Vice Chairman	Economist	3
4	Mr.Nzomo Mutuku	Representative of the Principal Secretary of the National Treasury	Economist	5
5	Prof. Francis Mwega	Member	Economist	7
6	Mrs. Farida Abdul	Member	Economist	7
7	Mr. Charles Koori	Member (Internal)	Economist	6
8	Mr. John Birech	Member (Internal)	Economist	7

≠ Was Vice Chairman up to 23rd October 2015 when his term ended.

1.3 Management Structure

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

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

1.4 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 embedded the *Staff Rules and Regulations* and the Employment Act 2007, apply to the entire Bank's staff.

1.5 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 done strictly in accordance with the Public Procurement & Disposal Act, 2015. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.6 Authorizations

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

1.7 Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. The 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 the Risk Management Unit are availed to the Audit Committee of the Board.

1.8 Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explain current monetary policy and also provide the expected monetary policy stance. In addition, the Bank issues policy briefs to the National Treasury on both the monetary and fiscal policies. On an annual basis, the financial statements are published in the Kenya Gazette and are also placed in the Bank's website.

2. Financial Performance

The Bank's financial Performance is affected by monetary policy stance adopted, money supply, interest rates and exchange rates. The Bank's financial performance is presented on page 10 of these financial statements.

During the financial year ended 30 June 2016, the Bank's net interest income after the impairment charge was Shs 11,917 million (2015: Shs 4,245 million). This category generated income of Shs 15,933 million against the budgeted estimates of Shs 8,960 million with the foreign earnings almost doubling on account of increased USD, GBP & AUD deposit levels as well as higher than anticipated interest earnings. The growth in deposits was achieved largely through flows from syndicated loan which helped boost Foreign exchange reserves.

However, this increase was diminished by higher monetary policy expenses arising from volatile market conditions and the monetary policy stance adopted. This resulted in increased sale of repos as well as rediscounted securities during the year. The Bank incurred unrealized foreign exchange loss of Shs 19,969 million against a record gain of Shs 40,740 million in June, 2015. The loss arose largely from the weakening of the Sterling Pound against other major currencies following the outcome of Brexit referendum vote in the last week of June, 2016.

Trading income generated mainly from the sale of foreign currency declined to Shs 6,446 million (2015: Shs 8,198 million) due to lower market interventions in the year under review. Additionally, there were lower earnings from the processing of foreign currency transactions.

Administrative expenses declined to Shs 8,091 million (2015: Shs 8,762 million) as a result of revaluation gains from retirement benefits assets of Shs 1,835 million (2015: Shs 1,241 million). In addition, currency costs decreased during the year to Shs 1,880 million from Shs 1,965 million in 2015. Staff expenses stood at Shs 2,122 million (2015: 3,059 million).

The outcome of the Bank's operations was a net deficit of Shs 4,640 million compared to a net surplus of Shs 49,725 million in June, 2015 that has been added to the General Reserve Fund.

The financial position for the year is set out on page 11. The Bank's assets increased to Shs 982,849 million (2015: Shs 805,369 million) attributed partially to receipt of syndicated loan proceeds of USD 343M (equivalent to Shs 35,000 million) in October, 2015 and USD 385 million (equivalent to Shs 39,300 million) received in December, 2015 and sold to CBK through SCB (London).

Advances to banks, mainly through discounting of securities, grew to Shs 44,679 million (2015: Shs 75 million), this was to address challenges posed by liquidity segmentation in the interbank market.

Liabilities also increased to Shs 865,856 million (2015: Shs 683,736 million) attributed mainly to growth in Government deposits arising from increased funding of State projects by development partners. The increase in Government deposits was shs172,000 million which accounted for 98% of the change in liabilities.

Director's Report

The Directors submit their report together with the audited financial statements for the year ended 30 June 2016, which shows the state of affairs of Central Bank of Kenya (the "Bank"/"CBK").

Incorporation

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

Principal Activities

The Bank is established and administered under the Constitution of Kenya, 2010 with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

Results and Dividend

The deficit for the year of Shs 4,640 million (2015: Shs 49,725 million) has been added to the General Reserve Fund. The Directors do not recommend the payment of a dividend (2015: Nil).

Board of Directors

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

Auditor

The Auditor General is responsible for the statutory audit of the Bank's financial statements in accordance with Section 35 of the Public Audit Act, 2015. Section 23(1) of the Act empowers the Auditor General to appoint other auditors to carry out the audit on his behalf. Accordingly, Deloitte & Touche were appointed to carry out the audit for the year ended 30 June 2016.

By order of the Board

Kennedy Abuga
Board Secretary

9th September 2016

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

The Directors accept responsibility for the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error. They also accept responsibility for:

(i) Designing, implementing and maintaining internal control necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;

(ii) Selecting and applying appropriate accounting policies; and

(iii) Making accounting estimates and judgments that are reasonable in the circumstances.

The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial position of the Bank at 30 June 2016 and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

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

Approved by the Board of Directors and signed on its behalf by:

Mr Mohammed Nyaoga
Chairman, Board of Directors

9th September, 2016

Patrick Njoroge

Dr Patrick Njoroge
Governor, Central Bank of Kenya

9th September, 2016

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HARAMBEE

OFFICE OF THE AUDITOR-GENERAL

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2016

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Central Bank of Kenya set out on pages 10 to 51 which comprise the consolidated statement of financial position as at 30 June 2016, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Delloitte and Touché, auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Management's Responsibility for the Financial Statements

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

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

Auditor-General's Responsibility

My responsibility is to express an opinion on these financial statements based on the audit and report in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229 of the Constitution. The audit was conducted in accordance with International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Central Bank of Kenya as at 30 June 2016, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Central Bank Act, Cap 491 of the Laws of Kenya.

FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

27 September 2016

Consolidated Statement of Profit or Loss and other Comprehensive Income

	Notes	Year ended 30 June 2016	2015
		Shs' million	Shs' million
Interest income	4	15,933	6,230
Interest expense	5	(3,957)	(1,977)
Net interest income		11,976	4,253
Impairment of loans and advances	15	(59)	(8)
Net interest income		11,917	4,245
Fees and commission income		3,000	3,000
Net trading income	6	6,446	8,198
Other income	7	536	686
Operating income		21,899	16,129
Operating expenses	8	(8,091)	(8,762)
Operating surplus before unrealised (losses)/ gains		13,808	7,367
Unrealised (losses) /gains:			
Foreign exchange (loss) /gain		(19,969)	40,740
Fair value gain on financial assets held for trading		347	24
(Deficit)/ surplus for the year		(5,814)	48,131
Other comprehensive income			
Actuarial gain/ (loss) in retirement benefit asset	17	1,174	(4,343)
Land and buildings revaluation gain	18	-	5,937)
Total comprehensive (loss)/ income for the year		(4,640)	49,725

The notes on pages 15 to 51 are an integral part of these financial statements.

Consolidated Statement of Financial Position

	Notes	2016 Shs' million	2015 Shs' million
Assets			
Balances due from banking institutions	10	696,004	591,962
Funds held with International Monetary Fund (IMF)	13(a)	1,923	4,385
Securities discounted by banks and other advances	14	44,679	75
Loans and advances	15	2,566	2,333
Financial assets at fair value through profit or loss	11	133,253	113,006
Investments securities – Available-for-sale	12	9	9
Other assets	16	4,285	4,531
Property and equipment	18	22,385	20,743
Intangible assets	19	207	494
Retirement benefit asset	17	7,776	4,668
Due from Government of Kenya	20	69,762	63,163
Total assets		982,849	805,369
Liabilities			
Currency in circulation	21	234,751	222,178
Deposits from banks and government	22	496,044	331,316
Due to International Monetary Fund (IMF)	13(b)	122,438	125,775
Liquidity deposits	23	7,843	-
Other liabilities	24	4,780	4,467
Total liabilities		865,856	683,736
Equity and reserves			
Share capital	25	5,000	5,000
General reserve fund		97,203	101,843
Revaluation reserve		14,790	14,790
Total equity		116,993	121,633
Total equity and liabilities		982,849	805,369

The financial statements on pages 10 to 51 were authorised for issue by the Board of Directors on 9th September 2016 and signed on its behalf by:

Patrick Njoroge

Mr. Mohammed Nyaoga
Chairman, of the Board

Dr. Patrick Njoroge
Governor, Central Bank of Kenya

Consolidated Statement of Changes in Equity

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Total Shs' million
Year ended 30 June 2015					
Balance at 1 July 2014 as previously reported		5,000	56,539	8,853	70,392
Restatement on change in accounting policy for coin minting costs	16	-	1,516	-	1,516
As restated on 1 July 2014		5,000	58,055	8,853	71,908
Surplus for the year		-	48,131	-	46,779
Land and buildings revaluation gain	18	-	-	5,937	5,937
Actuarial losses in retirement benefit asset	17	-	(4,343)	-	(4,343)
Total comprehensive income for the year		-	43,788	5,937	49,725
Balance at 30 June 2015		5,000	101,843	14,790	121,633

Note:

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

- *The share capital and proposed dividend reserve have been described in note 2 (n) and 2 (o) respectively.*

The notes on pages 15 to 51 are an integral part of these financial statements.

Consolidated Statement of Changes in Equity (continued)

	Notes	Share Capital Shs' million	General Reserve Fund Shs' million	Revaluation reserve Shs' million	Total Shs' million
Year ended 30 June 2016					
Balance at 1 July 2015		5,000	101,843	14,790	121,633
Deficit for the year		-	(5,814)	-	(5,814)
Actuarial gains in retirement benefit asset	17	-	1,174	-	1,174
Total comprehensive loss for the year		-	(4,640)	-	(4,640)
Balance at 30 June 2016		5,000	97,203	14,790	116,993

Note:

- *The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.*
- *The share capital and proposed dividend reserve have been described in note 2 (n) and 2 (o) respectively.*

The notes on pages 15 to 51 are an integral part of these financial statements.

Consolidated Statement of Cash flows

	Notes	Year ended 30 June 2016 Shs' million	2015 Shs' million
Net cash generated from/ (used in) operating activities	26	172,352	(44,802)
Cash flows from investing activities			
Purchase of property and equipment	18	(2,592)	(1,726)
Purchase of intangible assets	19	-	(98)
Proceeds from disposal of property and equipment		8	17
Net (purchase) / sale of financial assets			
- Fair value through profit or loss		(9,309)	(38,352)
- Held to maturity		69,906	(361,154)
- Available-for-sale		-	(3)
-Advances to the Bank		(2,762)	
- Funds held with International Monetary Fund (IMF)		2,462	(3,693)
Net cash generated from/ (used in) investing activities		57,713	(405,009)
Cash flows from financing activities			
Repayments to the International Monetary Fund (IMF)		(3,337)	(4,289)
Net cash used in financing activities		(3,337)	(4,289)
Increase/ (decrease) in cash and cash equivalents		226,728	(454,100)
Cash and cash equivalents at start of year		194,865	648,965
Cash and cash equivalents at end of year	27	421,593	194,865

The notes on pages 15 to 51 are an integral part of these financial statements.

Notes

1 General information

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

2 Summary of significant accounting policies

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

(a) Basis of preparation

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

Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

Amendments to IAS 19 Defined Benefit Plans: Employee Contribution clarify the accounting treatment for contributions from employees or third parties to a defined benefit plan. According to the amendments, discretionary contributions made by employees or third parties reduce service cost upon payment of these contributions to the plan. When the formal terms of the plan specify contributions from employees or third parties, the accounting depends on whether the contributions are linked to service. The amendment did not have a significant effect on the Bank financial statements.

Annual Improvements to IFRSs 2010 - 2012 Cycle which include amendments to a number of IFRSs:

- IFRS 3 Business Combinations, that clarifies that contingent consideration should be measured at fair value at each reporting date, irrespective of whether or not the contingent consideration falls within the scope of IFRS 9 or IAS 39. Changes in fair value (other than measurement period adjustments as defined in IFRS 3) should be recognised in profit and loss.

- IFRS 8 Operating Segments,that requires an entity to disclose the judgements made by management in applying the aggregation criteria to operating segments, including a brief description of the operating segments aggregated and the economic indicators assessed in determining whether the operating segments share similar economic characteristics.
- IFRS 13 Fair Value Measurement. The amendment to the basis for conclusions of IFRS 13 clarifies that the issuance of IFRS 13 and consequential amendments to IAS 39 and IFRS 9 did not remove the ability to measure short- term receivables and payables with no stated interest rate at their invoice amounts without discounting.
- IAS 24 Related Party Disclosures. The amendment clarifies that a management entity providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity.

The Bank has applied the amendments and there has been no significant impact on the Bank financial statements as a result.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

Changes in accounting policy and disclosures (continued)

(i) New and amended standards adopted by the Bank (continued)

Annual Improvements to IFRSs 2011 - 2013 Cycle which include amendments to a number of IFRSs:

-IFRS 13 Fair Value Measurement. The amendment clarifies that the scope of the portfolio exception for measuring the fair value of a Bank of financial assets and financial liabilities on a net basis includes all contracts that are within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, even if those contracts do not meet the definitions of financial assets or financial liabilities.

The application of other amendments and interpretations which are effective for the financial year beginning on 1 July 2015 had no impact on the disclosures or amounts recognised in the financial statements.

(ii) New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 July 2016, and have not been applied in preparing these financial statement. None of these is expected to have a significant effect on the financial statements of the Bank, except the following set out below:

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2015. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Bank is yet to assess IFRS 9's full impact.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 and earlier application is permitted. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

Notes (continued)

2 Summary of significant accounting policies (continued)

(a) Basis of preparation (continued)

Changes in accounting policy and disclosures (continued)

Amendments to IAS 1 Disclosure Initiative. The amendments were a response to comments that there were difficulties in applying the concept of materiality in practice as the wording of some of the requirements in IAS 1 had in some cases been read to prevent the use of judgement. An entity should not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions. The amendments to IAS 1 are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted. Application of the amendments need not be disclosed.

IFRS 16 Leases specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance and lessor accounting remain substantially unchanged from its predecessor, IAS 17. IFRS 16 was issued in January 2016 and applies to annual reporting periods beginning on or after 1 January 2019

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Bank.

(b) Accounting for currency costs

The cost of unissued bank note stocks is recognised in the statement of financial position as deferred currency costs under 'other assets'. Bank note costs are charged to profit or loss in the year in which the bank notes are issued.

Coin minting costs are charged to profit or loss when issued to the public. Also, the cost of new currency coins not yet issued is recognised as inventory within 'other assets' consistent with the accounting for the cost of unissued bank note stocks.

(c) Consolidation

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

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

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

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

Notes (continued)

necessary to ensure consistency with the policies adopted by the Bank.

2 Summary of significant accounting policies (continued)

(d) Functional currency and translation of foreign currencies

i. Functional and presentation currency

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

ii. Transactions and balances

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

(e) Sale and repurchase agreements

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

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

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

(f) Financial assets and liabilities

i. Financial assets

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

Financial assets at fair value through profit or loss

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

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

Notes (continued)

2 **Summary of significant accounting policies (continued)**

(f) **Financial assets and liabilities (continued)**

i. **Financial assets (continued)**

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

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

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

Loans and receivables

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

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

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period. Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value re-measurements are included in other comprehensive income.

ii. **Financial liabilities**

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

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial

Notes (continued)

institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

2 Summary of significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

iii. Determination of fair value

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

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

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

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

iv. De-recognition

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2016	2015
				Shs' million	Shs' million
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	30,515	28,822
			Fixed income securities	102,662	84,118
		Designated at initial recognition	Gold holdings	75	66
	Loans and receivables	Securities discounted by banks and other advances to banks		44,679	75
		Funds with IMF		1,923	4,385
		Net advances to staff and banks under liquidation		2,566	2,333
		Due from Government	Government loan	25,559	26,669
			Overdraft facility to Government	44,203	36,494
		Balances due from banking institutions	Foreign denominated Term deposits	695,932	523,189
	Available-for-sale	Investment securities	SWIFT shares	9	9
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	218,491	193,661
		Due to IMF		122,438	125,775
		Investment by Banks		7,843	-
		Deposits from Government institutions		277,481	136,780

vi. Impairment of financial assets

a. Loans and receivables

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

vi. Impairment of financial assets (continued)

b. Available for sale financial assets

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

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

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

vii. Offsetting financial instruments

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

(g) Cash and cash equivalents

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

(h) Property and equipment

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

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

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

Asset classification	Useful life	Depreciation rate
Leasehold land	Over the period of the lease	
Buildings	20 years	5%s
Motor vehicles	4 years	20%
Furniture and equipment	5 - 10 years	20-10%

No depreciation is charged on work in progress and assets held in clearing accounts. Depreciation of property and equipment is made from date of placement to use and it ceases when the asset is obsolete, classified as held for sale, fully depreciated or derecognized as per policy.

Notes (continued)

2 Summary of significant accounting policies (continued)

(i) Intangible assets

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

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

iii. the expenditure attributable to the software product during its development can be reliably measured.

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

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

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years. Computer software under installation and not yet place in use is held in software clearing account and not amortized until commissioned.

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

(j) Impairment of non-financial assets

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

(k) Employee benefits

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

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

(k) Employee benefits (continued)

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

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise.

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

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

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

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

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

(l) Income tax

Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

(m) Provisions

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

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

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

Notes (continued)

expense.

2 Summary of significant accounting policies (continued)

(n) Dividend payable

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

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

(o) Share capital

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

(p) Leases

Bank as lessee

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

Bank as lessor

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

(q) Interest income and expense

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

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

(r) Fee and commission income

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

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

Notes (continued)

2 Summary of significant accounting policies (continued)

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

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

(t) Currency in circulation

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

(u) Deferred currency costs (Inventories)

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

Bank notes printing expenses and coin minting costs for each denomination which include ordering, printing, minting, 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. The deferred amount is recognised as prepayment and represents un-issued bank notes and coins stock.

(v) Loan due from the Government of Kenya

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act to limit the Bank's lending to Government of Kenya to 5% of Government of Kenya audited revenue.

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

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at amortised cost.

Notes (continued)

2 Summary of significant accounting policies (continued)

(w) Funds held at/ due to International Monetary Fund (IMF)

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

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

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

(x) Comparatives

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

3 Critical accounting estimates and judgements in applying accounting policies

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

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

a. ***Post-retirement benefits***

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 17 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

b. ***Loans and advances***

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

c. ***Fair value of financial assets***

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

d. ***Property and equipment***

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

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

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

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

Notes (continued)

4 Interest income

	2016 Shs' million	2015 Shs' million
Financial assets - held to maturity	4,065	1,878
Loans and advances	10,858	3,860
Financial assets at fair value through profit or loss	1,010	492
	15,933	6,230

Interest income from loans and advances comprises:

Due from Government of Kenya – loan	794	825
Due from Government of Kenya - overdraft	4,077	2,240
Staff loans and advances	195	260
Securities discounted by banks and other advances	5,393	204
Local commercial banks overnight loans	61	65
Other interest income	338	266
	10,858	3,860

5 Interest expense

Interest on monetary policy issues – investments by banks	3,819	1,894
Interest paid to IMF	138	83
	3,957	1,977

6 Net trading income

Net gain on sale of foreign exchange currencies	6,496	8,169
Net (loss)/gain on held for trading financial assets	(50)	29
	6,446	8,198

7 Other income

Licence fees from commercial banks and foreign exchange bureaux	250	248
Penalties from commercial banks and foreign exchange bureaux	40	16
Rent income from Thomas De La Rue Kenya Limited	2	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	217	372
Gain on disposal of property and equipment	4	17
Miscellaneous income	23	31
	536	686

Notes (continued)

8 Operating expenses

	2016 Shs' million	2015 Shs' million
Employee benefits (Note 9)	2,122	3,059
Currency production expenses	1,880	1,965
Property maintenance and utility expenses	834	1,203
Depreciation (Note 18)	946	733
Amortisation (Note 19)	287	243
Provision for impairment loss on other assets (Note 16)	13	23
Auditor's remuneration	10	6
Transport and travelling	176	189
Office expenses	245	195
Postal service expense	120	126
Legal and professional fees	48	83
Other administrative expenses including KSMS	1,410	937
	8,091	8,762

9 Employee benefits

	2016 Shs' million	2015 Shs' million
Wages and salaries	3,390	3,614
Medical expenses	330	200
Other staff costs	210	424
Directors' emoluments (Note 27)	27	62
Net income relating to the retirement benefit asset (Note 17)	(1,835)	(1,241)
	2,122	3,059

10 Balances due from banking institutions

	2016 Shs' million	2015 Shs' million
Current accounts	69,108	31,118
Foreign denominated term deposits	266,363	125,542
Accrued interest on term deposits	1,060	475
Special project accounts	16,693	25,778
Domestic foreign currency cheque clearing	15,413	11,704
Repos clearing and regional central banks	101	173
Cash in cash and cash equivalents (note 26)	368,738	194,790
Foreign denominated term deposits	327,266	397,172
	696,004	591,962

Notes (continued)

10 Balances due from banking institutions (Continued)

Special project accounts relate to amounts received by the Government of Kenya (or its ministries) for specific projects or purposes. An equal and corresponding liability is recorded and disclosed under "Deposits from banks and government (note 22)". The movement in the year is mainly attributable to the proceeds from sponsors of various government projects. This has corresponding transaction leg on the growth of foreign reserves during the year.

11 Financial assets at fair value through profit or loss

	2016 Shs' million	2015 Shs' million
a. Designated at initial recognition		
Gold holdings	75	66

Movements in gold holdings are due to mark to market movements.

	2016 Shs' million	2015 Shs' million
b. Held for trading		
Fixed income securities	102,663	84,118
Fixed income securities under World Bank RAMP	30,515	28,822
	133,178	112,940
	133,253	113,006

12 Investments securities – Available-for-sale

	2016 Shs' million	2015 Shs' million
Unlisted equity securities	9	9
At start of year	9	6
Additions	-	3
At end of year	9	9

"Unlisted equity securities" relate to the Bank's investment in shares of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) which member is owned co-operative with its headquarters in Belgium. The Bank held 24 (2015: 24) SWIFT shares at 30 June 2016.

Notes (continued)

13 Funds held at/ due to International Monetary Fund (IMF)

	2016 SDR million	2016 Shs' million	2015 SDR million	2015 Shs' million
(a) Assets				
IMF balances (SDR asset account)	14	1,923	32	4,385
(b) Liabilities				
International Monetary Fund Account No. 1	20	2,837	19	2,631
International Monetary Fund Account No. 2		-	-	2
International Monetary Fund – PRGF Account	588	82,995	631	87,236
IMF - SDR Allocation account	260	36,606	260	35,906
	868	122,438	910	125,775

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

Kenya's quota in IMF of SDR 271.4 million (2014: SDR 271.4 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government of Kenya's Fiscal Agent and allocations of SDR 258.3 million (2015: 258.3 million) are included in the financial statements of the Bank as custodian.

14 Securities discounted by banks and other advances

	2016 Shs' million	2015 Shs' million
Treasury bonds discounted	2,629	38
Treasury bills discounted	6,751	36
Accrued interest Bonds Discounted	96	1
Repo Treasury Bills(Injection)	28,592	-
Accrued interest Repo	114	-
Liquidity Support framework	6,497	-
	44,679	75

Securities discounted by banks and other advances

As at 30 June 2016

	1-3 months Shs' million	Maturity period 3-12 months Shs' million	Over 1 year Shs' million	Total Shs' million
Treasury bonds discounted	-	1,467	1,162	2,629
Treasury bills discounted	6,714	37	-	6,751
Accrued interest Bonds Discounted	-	96	-	96
Repo Treasury Bills(Injection)	28,592	-	-	28,592
Accrued interest Repo	114	-	-	114
Liquidity Support Framework	6,497	-	-	6,497
	41,917	1,600	1,162	44,679

Notes (continued)

14 Securities discounted by banks and other advances (continued)

At 30 June 2015

	1-3 months Shs' million	3-12 months Shs' million	Over 1 year Shs' million	Total Shs' million
Treasury bonds discounted	38	-	-	38
Treasury bills discounted	36	-	-	36
Accrued interest Bonds	1	-	-	1
	75	-	-	75

Financial sector reforms implemented during the year under review have since stabilized the industry which is now on a sound footing.

15 Loans and advances

	2016 Shs' million	2015 Shs' million
Due from banks under liquidation	3,656	3,656
Advances to employees	2,657	2,365
	6,314	6,021
Allowance for impairment	(3,747)	(3,688)
Net advances	2,566	2,333

Movement in the loan impairment allowance is as follows:

	2016 Shs' million	2015 Shs' million
At start of year	3,688	3,680
Increase in impairment allowance	59	8
At end of year	3,747	3,688

16 Other assets

	2016 Shs' million	2015 Shs' million
Prepayments	889	526
Deferred currency cost	2,078	3,704
Sundry debtors	5,837	5,102
Items in the course of collection	297	82
Un cleared effects	80	-
	9,181	9,414
Provision for impairment	(4,896)	(4,883)
	4,285	4,531

Notes (continued)

16 Other assets (continued)

All other assets balances are recoverable within one year.

Movement in the impairment allowance is as follows:

	2016 Shs' million	2015 Shs' million
At start of year	4,883	4,860
Increase in impairment allowance	13	23
At end of year	4,896	4,883

17 Retirement benefit asset

	2016 Shs' million	2015 Shs' million
Present value of funded obligations	17,623	17,820
Fair value of plan assets	(27,161)	(27,156)
Net underfunding in funded plan	(9,538)	(9,336)
Limit arising from asset ceiling	1,762	4,668
Asset in the statement of financial position	(7,776)	(4,668)

Movements in the net defined benefit asset recognised are as follows:

	2016 Shs' million	2015 Shs' million
At start of year	4,668	7,659
Net income recognised in the income statement	1,835	1,241
Net income/(expense) recognized in other comprehensive income (OCI)	1,174	(4,343)
Employer contributions	99	111
At end of year	7,776	4,668

Movements in the plan assets are as follows:

	2016 Shs' million	2015 Shs' million
At start of year	27,156	24,665
Expected return on scheme assets	3,646	3,205
Actuarial loss	(3,517)	(539)
Employer contributions	99	111
Employee contributions	48	56
Benefits expenses paid	(1,119)	(942)
Adjustment for previous year values	848	600
At end of year	27,161	27,156

Notes (continued)

17 Retirement benefit asset (continued)

Movements in the plan benefit obligation are as follows:

	2016 Shs' million	2015 Shs' million
At start of year	17,820	17,006
Current service cost net of employees' contributions	347	404
Interest cost	2,313	2,160
Employee contributions	49	55
Actuarial loss	(1,787)	(863)
Benefits paid	(1,119)	(942)
At end of year	17,623	17,820

The principal actuarial assumptions at the reporting date were:

	2016	2015
Discount rate (p.a.)	13.3%	12.9%
Salary increase (p.a.)	11.3%	10.9%
Expected return on plan assets (p.a.)	12.9%	12.9%
Future pension increases	3.0%	3.0%

Five year summary	2016 Shs' million	2015 Shs' million	2014 Shs' million	2013 Shs' million	2012 Shs' million
Fair value of plan assets	27,161	27,156	24,665	21,173	17,103
Present value of funded obligations	(17,623)	(17,820)	(17,006)	(13,065)	(12,673)
Asset ceiling adjustment	(1,762)	(4,668)	-	-	-
Net retirement benefit asset	7,776	4,668	7,659	8,108	4,430

Plan assets are distributed as follows:

	2016 Shs' million	%	2015 Shs' million	%
Quoted shares	9,268	34%	10,770	40%
Investment properties	5,477	20%	4,137	15%
Government of Kenya treasury bills and bonds	9,672	36%	7,543	28%
Commercial paper and corporate bonds	1,760	6%	1,928	7%
Offshore investments	-		2,436	9%
Fixed and term deposits	603	2%	342	1%
Net current assets	381	1%	-	-
	27,161	100%	27,156	100%

Notes (continued)

18 Property and equipment

	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor vehicles Shs' million	Furniture and equipment Shs' million	Total Shs' million
Year ended 30 June 2015						
Opening net amount	5,390	1,737	4,481	141	2,064	13,813
Additions	-	-	1,437	40	249	1,726
Revaluation gain	4,513	397	-	-	-	4,910
Disposals	-	-	-	(34)	-	(34)
Charge for the year	(300)	(32)	-	(93)	(308)	(733)
Reversal of charge on disposals	-	-	-	34		34
Adjustment to revaluation reserve	926	101	-	-	-	1,027
At end of year	10,529	2,203	5,918	88	2,005	20,743
At 30 June 2015						
Cost	10,529	2,203	5,918	370	4,221	23,241
Accumulated depreciation	-	-	-	(282)	(2,216)	(2,498)
Net book amount	10,529	2,203	5,918	88	2,005	20,743
Year ended 30 June 2016						
Opening net amount	10,529	2,203	5,918	88	2,005	20,743
Additions	1,962	-	413	25	192	2,592
Disposals	-	-	-	(3)	(1)	(4)
Charge for the year	(421)	(46)	-	(53)	(426)	(946)
At end of year	12,070	2,157	6,331	57	1,770	22,385
At 30 June 2016						
Cost	12,491	2,203	6,331	388	4,435	25,848
Accumulated depreciation	(421)	(46)	-	(331)	(2,665)	(3,463)
Net book amount	12,070	2,157	6,331	57	1,770	22,385

Land and buildings were revalued by internal professional valuers in 2015 on an open market basis and the revaluation has been included in the revaluation reserve. Land and buildings are included in the level 2 of the fair valuation hierarchy (that is, the fair value is based on inputs other than quoted prices that are observable).

Notes (continued)

18 Property and equipment (continued)

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

- The Bank's residential properties are all owner-occupied for purposes of carrying out its mandate. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property is comparable to going rentals for similar properties within the same location.
- The Bank has taken into account comparable 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 Bank occupies all its properties and is in possession of all their title deeds.

19 Intangible assets

	Software	Work-in-Progress	Total
	Shs' million	Shs' million	Shs' million
Year ended 30 June 2015			
Cost			
At start of year	1,618	9	1,627
Additions	98	-	98
Transfers	7	(7)	-
At end of year	1,723	2	1,725
Accumulated amortisation			
At start of year	988	-	988
Amortisation for the year	243	-	243
At end of year	1,231	-	1,231
Net carrying value	492	2	494
Year ended 30 June 2016			
Cost			
At start of year	1,723	2	1,725
Disposals	(4)	-	(4)
Transfers	2	(2)	-
At end of year	1,721	-	1,721
Accumulated amortisation			
At start of year	1,231	-	1,231
Eliminated on disposals	(4)	-	(4)
Amortisation for the year	287	-	287
At end of year	1,514	-	1,514
Net carrying value	207	-	207

Software relates to the computer systems the Bank uses in its operations.

Notes (continued)

20 Due from Government of Kenya

	2016 Shs' million	2015 Shs' million
Overdraft	44,203	36,494
Government loan	25,559	26,669
	69,762	63,163

The Government of Kenya overdraft account is used to fund the treasury bills and interest related accounts that overdraw as a result of shortfalls from primary issues in the market. Whenever the previously funded account receives funding as a result of proceeds from primary issues of call-ups, the overdraft account is refunded the previously owed amount.

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 for the year ending 30 June 2016 is Shs 46,813 million (2015: Shs 39,123 million) based on the gross recurrent revenue for the year ended 30 June 2014 (which are the latest audited financial statements at the date of approval of these financial statements) was Shs 936,255 million and interest is charged at the Central Bank Rate currently at 10.5%.

The Bank has issued a loan to the Government of Kenya. Principal repayments of Shs 555 million plus interest accruing are paid half yearly. The movement in the balance in the current year includes the year repayment of principal of Shs 1,110 million which was received by 30 June, 2016.

21 Currency in circulation

	2016 Shs' million	2015 Shs' million
Kenya bank notes	227,192	215,190
Kenya coins	7,559	6,988
	234,751	222,178
Movement in the account was as follows:		
At start of year	222,178	199,966
Deposits by banks	(513,086)	(489,768)
Withdrawals by banks	525,568	512,011
Net Withdrawals in bank	91	(31)
At end of year	234,751	222,178

22 Deposits from banks and government

	2016 Shs' million	2015 Shs' million
Local commercial banks clearing accounts and cash ratio reserve	179,835	176,520
Local banks foreign exchange settlement accounts	14,133	17,054
External banks foreign exchange settlement accounts	36	37
Other public entities and Special project accounts	24,559	32,185
Government of Kenya	277,481	105,520
	496,044	331,316

Notes (continued)

22 Deposits from banks and government (continued)

Special project accounts relate to amounts received by the Government of Kenya (GoK) or its ministries, for specific projects or purposes. An equal and corresponding asset is recorded and disclosed under "Balances due from banking institutions (note 10)". The increase was mainly in Government of Kenya account and commercial banks deposits. The GoK partially received a syndicated loan of USD343M equivalent to Kes.35B in October 2015 and USD385M equivalent to Kes.39.3B in December 2015 from SCB (London). The movement is further attributed to the utilization of the overdraft facility by the Government of Kenya amounting to Kes.44bn in the year under review.

23 Liquidity deposits

	2016 Shs' million	2015 Shs' million
Liquidity deposits	7,843	-
	7,843	-

Liquidity deposits relates to amounts arising from mopping up of excess liquidity in the market. This is managed through selling of repurchase agreements ('repos') to commercial banks.

24 Other liabilities

	2016 Shs' million	2015 Shs' million
Impersonal accounts	1,399	3,496
Sundry creditors	2,402	409
Bonds pending payables	-	109
Refundable deposits	797	283
Leave accrual	126	122
Gratuity to staff members	56	48
	4,780	4,467

Impersonal accounts are accounts to which the Bank posts amounts from the National Treasury temporarily pending allocation to a Government of Kenya ministry.

25 Share capital

	Authorised share capital Shs' million	Authorised share capital Shs' million
Balance at 1 July 2014, 30 June 2015 and 30 June 2016	5,000	5,000

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

Notes (continued)

26 Cash generated from operations

Reconciliation of net (deficit)/ surplus to cash flows from operations:	2016 Shs' million	2015 Shs' million
(Deficit) /surplus for the year	(5,814)	48,131
Adjustments for:		
Depreciation (Note 18)	946	733
Amortisation (Note 19)	287	243
Gain on disposal of property and equipment (Note 7)	(4)	(17)
Net credit relating to the retirement benefit asset (Note 17)	(1,835)	(1,241)
Employer contributions on defined benefits scheme	(99)	(111)
Changes in working capital:		
Loans and advances	(233)	321
Other assets	246	351
Due from Government of Kenya	(6,599)	2,975
Currency in circulation	12,573	22,212
Deposits	164,728	(117,484)
Other liabilities	313	(915)
Liquidity deposits	7,843	-
Net cash generated from/(used in) operations	172,352	(44,802)

27 Cash and cash equivalents

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

	2016 Shs' million	2015 Shs' million
Balances due from banking institutions (Note 10)	368,738	194,790
Financial assets - FVPL	10,938	-
Securities discounted by banks and other advances (Note 14)	41,917	75
	421,593	194,865

28 Related party transactions

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya (the ultimate owner of the Bank) and the Kenya Deposit Insurance Corporation (formerly, the Deposit Protection Fund Board - a corporation established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institutions. It is managed by a Board comprising the Governor of the Central Bank of Kenya).

The main transactions include ordinary banking facilities to Government ministries included in Note 22 and lending to the Government of Kenya included in Note 20.

(i) Loans

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

Notes (continued)

28 Related party transactions (continued)

Loans to executive director	2016 Shs' million	2015 Shs' million
At start of the year	-	8
Loan repayments	-	(8)
At end of the year	-	-

Loans to key management personnel		
At start of the year	60	71
Loans advanced during the year	8	12
Loan repayments	(16)	(23)
At end of the year	52	60

(ii) Directors' emoluments:		
Fees to non-executive directors	6	20
Other remuneration to executive directors	21	20
Gratuity for the Governor, who retired in the year	-	22
	27	62

(iii) Remuneration to senior management	181	171
(iv) Post–employment pension to senior management	12	10

(v) Government of Kenya

	2016 Shs' million	2015 Shs' million
Due from Government of Kenya (Note 20)	69,762	63,163
Government of Kenya Deposits (Note 22)	277,481	105,520
Interest earned from Government of Kenya –Loan(Note 4)	794	825
Interest earned from Government of Kenya- Overdraft (Note 4)	4,077	2,240
Loans principal repayment	1,110	1,110

Transactions entered into with the Government include:

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

Notes (continued)

28 Related party transactions (continued)

(vi) Kenya Deposit Insurance Corporation (KDIC)

The Bank has a close working relationship with the KDIC (formerly the Deposit Protection Fund Board), an entity incorporated under the Kenya Deposit Insurance Act 2012. The Bank provides KDIC with staff incurs certain costs on its behalf. All such costs are fully reimbursed to the Bank.

The balance outstanding from the KDIC and included in other assets as at year end was Shs 2.4 million (2015: Shs 2.6 million).

The deposits relating to KDIC and included in deposits from banks and Government as at year end was Shs 143 million (2015: Shs 153 million).

The staff of the Corporation are contractually employees of the Central Bank but seconded to the Corporation. Salaries of these staff are met by the Central Bank and fully reimbursed by the Corporation. In the year, salaries paid to the staff of the Corporation by the Central Bank amounted to KShs 170,747 million (2015 - KShs 168.5 million).

(vii) Kenya School of Monetary Studies (KSMS)

The Kenya School of Monetary Studies (the "School") is a registered legal entity which is 99 % owned by the Bank and 1% by the National Treasury. The accounts of KSMS have been consolidated in these financial statements. The School is the strategic capacity building institution for the Bank and the financial sector.

The Bank's Board of directors also serves as part of the KSMS Board. The permanent staff working at the KSMS are employees of CBK. The fixed assets at the School are also wholly owned by the Bank and a letter of support is issued annually to the external auditor of the School as part of the commitment of the Bank for going concern purposes.

During the year under review, the School's physical developments projects continued as planned with significant percentage of completion recorded. The completed projects include the School's Library and Academic Block which are now in use while, the construction of the hostels and a new restaurant is on schedule and expected to be completed during the next financial year. These facilities are meant to modernize the School and enhance its accommodation capacity.

Key Highlights

	2016 Shs' million	2015 Shs' million
Grants from CBK	450	460
Buildings	3,223	1,261
Land	4,800	4,800
Deficit	47	7
Receivable from KSMS	58	58

(viii) Central Bank of Kenya Pension Fund and Banki Kuu Pension Scheme 2012

The pension schemes (that is, the Defined Benefit and Defined Contribution Schemes) are managed and administered by Secretariats appointed by the sponsor.

Notes (continued)

29 Financial risk management objectives and policies

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

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

(a) Strategy in using financial instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-debt government and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate volatilities. The Bank is committed to an open foreign exchange market operations and will only intervene to stabilize unnecessary volatitity.
Governed by the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya.

The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach.

Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

(b) Risks facing the Bank

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

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

i. Credit risk

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

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

Notes (continued)

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

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

The Bank does not grade the credit quality of these assets. None of the balances have had their terms renegotiated. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Provisions of Shs. 59 million (2015: Shs 64 million) have been recorded due to impaired balances to related parties.

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

	Neither past due nor impaired 2016 Shs' million	Individually impaired 2016 Shs' million	Neither past due nor impaired 2015 Shs' million	Individually impaired 2015 Shs' million
Balances due from banking Inst	696,004	-	591,962	-
Advances to banks	44,679	-	75	-
Investments securities – AFS	9	-	9	-
Funds held with (IMF)	1,923	-	4,385	-
Financial assets at FVPL	133,253	-	113,006	-
Due from Government of Kenya	69,762	-	63,163	-
Advances to employees	2,566	91	2,333	32
Due from banks under liquidation	-	3,656	-	3,656
Sundry debtors	4,285	4,896	4,531	4,883
	952,481	8,643	779,464	8,571
Allowance for impairment				
- other assets (Note 16)	-	(4,896)	-	(4,883)
- loans and advances (Note 15)	-	(3,747)	-	(3,688)
	-	(8,643)	-	(8,571)
	952,481	-	779,464	-

There were no past due but not impaired balances as at 30 June 2016 - (2015: Nil).

Notes (continued)

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

No.	List of Foreign Correspondent Banks - Current Accounts Balances	Type of Institution	Credit Ratings as of 30th June 2016		
			Fitch	S & P	Moody's
1	Reserve Bank of Australia	Central Bank	NR	NR	NR
2	Bank of Canada	Central Bank	NR	NR	NR
3	Schwerizerische National	Central Bank	NR	NR	NR
4	Bank of China	Commercial Bank	A	A	A1
5	Danmarks National Bank	Central Bank	NR	NR	NR
6	Commerz Bank AG	Commercial Bank	BBB	BBB+	Baa1
7	Bank of France	Central Bank	NR	NR	NR
8	Standard Chartered Bank, Germany	Commercial Bank	AA-	AA-	Aa3
9	Bank of England	Central Bank	NR	NR	NR
10	Bank of Japan	Central Bank	NR	NR	NR
11	Bank of Tokyo, Mitsubishi	Commercial Bank	A	A+	A1
12	Sverigs Riksbank	Central Bank	NR	NR	NR
13	Central Bank of Uganda	Central Bank	NR	NR	NR
14	J P Morgan Chase, New York	Commercial Bank	AA-	A+	Aa3
15	Citibank Na , New York	Commercial Bank	A	A+	A1
16	Federal Reserve , New York	Central Bank	NR	NR	NR
17	Bank of New York Mellon	Commercial Bank	AA-	A+	A1
18	South African Reserve Bank	Central Bank	NR	NR	NR

Note: Central Banks do not have a rating thus ***NR*** means ***No Rating***

Notes (continued)

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

No.	List of Active Depository Banks	Type of Institution	Credit Ratings as of 30th June 2016		
1	AUST AND NZ BANKING GROUP	Commercial Bank	AA-	AA-	Aa2
2	ABN AMRO BANK NV	Commercial Bank	A	A	A2
3	BANK OF NEW YORK MELLON CORP	Commercial Bank	AA-	A+	A1
4	BANK OF MONTREAL	Commercial Bank	AA-	A+	Aa3
5	BARCLAYS PLC	Commercial Bank	A	BBB	Baa3
6	BNP PARIBAS	Commercial Bank	A+	A+	A1
7	CAN IMPERIAL BK OF COMMERCE	Commercial Bank	AA-	A+	Aa3
8	COMMERZBANK AG	Commercial Bank	BBB	BBB+	Baa1
9	COMMONWEALTH BANK OF AUSTRAL	Commercial Bank	AA-	AA-	Aa2
10	RABOBANK	Commercial Bank	AA-	A+	Aa2
11	CREDIT AGRICOLE SA	Commercial Bank	A	A	A2
12	CREDIT SUISSE GROUP AG-REG	Commercial Bank	A	BBB+	Baa2
13	DANSKE BANK A/S	Commercial Bank	A	A	A2
14	DZ BANK AG DEUTSCHE ZENTRAL-	Commercial Bank	AA-	AA-	A1
15	ING BANK NV	Commercial Bank	A	A	A1
16	JPMORGAN CHASE & CO	Commercial Bank	A+	A	A3
17	LANDESBANK BADEN-WUERTTEMBER	Commercial Bank	A-	NR	A2
18	MIZUHO FINANCIAL GROUP INC	Commercial Bank	A-	A	NR
19	NATIONAL AUSTRALIA BANK LTD	Commercial Bank	AA-	AA-	Aa2
20	NORDEA BANK AB	Commercial Bank	AA-	AA-	Aa3
21	SKANDINAVISKA ENSKILDA BAN-A	Commercial Bank	A+	A+	Aa3
22	SOCIETE GENERALE SA	Commercial Bank	A	A	A2
23	STANDARD CHARTERED PLC	Commercial Bank	AA-	A-	Aa3
24	SVENSKA HANDELSBANKEN-A SHS	Commercial Bank	AA-	AA-	Aa2
25	SWEDBANK AB - A SHARES	Commercial Bank	A+	A+	Aa3

ii. Market risk

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

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

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

Interest rate risk

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

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

Notes (continued)

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

At 30 June 2016	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	368,666	312,605	-	-	14,733	696,004
Securities discounted by banks and other advances	41,917	1,600	1,162	-	-	44,679
Financial assets at FVPL	10,938	31,862	90,378	-	75	133,253
Funds held with International Monetary Fund (IMF)	-	-	-	-	1,923	1,923
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	111	342	1,109	1,004	-	2,566
Other assets	-	-	-	-	4,285	4,285
Due from Government of Kenya	-	45,303	4,440	20,019	-	69,762
Total financial assets	421,632	391,712	97,089	21,023	21,025	952,481
Liabilities						
Deposits from banks and government	-	-	-	-	496,044	496,044
Due to International Monetary Fund (IMF)	-	-	-	-	122,438	122,438
Other liabilities	-	-	-	-	4,780	4,780
Liquidity deposit	7,843	-	--	-	-	7,843
Total financial liabilities	7,843	-	-	-	623,262	631,105
Interest sensitivity gap	413,789	391,712	97,089	21,023	(602,237)	321,376

Notes (continued)

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

At 30 June 2015	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	513,096	53,088	-	-	25,778	591,962
Securities discounted by banks and other advances	75	-	-	-	-	75
Financial assets at FVPL	-	84,164	-	28,776	66	113,006
Funds held with International Monetary Fund (IMF)	-	-	-	-	4,385	4,385
Investments securities – Available-for-sale	-	-	-	-	9	9
Loans and advances	22	84	656	1,571-	-	2,333
Other assets	-	-	-	-	4,531	4,531
Due from Government of Kenya	-	36,483	4,440	22,240	-	63,163
Total financial assets	513,193	173,819	5,096	52,587	34,769	779,464
Liabilities						
Deposits from banks and government	-	-	-	-	331,316	331,316
Due to International Monetary Fund (IMF)	-	-	-	-	125,775	125,775
Other liabilities	-	-	-	-	4,467	4,467
Total financial liabilities	-	-	-	-	461.558	461.558
Interest sensitivity gap	513,193	173,819	5,096	52,587	(426,789)	317,906

As at 30 June 2016, an increase/decrease of 10 basis points would have resulted in a decrease/increase in profit of Shs 92,361 million (2015: Shs 745 million).

Notes (continued)

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk

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

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2015. Included in the table are the Bank's financial instruments categorised by currency:

At 30 June 2016	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs 'million	Total Shs' million
Assets						
Balances due from banking institutions	372,302	162,392	-	-	161,310	696,004
Financial assets at fair value	133,253	-	-	-	-	133,253
Funds held with International Monetary Fund (IMF)	-	-	-	1,923	-	1,923
Total financial assets	505,555	162,392	-	1,923	161,310	831,180
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	122,438	-	122,438
Deposits from banks and government	35,573	1,652	1,451	-	84	38,760
Total financial liabilities	35,573	1,652	1,451	122,438	84	161,198
Net position	469,982	160,740	(1,451)	(120,615)	161,226	669,982

Notes (continued)

29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign exchange risk (continued)

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs 'million	Total Shs' million
At 30 June 2015						
Assets						
Balances due from banking institutions – Local	347,319	158,693	38,890	-	47,060	591,962
Financial assets at fair value	113,006	-	-	-	-	113,006
Funds held with International Monetary Fund (IMF)	-	-	-	4,385	-	4,385
Total financial assets	460,325	158,693	38,890	4,385	47,060	709,353
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	125,775	-	125,775
Deposits from banks and government	35,048	1,581	5,165	-	197	41,991
Total financial liabilities	35,048	1,581	5,165	125,775	197	167,766
Net position	425,277	157,112	33,775	(121,390)	46,863	541,587

As at 30 June 2016, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's profit would have been:

- USD Shs 23,499 million (2015: Shs 21,864 million)
- Euro Shs 8,037 million (2015: Shs 1,686 million)
- British Pound Shs 73 million (2015: Shs 7,856 million)
- SDR Shs 6,031 million (2015: Shs 6,070 million)

Notes (continued)

29 Financial risk management objectives and policies (continued)

iii. Liquidity risk

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

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

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

	On demand Shs' million	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Total Shs' million
At 30 June 2016						
Currency in circulation	-	-	-	-	234,751	234,751
Deposits from banks and government	473,852	-	22,192	-	-	496,044
Due to International Monetary Fund (IMF)	-	-	-	-	122,438	122,438
Other liabilities	-	-	4,780	-	-	4,780
Repos sold to Banks	-	7,843	-	-	-	7,843
Total financial liabilities	473,852	7,843	26,972	-	357,189	865,856
At 30 June 2015						
Currency in circulation	-	-	-	-	222,178	222,178
Deposits from banks and government	314,284	-	17,104	-	-	331,388
Due to International Monetary Fund (IMF)	-	-	-	-	125,775	125,775
Other liabilities	-	-	4,467	-	-	4,467
Total financial liabilities	314,284	-	21,571	-	347,953	683,736

Notes (continued)

29 Financial risk management objectives and policies (continued)

Fair value of financial instruments

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

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

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
At 30 June 2016:				
Financial assets at fair value	133,178	75	-	133,253
Investment securities – Available-for-sale	-	-	9	9
Total assets	133,178	75	9	133,262
As at 30 June 2015:				
Financial assets at fair value	112,940	66	-	113,006
Investment securities – Available-for-sale	-	-	9	9
Total assets	112,940	66	9	113,015

Changes in level 3 instrument are disclosed in Note 12 of the financial statements.

30 Contingent liabilities and commitments

The Bank is party to various legal proceedings. Based on legal advice, the directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2016, the Bank had capital commitments of Shs.2,059 (2015: Shs 2,921 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2016 Shs' million	2015 Shs' million
Not later than 1 year	151	166
Later than 1 year and not later than 5 years	176	325
	327	491

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