



Central Bank of Kenya



ANNUAL REPORT AND FINANCIAL STATEMENTS 2018/2019

HIGHLIGHTS



MANDATES

Article 231 of the Constitution of Kenya and Sections 4 and 4A of the Central Bank of Kenya Act outline key mandates of Central Bank of Kenya (CBK) as to:

- i). Formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices.
- ii). Foster the liquidity, solvency and proper functioning, efficient, sound and stable market-based financial system.
- iii). Formulate and implement such policies as best to promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems.
- iv). Design, issue and manage efficient distribution of quality currency (notes and coins) that are easily accepted and secure against counterfeiting.
- v). Support the Government's economic and financial policies including its objectives for growth and employment.

The other mandates of the Bank include: – formulating and implementing foreign exchange policy; effective management of the nation's foreign exchange reserves; licensing and supervising authorized dealers; act as banker and adviser to, and fiscal agent of the Government.

OUR VISION

The Vision of the Bank is To be a World Class Modern Central Bank.

OUR MISSION

To formulate and implement monetary policy for price stability, foster a stable market-based financial system and ensure a sound national payment system.

Professionalism and Relevance

The Board and staff will always endeavour to offer quality services to its internal and external customers, diligently observing high professional standards at all times and respecting the rules and regulations set by the Bank. All initiatives and activities undertaken remain relevant to the Bank's strategic objectives in pursuit of its core mandate.

Commitment

The Board and staff are committed to implementing the Bank's mandate as stipulated in the Constitution of Kenya and the CBK Act.



OUR VALUES

Efficiency & Effectiveness

The Bank will at all times undertake its operations in the most cost efficient and effective manner while maintaining high standards of performance in execution of its mandate.

Transparency, Accountability and Integrity:

The Board and staff will always act in a transparent and accountable manner when handling all the affairs of the Bank both internally and with external parties so as to uphold the Bank's image at all times. In addition, the Bank will uphold high standards of ethics, integrity and honesty as guided by the Constitution, act in an ethical manner as guided by the Leadership and Integrity Act and the Public Officers' Ethics Act, and observe high moral standards.

Diversity and Inclusiveness:

The Bank appreciates and embraces the differences in its employees' skills sets and abilities and encourages consultations and inclusiveness in pursuit of its mandate across departments. This is aimed at maximising productivity and enhancing the Bank's overall performance.

Innovativeness

The Bank will encourage, nurture and support creativity and the development of new ideas and processes for the continued improvement of organisational performance.

Mutual Respect and Teamwork:

Mutual respect shall at all times be observed internally amongst colleagues and when dealing with the Bank's external clients. In addition, the Board and staff will cooperate and collaborate to enhance performance and create a healthy work environment.

CONTENTS

ABBREVIATIONS AND ACRONYMS	vii
FOREWORD BY THE GOVERNOR	ix
STATEMENT BY THE CHAIRMAN OF THE BOARD	x
1.0 GLOBAL ECONOMY	1
2.0 DOMESTIC ECONOMY	4
2.1 Real Sector	5
2.2 Inflation	6
2.2 Balance of Payments	8
2.3 Government Budget	11
2.4 Public Debt	13
3.0 REGIONAL INTEGRATION DEVELOPMENTS	16
4.0 CENTRAL BANK OPERATIONS	19
4.1 Monetary Operations	20
4.2 Interest Rates	23
4.3 Foreign Exchange Operations and Reserves Management	24
4.4 Banking Sector	25
4.5 Currency Operations	28
4.6 Banking Services and National Payments	29
4.7 Domestic Debt Operations	30
5.0 ISSUANCE OF NEW GENERATION CURRENCY	32
6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019	35

ABBREVIATIONS AND ACRONYMS

AACB	Association of African Central Banks	MFB's	Microfinance Banks
ACH	Automated Clearing House	MPC	Monetary Policy Committee
A-I-A	Appropriation in Aid	MPCC	Monetary Policy Consultation Clause
AMCP	African Monetary Cooperation Programme	MSME	Micro Small and Medium Enterprises
ATM	Automatic Teller Machine	NDA	Net Domestic Assets
CBK	Central Bank of Kenya	NFA	Net Foreign Assets
CBKIP	Central Bank of Kenya Internship Program	NFNF	Non-Food-Non-Fuel
CBR	Central Bank Rate	NPL	Non-Performing Loan
COMESA	Common Market for Eastern and Southern Africa	NSI	Net Settlement Instruction
CPIA	Country Policy and Institutional Assessment	OPEC	Organization of the Petroleum Exporting Countries
EAC	East African Community	OTC	Over the Counter
EAMU	East African Monetary Union	POS	Point of Sale
EAPS	East Africa Payment System	REPSS	Regional Payment and Settlement System
EFTs	Electronic Fund Transfers	RTGS	Real Time Gross Settlement
Fintech	Financial Technologies	SACCOs	Savings and Credit Cooperative Societies
FY	Financial Year	SBA	Stand-By Arrangement
GDP	Gross Domestic Product	SGR	Standard Gauge Railway
IB	Internet Banking	SSA	Sub-Saharan Africa
IMF	International Monetary Fund	TMD	Treasury Mobile Direct
KEPSS	Kenya Electronic Payments and Settlement System	TRWA	Total Risk Weighted Assets
KIB	Kenya Institute of Bankers	VAT	Value Added Tax
KSh	Kenya Shillings	WEO	World Economic Outlook

LETTER OF TRANSMITTAL



In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Cabinet Secretary of the National Treasury and Planning, the Annual Report of the Central Bank of Kenya for the Financial Year 2018/19. The Annual Report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Financial Year ended June 30, 2019.

A handwritten signature in green ink that reads "Patrick Njoroge".

Dr. Patrick Njoroge
Governor

FOREWORD BY THE GOVERNOR

I am pleased to present the Central Bank of Kenya's Annual Report for Financial Year 2018/19, a year of great milestones for the Bank. We not only fulfilled our core mandates of maintaining price stability and ensuring a stable market based financial system but also actualised the dictates of the 2010 Constitution. As shown in the highlights of the Annual Report, inflation remained stable and within the Government target, the exchange rate was stable with marginal appreciation, the interest rates especially on the Government securities fell gradually, the current account deficit continued to narrow while we continued to build the foreign exchange reserves. These conditions supported a robust GDP growth in 2018 and in the first half of 2019.

During the year, the CBK fulfilled a key requirement of the Constitution by issuing new currency notes and coins. His Excellency the President unveiled the new generation coins in December 2018 followed by the launch of the new generation banknotes on June 1, 2019. The design of the new notes took into account views received from a wide range of stakeholders including the public and have adopted concepts to symbolise the drivers of a prosperous Kenya. They have images symbolising green energy, agriculture, social services, tourism and governance. The banknotes have enhanced security features and are more accessible to the visually impaired persons. Upon the issuance of the new banknotes, the CBK announced a gradual demonetisation (withdrawal) of the old KSh 1,000 notes from circulation, with the objective of addressing concerns on increased illicit financial flows and emergence of counterfeits.

Another milestone achieved during the year was the rallying of the banking industry and the mobile network operators to leverage technology in providing credit to the previously underserved segments of the population. In this regard, two innovative and revolutionary lending products namely Fuliza and Stawi, were introduced. These target low-income earners with Stawi specifically focusing on the Micro, Small and Medium Enterprises (MSMEs). In the recent past, the service sector has acted as the main anchor for growth in Kenya. Therefore, increased credit and policy support to MSMEs is expected to be a trigger for enhanced economic performance. The Bank also continued implementation of measures aimed at achieving the banking industry's vision which envisages adoption of customer-centric business models and risk-based credit pricing, enhanced transparency and information disclosure, and entrenching an ethical culture. In this regard, the CBK issued the Kenya Banking Sector Charter, which engenders a commitment by banks to entrench a responsible and disciplined industry that is responsive to the needs of their customers and Kenyans in general. To ensure a sound, secure and efficient payments system, the CBK issued Cyber Security Guidelines to the Payment Service Providers during the year.

Other notable initiatives undertaken by the Bank during the year include human resource capacity development, sustained stakeholder outreach through regular engagements and communication, support to the youth through schemes such as the CBK youth internship and mentorship programme.

Going forward, the Bank will continue to work with the stakeholders including the Board of Directors to implement policies and programmes that not only ensure a seamless achievement of its mandate but also support the interests of the Kenyan 'Mwananchi'.

Dr Patrick Njoroje
Governor

STATEMENT BY THE CHAIRMAN OF THE BOARD

STATEMENT BY THE CHAIRMAN OF THE BOARD

The FY2018/19 marked the first year of implementation of the CBK's Strategic Plan for 2018-2021, and gave the Board and Management an opportunity to oversee implementation of new initiatives aimed at achieving the Bank's vision of a modern world class Central Bank. Among the key milestones during the year, was the launch of the new generation currency coins and banknotes, in compliance with Article 231 of the 2010 Constitution. This was achieved at a time when the Bank also made strides in modernising currency management by installing advanced currency processing machines, which was part of the wider systems modernisation programme. Other initiatives accomplished during the year, with the aim of enhancing systems and processes, include modernisation and strengthening of information technology systems, reengineering business processes, review of human resource frameworks, and modernising data management systems through development of an Enterprise Data Warehouse System. Part of the IT systems upgrades involved enhanced infrastructure to ensure business continuity by installing advanced servers and upgrading the network infrastructure at the disaster recovery data centres. These projects are expected to ensure excellent operational effectiveness in the face of domestic and external challenges.

During the year the Board also approved the enhancement of CBK's authorized capital to KSh 50 billion, and in June 2019 the paid up capital was increased to KSh 20 billion. This was in line with the regional integration requirements on the central banks' paid up capital and enhances the Bank's capacity to fulfil its core mandates.

As the CBK continues its journey to become a World Class Modern Central Bank, reflected in its people, processes, and systems, we look forward to continued collaboration with our domestic, regional and international partners and stakeholders. The CBK Board will continue working closely with the Bank Management, to ensure that the Bank responds to the needs of its stakeholders more effectively and efficiently.

On behalf of the CBK Board, I wish to thank the CBK Management and staff for the commitment and dedication, and for the support accorded to the Board in the execution of its responsibilities throughout the year.

Mr. Mohamed Nyaoga
Chairman,
CBK Board of Directors

BOARD OF DIRECTORS



Mohammed Nyaoga
Chairman



Dr Patrick Njoroge (Ph.D.)
Governor



Dr. Kamau Thugge (CBS)
PS, National Treasury



Nelius W. Kariuki
Member



Samson Kimeli Cherutich
Member



Charity Seleina Kisotu
Member



Ravi Ruparel
Member



Mrs. Rachel Bessie Dzombo
Member

SENIOR MANAGEMENT



Dr. Patrick Njoroge (Ph.D.)
Governor



Mrs. Sheila M'Mbijjewe
Deputy Governor



Mr. Kennedy Kaunda Abuga
Director, Governors' Office



Mr. Joshua Ngundi Kimoro
Acting Director, Kenya School of Monetary Studies (KSMS)



Mr. Raphael Owino Otieno
Acting Director, Research



Ms. Rose A. Detho
Director, Strategic Management



Mr. Gerald Arita Nyaoma
Director, Bank Supervision

SENIOR MANAGEMENT



MEMBERS OF THE MONETARY POLICY COMMITTEE



Seated (L - R) Prof Jane Kabubo-Mariara, Dr. Patrick Njoroge (Governor and Chairman), Mrs Sheila M'Mbijjewe (Deputy Governor and Deputy Chairman), Dr. Margaret Chemengich.

Standing (L - R) Mr. Musa Kathanje (Representative of the Principal Secretary, The National Treasury), Mr. William Nyagaka, Dr. Benson Ateng, Mr. Humphrey Muga, Mr Raphael Otieno

1.0 GLOBAL ECONOMY

1.0 GLOBAL ECONOMY

Global economic growth momentum slowed down in the advanced and emerging markets amid heightened trade tension, geopolitics and policy uncertainties. Global growth was expected at 3.2 percent in 2019 and 3.5 percent in 2020, lower than the 3.6 percent growth in 2018 (IMF World Economic Outlook). Growth in advanced economies was projected at 1.9 percent in 2019 down from 2.2 percent in 2018, while in emerging and developing economies, growth was projected at 4.1 percent, which was 0.4 percentage points lower than in 2018, with the effects of trade tensions and weakening external demand dampening growth to varying extents across countries.

Despite the slowdown in growth of major emerging and developing economies, economic activity in sub-Saharan Africa (SSA) was expected to expand at a robust pace, rising from 3.1 percent in 2018 to 3.4 percent in 2019 and 3.6 percent in 2020. The higher growth was expected in major oil exporting countries like Angola and Nigeria. In Nigeria, growth was expected to pick-up to 2.3 percent and 2.6 percent in 2019 and 2020 respectively, from 1.9 percent in 2018. However, growth in South Africa was expected to slow down to 0.7 percent in 2019, a 0.1 percentage point drop from the 2018 growth, reflecting a larger-than-anticipated impact of strike activity, energy supply issues and weak agricultural production.

A key factor that is expected to undermine global growth is the weakening global trade. Global trade weakened following the slowdown in global investment activities, elevated trade tensions and policy uncertainties. World trade volume is projected to slow down to 2.5 percent in 2019 from 3.7 percent in 2018. The deceleration is broad-based affecting both advanced countries and emerging market and developing economies. In addition, the prolonged uncertainty surrounding the United Kingdom's withdrawal from the European Union has had negative effects on intra-Euro trade and investment. Global trade has also been affected as countries in the Middle East and North Africa have recorded lower export growth following oil production cuts in OPEC countries and U.S. sanctions on Iran.

Nevertheless, global inflationary pressures remain contained in both advanced and emerging markets and developing economies. In advanced countries annual headline consumer price inflation is expected to average 1.6 percent, while that of emerging markets and developing economies at 4.8 percent in 2019, owing to the expected slowdown in the contribution of both fuel and non-fuel inflation.

Downside risks to global activity have intensified. The escalation of trade disputes among major economies and a further escalation of geopolitical tensions could lead to increase in trade barriers and may pose risks to global trade and increase the probability of a marked global downturn.

1.0 GLOBAL ECONOMY

Table 1.1: Actual and Projected Output in Selected Countries/Regions (Percent Change)

Country/Region	Actual			Projections	
	2016	2017	2018	2019	2020
World Output	3.2	3.8	3.6	3.2	3.5
Advanced Economies	1.7	2.4	2.2	1.9	1.7
United States	1.5	2.2	2.9	2.6	1.9
Euro area	1.8	2.4	1.9	1.3	1.6
Japan	1.0	1.9	0.8	0.9	0.4
United Kingdom	1.8	1.8	1.4	1.3	1.4
Emerging Market and Developing Economies	4.4	4.8	4.5	4.1	4.7
Emerging and Developing Asia	6.5	6.6	6.4	6.2	6.2
China	6.7	6.8	6.6	6.2	6.0
India	7.1	7.2	6.8	7.0	7.2
Latin America and the Caribbean	-0.6	1.2	1.0	0.6	2.3
Brazil	-3.5	1.1	1.1	0.8	2.4
Sub-Saharan Africa	1.5	2.9	3.1	3.4	3.6
South Africa	0.6	1.4	0.8	0.7	1.1
Nigeria	-1.6	0.8	1.9	2.3	2.6
Middle East, North Africa, Afghanistan and Pakistan	5.0	2.1	1.6	1.0	3.0

Source: IMF, World Economic Outlook, July 2019 update

2.0 DOMESTIC ECONOMY

2.0 DOMESTIC ECONOMY

2.1 Real Sector

Overview

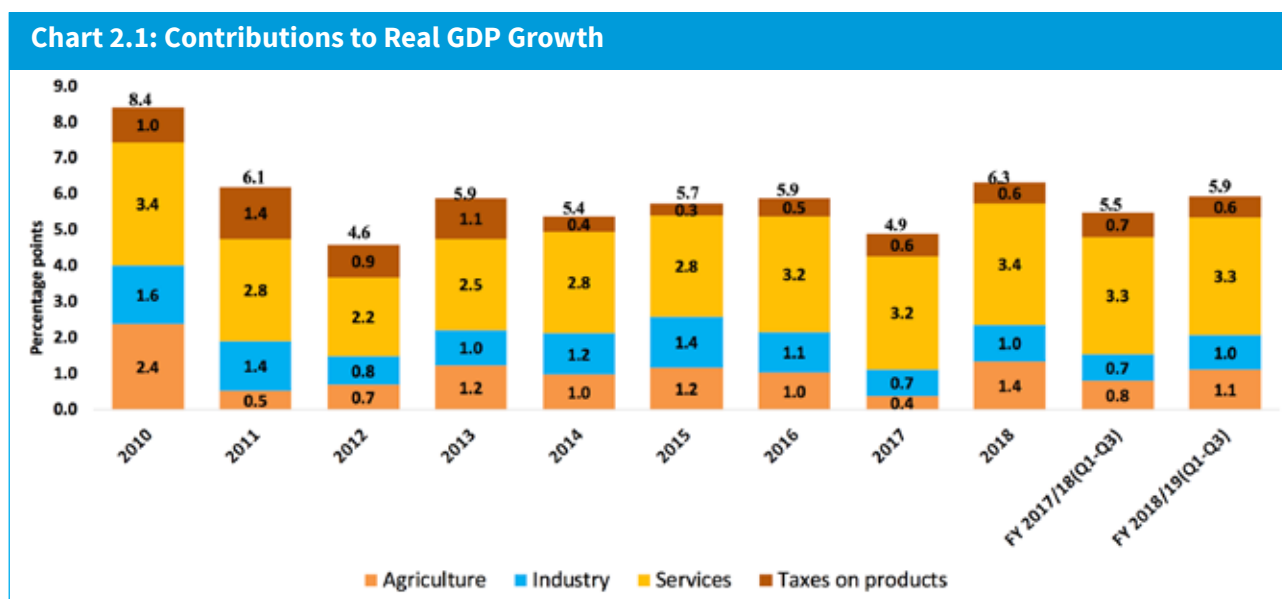
The economy rebounded in 2018 and grew by 6.3 percent compared to 4.9 percent in 2017. The strong performance was driven by favourable weather conditions, which supported agricultural activity, the resilience of the services and a resurgent manufacturing sector. The non-agriculture sector growth improved to 6.3 percent compared to 5.7 percent in 2017, mainly driven by strong performance of the services sectors (**Table 2.1**).

Main Sectors	Growth Rates (Percent)						
	2014*	2015*	2016*	2017*	2018*	FY 2017/18 (Q1-Q3)	FY 2018/19 (Q1-Q3)
1. Agriculture	4.4	5.3	4.7	1.9	6.4	3.8	5.4
2. Non-Agriculture (o/w)	5.6	5.8	6.2	5.7	6.3	5.9	6.1
2.1 Industry	6.1	7.3	5.9	3.8	5.3	4.0	5.1
Mining & Quarrying	14.9	12.3	9.5	4.5	2.8	3.4	2.7
Manufacturing	2.5	3.6	3.1	0.5	4.2	1.4	3.8
Electricity & water supply	6.1	8.5	8.4	7.0	7.9	5.9	7.5
Construction	13.1	13.8	9.9	8.5	6.6	7.9	6.7
2.2 Services	6.0	6.0	6.8	6.5	6.9	6.7	6.7
Wholesale & Retail Trade	6.9	5.9	3.7	5.7	6.3	6.7	6.1
Accommodation & restaurant	-16.8	-1.3	13.3	14.3	16.6	11.3	15.6
Transport & Storage	5.5	8.0	6.5	7.2	8.8	7.8	8.4
Information & Communication	14.5	7.4	9.9	11.0	11.4	10.7	10.8
Financial & Insurance	8.3	9.4	6.9	2.8	5.6	3.2	5.8
Public administration	5.6	5.5	5.6	6.5	6.1	7.9	6.3
Professional, Administration & Support Services	3.2	2.5	4.5	3.7	5.9	3.1	2.9
Real estate	5.6	7.2	8.8	6.1	4.1	5.7	3.6
Education	7.8	4.9	5.3	5.1	5.8	5.1	6.1
Health	8.1	5.8	4.8	4.3	4.5	4.4	4.5
Other services	4.2	3.9	4.3	5.1	4.9	4.6	4.5
FISIM	11.3	13.5	0.5	-3.3	1.1	-2.2	0.1
2.3 Taxes on products	3.4	2.8	4.4	5.4	5.2	5.7	5.1
Real GDP Growth	5.4	5.7	5.9	4.9	6.3	5.5	5.9
* Revised							
Source: Kenya National Bureau of Statistics							

2.0 DOMESTIC ECONOMY

Agriculture

The Agriculture sector grew by 6.4 percent in 2018, a significant improvement compared to 1.9 percent in 2017 arising from favourable weather conditions, which supported increased production of crops and animal husbandry. As a result, its contribution to real GDP growth increased to 1.4 percentage points from 0.4 percentage points in 2017 (**Chart 2.1**).



Source: Kenya National Bureau of Statistics

Services

The services sector continues to be the main driver of growth due to strong and resilient performance of Accommodation and Restaurants, Transport and Storage, Information and Communication, and wholesale and retail. The sector grew by 6.9 percent compared to 6.5 percent in 2017. Consequently, its contribution to real GDP growth increased to 3.4 percentage points from 3.2 percentage points in 2017.

Industry

The growth of Industry rebounded to 5.3 percent from 3.8 percent in 2017 reflecting good performance of manufacturing sector, which grew by 4.5 percent compared to 0.5 percent, consistent with increased government and private sector activity to support the Big 4 Agenda. Electricity and Water supply also remained strong reflecting the effects of favourable weather conditions, which enhanced electricity generation and water supply. However, the contribution of industry to overall GDP growth remains low.

2.2 Inflation

Overall inflation remained within the target range in the FY2018/19. The overall inflation rate rose from 4.4 percent in July 2018 to 5.7 percent in June 2019, mainly on account of elevated energy and food prices (**Table 2.2**).

On average, inflation rate was 5.2 percent during the FY2018/19, similar to the average inflation in the FY 2017/18.

Non-Food-Non-Fuel inflation

Despite the imposition of excise taxes on alcoholic beverages, airtime and internet service, Non-Food-Non-Fuel inflation remained low and stable during FY 2018/19. It declined to 3.4 percent in June 2019 from 4.7 percent in September 2018. Its contribution to overall inflation remained low mainly arising from the success of monetary policy in containing demand pressures in the economy during the financial year.

2.0 DOMESTIC ECONOMY

Table 2.2: Developments in Inflation

Percent	2018						2019					
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Overall 12-month inflation	4.4	4.0	5.7	5.5	5.6	5.7	4.7	4.1	4.4	6.6	5.5	5.7
Food Inflation	0.9	-0.6	0.9	0.9	2.0	2.6	1.8	1.3	2.9	7.7	6.0	6.6
Fuel Inflation	12.4	14.2	17.4	16.5	14.3	13.8	12.1	11.4	8.8	7.5	6.7	6.3
Non-(Food & Fuel) Inflation	4.0	4.2	4.7	4.7	4.6	4.2	3.5	3.1	3.1	3.5	3.3	3.4
Average annual	5.0	4.6	4.5	4.5	4.6	4.7	4.7	4.7	4.7	4.9	5.0	5.2
Three months annualised	-3.3	-5.8	1.7	2.1	0.1	-1.3	3.3	7.5	11.6	26.4	22.0	11.4

Source: Kenya National Bureau of Statistics and Central Bank of Kenya

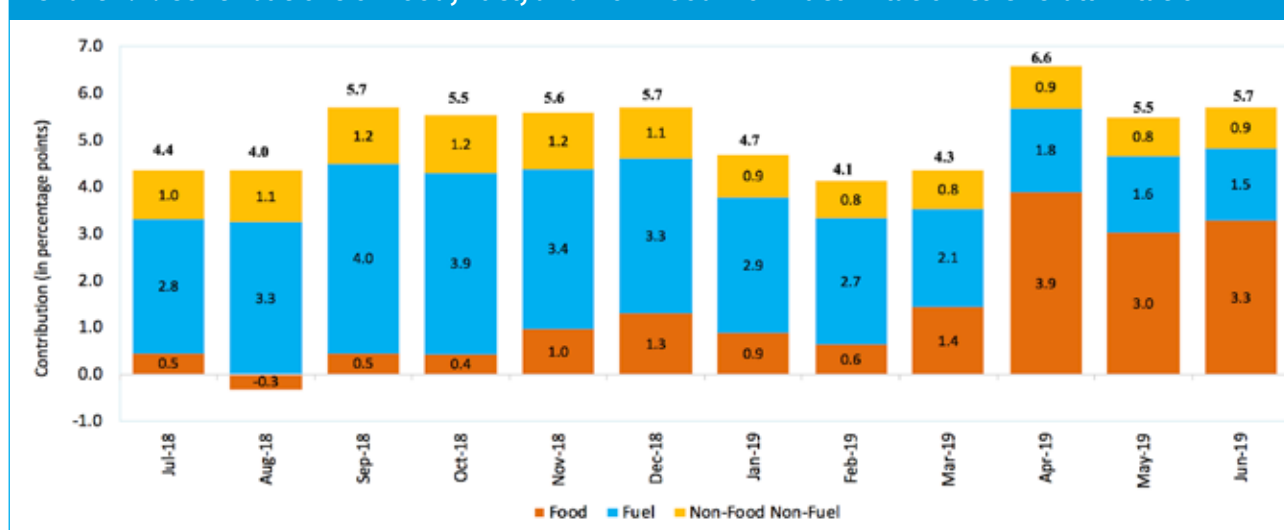
Fuel Inflation

Fuel inflation remained the most significant driver of inflation in FY 2018/19 arising from higher energy prices following a ban on logging and restrictions in charcoal trade in March 2018, and imposition of Value Added Tax (VAT) on pump prices in September 2018. It increased to 17.4 percent in September 2018 from 12.4 percent in July 2018 largely driven by rising domestic and international energy¹ prices. Its contribution to overall inflation increased from 2.8 percentage points in July 2018 to 4.0 percentage points in September 2018 before declining gradually to 1.5 percentage points in June 2019 as the impact of high charcoal prices on inflation dissipated (Chart 2.2).

Food inflation

Food inflation remained relatively low during the financial year owing to favourable weather conditions, which supported improved food supply. It stood at 0.9 percent in July and decelerated to -0.6 percent in August 2018 before recovering to stand at 2.6 percent in December 2018. Its contribution to overall inflation remained low in the first nine months of the financial year supported by abundant supply of food, which resulted in significant reduction in food prices. Its contribution to overall inflation edged up towards the end of the financial year following depressed food supply arising from below average and delayed onset of the long rains in March- April 2019.

Chart 2.2: Contributions of Food, Fuel, and Non-Food-Non-Fuel Inflation to Overall Inflation



Source: Kenya National Bureau of Statistics and Central Bank of Kenya

¹ Energy items comprise Petrol, Diesel, LPG Gas, Kerosene, Firewood, Charcoal and Electricity.

2.0 DOMESTIC ECONOMY

2.3 Balance of Payments

The Current Account

During the FY 2018/19, the current account balance improved by USD 989 million to a deficit of USD 3,788 million (4.2 percent of GDP) from a deficit of USD 4,778 million (5.4 percent of GDP) in the FY 2017/18. The improvement was recorded in the goods account, services and secondary income account (**Table 2.3**).

Item	FY 2017/18*	FY 2018/19				FY 2018/19**	FY 2018/19- 2017/18	
		Jul-Sep Q1	Oct-Dec Q2	Jan-Mar Q3	Apr-Jun Q4		Change	%
	Current Account	-4,778	-1,081	-913	-782	-1,012	-3,788	989
Goods	-10,463	-2,525	-2,519	-2,372	-2,693	-10,110	354	-3.4
Exports (fob)	6,054	1,510	1,411	1,570	1,462	5,953	-100	-1.7
o.w Coffee	220	52	41	57	72	222	2	1.0
Tea	1,463	324	315	311	248	1,198	-265	-18.1
Horticulture	972	269	225	284	259	1,037	65	6.7
Oil products	49	11	9	8	8	36	-12	-25.0
Manufactured Goods	389	91	98	96	100	384	-5	-1.2
Raw Materials	344	86	88	77	93	344	-0	-0.1
Chemicals and Related Products	424	121	113	113	112	460	36	8.5
Miscellaneous Man.Articles	578	160	140	134	156	589	10	1.8
Re-exports	680	182	144	192	174	693	13	1.9
Other	934	214	237	299	240	990	56	6.0
Imports (fob)	16,517	4,036	3,930	3,943	4,155	16,063	-454	-2.7
o.w Oil	3,130	879	818	742	1,020	3,459	329	10.5
Chemicals	2,393	633	607	658	612	2,511	118	4.9
Manufactured Goods	2,810	746	688	683	756	2,872	63	2.2
Machinery	2,783	710	783	646	684	2,823	40	1.4
Transport Equipment	1,688	411	336	494	386	1,627	-61	-3.6
Food	2,387	380	360	435	445	1,620	-767	-32.2
Other	1,327	276	338	285	252	1,151	-176	-13.2
Services	1,535	414	496	604	413	1,927	392	25.5
Transport Services (Net)	539	143	189	214	199	744	205	38.1
Travel Services (Net)	754	210	218	189	202	818	64	8.5
Other Services (Net)	242	62	90	201	12	364	122	50.5
Primary Income (Net)	-713	-197	-160	-289	-202	-848	-135	18.9
Secondary Income (Net)	4,864	1,226	1,271	1,276	1,470	5,243	379	7.8
* Revised								
**Provisional								
fob - free on board								
Source: Central Bank of Kenya								

2.0 DOMESTIC ECONOMY

Goods Account

The balance in the goods account improved by USD 354 million to a trade deficit of USD 10,110 million in the FY 2018/19, attributed to lower merchandise imports, which more than offset the reduction in merchandise exports. The lower imports were mainly food, machinery and transport equipment. Analysis by direction of trade shows that the lower imports were from Africa mainly the EAC and COMESA regions, and China (**Table 2.4**). The lower imports from China was on account of reduced importation of machinery and transport equipment following the near completion of the Nairobi- Naivasha standard gauge railway line. However, oil import bill increased during the period under review, following higher oil prices.

The decline in merchandise exports was mainly attributed to lower receipts from tea exports following lower tea prices in the first half of FY 2018/19 and lower tea production caused by dry weather in the second half of FY 2018/19.

Exports by direction of trade shows that Kenya's exports to Africa was lower by USD 53 million to USD 2,116, following reduced exports to Egypt, South Sudan and Somalia (**Table 2.4**). The decline was also recorded in reduced exports to Pakistan, with its share dropping to 8.2 percent in FY 2018/19 from 10.2 percent in FY 2017/18. However, exports to the EAC region increased marginally to USD 1,172 million, with its share increasing to 19.7 percent from 18.7 percent. The increase in exports to European Union was on account of higher exports of horticulture to the Netherlands and Germany.

Services Account

The balance in the services account improved by USD 392 million to a surplus of USD 1,927 million in 2018/19 (**Table 2.3**). The improvement was on account of higher receipts from transport, travel and other services specifically

financial and telecommunications services. The increase in transport services was attributed to higher receipts from freight and air transport. The increase in cross border financial services and adoption of modern financial technology contributed to higher financial and telecommunications services. Improved performance on travel services was on account of increased tourist arrivals following improved security and marketing of Kenya as a tourist destination.

The balance in the secondary income account improved by USD 379 million to USD 5,243 million in the FY 2018/19. The improvement was mainly on account of higher remittance receipts, which increased by USD 678 million to USD 2,768 million. However, the balance in the primary income account worsened by USD 135 million to a deficit of USD 845 million following higher foreign interest payments.

Capital and Financial Account

The capital account recorded a surplus of USD 32 million in the FY 2018/19, mainly because of an increase in project grants. The financial account recorded net inflows of USD 1,637 million, reflecting higher inward Direct Investment and Other Investment liabilities (**Table 2.5**). Inward Direct Investment increased by USD 610 million and was mainly in the form of equity and investment fund shares amounting to USD 446 million and debt instrument of USD 164 million. Other Investment liabilities increased by USD 821 million, attributed to uptake of loans by the government. Portfolio liabilities increased by USD 136 million but was offset by an increase in portfolio assets of USD 135 million.

2.0 DOMESTIC ECONOMY

IMPORTS	(in millions of US dollars)			Share of Imports (%)			EXPORTS	(in millions of US dollars)			Share of Exports (%)		
	Year to June			Year to June				Year to June			Year to June		
Region/ Country	2017	2018	2019	2017	2018	2019	Region/ Country	2017	2018	2019	2017	2018	2019
Africa	1,632	2,136	2,029	11.0	12.9	12.6	Africa	2,199	2,169	2,116	38.5	35.8	35.5
<i>Of which</i>							<i>Of which</i>						
South Africa	567	637	676	3.8	3.9	4.2	Uganda	611	601	609	10.7	9.9	10.2
Egypt	332	359	369	2.2	2.2	2.3	Tanzania	281	294	304	4.9	4.9	5.1
Others	732	1,140	984	4.9	6.9	6.1	Egypt	170	213	192	3.0	3.5	3.2
							Sudan	54	67	62	0.9	1.1	1.0
EAC	417	743	564	2.8	4.5	3.5	South Sudan	157	152	114	2.8	2.5	1.9
COMESA	854	1,258	1,066	5.8	7.6	6.6	Somalia	201	167	133	3.5	2.8	2.2
Rest of the World	13,178	14,381	14,034	89.0	87.1	87.4	DRC	197	167	141	3.4	2.8	2.4
<i>Of which</i>							Rwanda	167	176	185	2.9	2.9	3.1
India	1,826	1,627	1,779	12.3	9.9	11.1	Others	362	333	377	6.3	5.5	6.3
United Arab Emirates	1,029	1,029	1,635	6.9	6.2	10.2							
China	3,904	3,904	3,720	26.4	23.6	23.2	EAC	1,135	1,129	1,172	19.9	18.7	19.7
Japan	809	809	819	5.5	4.9	5.1	COMESA	1,470	1,460	1,455	25.8	24.1	24.4
USA	515	515	568	3.5	3.1	3.5	Rest of the World	3,505	3,885	3,837	61.5	64.2	64.5
United Kingdom	312	299	328	2.1	1.8	2.0	<i>Of which</i>						
Singapore	65	43	56	0.4	0.3	0.3	United Kingdom	357	397	389	6.3	6.6	6.5
Germany	385	460	447	2.6	2.8	2.8	Netherlands	418	447	467	7.3	7.4	7.8
Saudi Arabia	964	1,315	1,587	6.5	8.0	9.9	USA	463	446	511	8.1	7.4	8.6
Indonesia	506	481	508	3.4	2.9	3.2	Pakistan	516	644	490	9.0	10.6	8.2
Netherlands	163	219	309	1.1	1.3	1.9	United Arab Emirates	273	307	367	4.8	5.1	6.2
France	246	224	246	1.7	1.4	1.5	Germany	123	109	112	2.2	1.8	1.9
Bahrain	117	46	51	0.8	0.3	0.3	India	81	76	72	1.4	1.3	1.2
Italy	241	238	217	1.6	1.4	1.3	Afghanistan	36	29	38	0.6	0.5	0.6
Others	2,094	3,172	1,765	14.1	19.2	11.0	Others	1,238	1,428	1,392	21.7	23.6	23.4
Total	14,810	16,517	16,063	100	100	100	Total	5,704	6,054	5,953	100	100	100
EU	1,947	2,088	2,214	13.1	12.6	13.8	EU	1,184	1,183	1,273	20.8	19.5	21.4
China	3,904	3,904	3,720	26.4	23.6	23.2	China	122	75	141	2.1	1.2	2.4

Source: Kenya Revenue Authority and Central Bank of Kenya

2.0 DOMESTIC ECONOMY

Table 2.5: Balance on the Capital and Financial Account (USD Million)

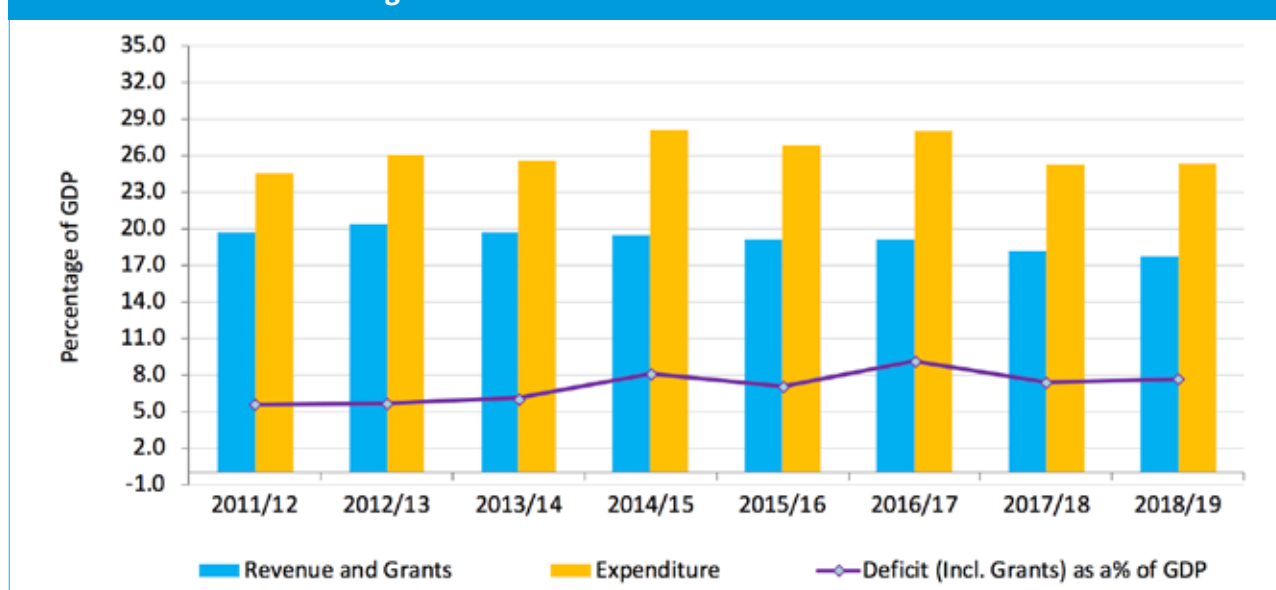
ITEM	FY 2017/18*	FY 2018/19				FY 2018/19**	FY 2018/19-2017/18	
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun		Change	%
		Q1	Q2	Q3	Q4			
Capital account credit	225	36	51	42	128	257	32	14.2
Capital account credit	225	36	51	42	128	257	32	14.2
Capital account: debit	0	0	0	0	0	0	0	0.0
Financial Account	-5,038	-836	-2,373	-957	-2,509	-6,674	-1,637	32.5
Direct investment: assets	154	18	111	49	69	248	93	60.4
Direct investment: liabilities	1,197	383	836	284	304	1,807	610	51.0
Portfolio investment: assets	868	265	282	259	197	1,003	135	15.6
Portfolio investment: liabilities	1,777	-66	-65	7	2,037	1,913	136	7.6
Financial derivatives: net	-0	0	2	-6	-4	-9	-8	3,735.8
Other investment: assets	724	180	-11	-16	282	435	-289	-40.0
Other investment: liabilities	3,810	983	1,986	951	711	4,631	821	21.6

* Revised
 ** Provisional
 Source: Central Bank of Kenya

2.4 Government Budget

Government budgetary operations in the Fiscal Year 2018/19 resulted in a deficit including grants of KSh 721.1 billion (7.6 per cent of GDP) compared to KSh 632.4 billion 7.4 per cent of GDP) in the previous year. However, it was above the target level of 6.8 per cent of GDP (**Table 2.6 and Chart 2.3**).

Chart 2.3: Government Budget Performance



Source: The National Treasury-Provisional BOT June 2019

2.0 DOMESTIC ECONOMY

Government Revenue

Government revenue (including grants) increased by 9.2 per cent to KSh 1,690.8 billion (17.8 percent of GDP) compared to the previous fiscal year. Appropriations-In-Aid increased by 10.7 per cent while external grants declined by 25.6 per cent. Tax revenue accounted for 82.8 per cent of revenues (**Table 2.6**).

Expenditure and Net Lending

Government expenditure and net lending increased by 12.1 per cent to KSh 2,405.9 billion (25.3 percent of GDP) in the FY 2018/19, but was below the programmed target. Development expenditure and recurrent expenditures rose by 15.4 per cent, and 10.9 percent, respectively. Recurrent expenditure accounted for 62.2 per cent of total government expenditure.

	FY 2015/16	FY 2016/17	FY 2017/18	FY 2018/19		
	Actual	Actual	Actual	Provisional	Target	Over(+) / Below (-)
1. REVENUE & GRANTS	1,284.4	1,463.6	1,548.9	1,690.8	1,829.0	-138.3
Revenue	1,152.5	1,306.5	1,522.4	1,496.9	1,588.9	-92.0
Tax Revenue	1,069.8	1,219.5	1,282.9	1,400.6	1,474.6	-74.0
Non Tax Revenue	82.7	87.0	82.1	96.4	113.5	-17.2
Appropriations-in-Aid	102.2	133.0	157.4	174.1	206.2	-32.0
External Grants	29.6	24.1	26.5	19.7	34.7	-15.0
2. EXPENDITURE AND NET LENDING	1,804.5	2,146.3	2,146.7	2,405.9	2,541.9	-135.9
Recurrent Expenditure	1,036.6	1,201.3	1,349.7	1,496.2	1,574.1	-77.9
Development Expenditure	486.7	639.9	469.7	542.0	598.1	-56.1
County Transfers	276.2	305.0	327.3	360.7	365.0	-4.2
Other		6.0		7.0	4.7	2.3
3. DEFICIT (incl Grants) on a commitment basis (1-2)	-520.1	-682.7	-597.7	-715.2	-712.8	-2.3
Deficit (incl Grants) on a commitment basis (% of GDP)	-7.6	-8.9	-7.0	-7.5	-7.5	-0.0
4. ADJUSTMENT TO CASH BASIS	45.6	-15.0	-34.7	-5.9	62.3	-68.2
5. DEFICIT ON A CASH BASIS	-474.6	-697.7	-632.4	-721.1	-650.5	-70.5
Deficit on a cash basis (% of GDP)	-7.1	-9.1	-7.4	-7.6	-6.8	-0.7
6. DISCREPANCY: Expenditure (+) / Revenue (-)			-1.1			
7. FINANCING	474.6	697.7	631.3	721.1	650.5	70.5
Domestic (Net)	202.3	309.2	273.7	303.7	255.4	48.2
External (Net)	269.9	386.2	355.0	414.5	391.2	23.4
Capital Receipts (net of restructuring costs)	2.4	2.3		2.9	3.9	-1.0
Others	0.0	0.0	2.6	0.0	0.0	0.0

Source: The National Treasury-Provisional BOT June 2019

2.0 DOMESTIC ECONOMY

Financing

Net domestic borrowing during FY 2018/19 amounted to KSh 303.7 billion and was within target. The borrowing comprised KSh 13.6 billion from the Central Bank, KSh 126.9 billion from Commercial Banks, KSh 160.3 billion from Non-Banking Financial Institutions and KSh 2.8 billion from Non-residents (**Table 2.7**).

Outlook for FY 2019/20

In the budget estimates for the FY 2019/20 total revenue is projected at KSh 2.1 trillion (19.7 per cent of GDP) while Government expenditure and net lending is projected at KSh 2.8 trillion (25.9 per cent of GDP). The overall budget deficit including grants on commitment basis is, therefore, projected at KSh 634.8 billion (5.9 per cent of GDP), to be financed through net external borrowing of KSh 331.3 billion (3.1 per cent of GDP) and net domestic borrowing of KSh 300.3 billion (2.8 per cent of GDP).

Table 2.7: Domestic Financing (KSh Billion)

	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19
1. From CBK	(121.1)	136.3	(111.1)	(22.4)	(26.3)	13.6
2. From commercial banks	73.4	108.0	187.2	169.5	124.3	126.9
3. From Non-banks	102.5	27.5	139.4	160.7	172.8	160.3
4. From Non-Residents	6.4	(3.5)	4.6	1.9	3.0	2.8
Change in Credit from banks (From 30th June)	(47.7)	244.3	76.0	147.2	97.9	140.5
Change in Credit from non-banks (From 30th June)	102.5	27.5	139.4	160.7	172.8	160.3
Change in Credit from non-residents (From 30th June)	6.4	(3.5)	4.6	1.9	3.0	2.8
5. Total Change in Dom. Credit (From 30th June)	61.2	268.4	220.1	309.8	273.7	303.7
NB. Treasury Bills are reflected at Cost						
Source: Central Bank of Kenya						

2.5 Public Debt

Kenya's public and publicly guaranteed debt increased by 15.3 percent during the FY 2018/19, with both domestic and external debt increasing at 12.4 percent and 18.1 percent, respectively. Public debt profile comprised 48.0 percent and 52.0 percent of domestic and external debt respectively. The rate of public debt accumulation was faster than the projected rate of economic expansion (8.2 percent), and the government ran a budget deficit of 7.6 percent during the FY 2018/19. As a result, the ratio of public debt to GDP rose to 61.1 percent from 57.3 percent in the previous FY (**Table 2.8**).

Domestic Debt

The 12.4 percent increase in domestic debt was mainly driven by increased uptake of Treasury bonds (by 15.6 percent) in line with the government objective of lengthening the average time to maturity of domestic debt securities (**Table 2.8**). The Government issued and re-opened long-dated instruments during the FY2018/19. The 364 days Treasury bill and 15 years Treasury bond accounted for the largest increase of outstanding debt securities during the fiscal year. As a result, the domestic debt maturity profile for all securities improved from 4.13 years in June 2018 to 4.87 years in June 2019.

2.0 DOMESTIC ECONOMY

External Debt

Kenya's public and publicly guaranteed external debt increased by 18.1 percent to KSh 3,023.1 billion (**Table 2.8**). The growth in external debt during this period was mainly attributed to the US dollar 2.1 billion Eurobond contracted in June 2019 and loans from the Chinese government to finance the Nairobi – Naivasha Standard Gauge Railway. The proportion of debt owed to multilateral lenders declined by 1.9 percent while that of commercial loans and bilateral lenders increased by 0.8 percent and 1.0 percent, respectively.

Public Debt Service

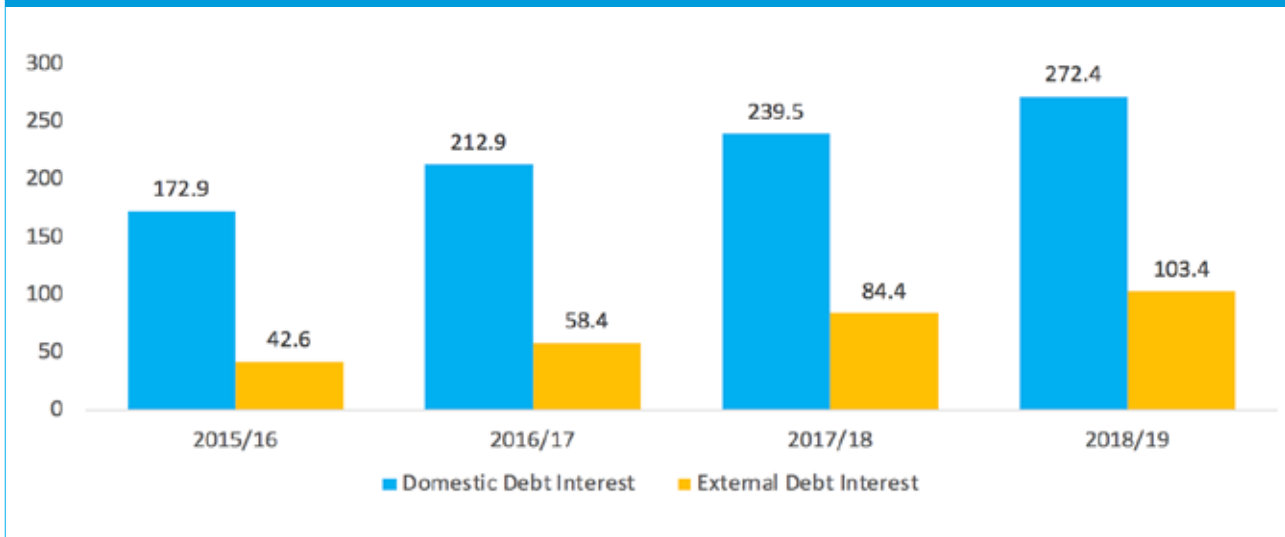
Cumulative interest and other charges on domestic and external debt for the FY 2018/19 increased by 13.7 percent and 22.4 percent, respectively (**Chart 2.4**).

Total external debt service increased during the FY 2018/19 mainly on account of the one off repayments of US 750 million on the 2014, 5-year Eurobond and US dollar 750 million syndicated loan. Debt service to revenues and exports ratios stood at 22.0 percent and 31.0 percent, respectively (**Chart 2.5**).

	June 2016		June 2017		June 2018		June 2019**	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT								
Securitised debt	1,765.1	97.2	2,100.5	99.4	2,413.8	97.4	2,723.5	97.8
Treasury Bills	613.0	33.8	768.5	36.4	901.9	36.4	975.3	35.0
Of which Repo Treasury bills	25.0	1.4	24.4	1.2	23.3	0.9	21.1	0.8
Treasury Bonds	1,152.0	63.5	1,332.0	63.1	1,511.9	61.0	1,748.1	62.7
Non Securitised debt	50.1	2.8	11.1	0.5	65.0	2.6	62.5	2.2
Overdraft at CBK	44.2	2.4	0.0	0.0	56.8	2.3	57.3	2.1
others	5.9	0.3	11.1	0.5	8.1	0.3	5.1	0.2
TOTAL DOMESTIC DEBT	1,815.1	100.0	2,112.3	100.0	2,478.8	100.0	2,785.9	100.0
(as a % of GDP)*	27.0		27.6		28.2		29.3	
(as a % of Total Debt)	50.2		47.9		49.2		48.0	
EXTERNAL DEBT**								
Bilateral	548.4	30.5	724.8	31.6	816.1	35.6	996.1	32.9
Multilateral	798.8	44.5	841.9	36.7	821.0	35.8	914.4	30.2
Comm. Banks	432.4	24.1	712.1	31.0	906.4	39.5	1,095.8	36.2
Export Credit	16.6	0.9	15.9	0.7	16.7	0.7	16.9	0.6
TOTAL EXTERNAL DEBT	1,796.2	100.0	2,294.7	100.0	2,560.2	100.0	3,023.1	100.0
(as a % of GDP)*	26.8		30.0		29.1		31.8	
(as a % of Total Debt)	49.8		52.1		50.8		52.0	
TOTAL PUBLIC DEBT	3,611.3		4,407.0		5,039.0		5,809.1	
(as a % of GDP)*	53.8		57.5		57.3		61.1	
* Estimates								
** Provisional								
Source: The National Treasury and Central Bank of Kenya								

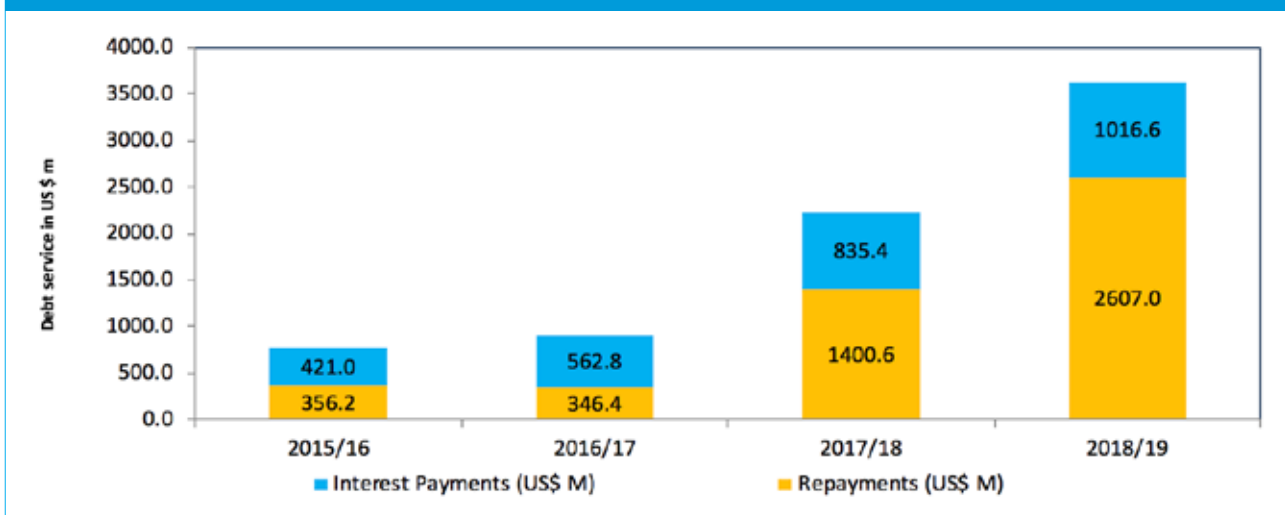
2.0 DOMESTIC ECONOMY

Chart 2.4: Domestic and External Debt Interest Payments



Source: The National Treasury

Chart 2.5: External Debt Service



Source: The National Treasury

3.0 REGIONAL INTEGRATION DEVELOPMENTS

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Background

The Central Bank is involved in a number of regional integration initiatives under the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). The CBK focuses mainly on monetary and financial integration, and monitors progress in the implementation of macroeconomic convergence and other financial and monetary developments. The following are highlights of progress in meeting the regional integration commitments.

The EAC Monetary Cooperation Programme

The EAC Central Banks, through the Monetary Affairs Committee, are mandated to steer aspects of monetary and financial cooperation, especially laying the foundation for the EAC Monetary Union (EAMU), which encompasses a single currency and an East African Central Bank. In preparation for the EAMU, the EAC Partner States have agreed to attain and maintain for at least three consecutive years four macroeconomic convergence criteria: a ceiling on overall inflation of 8 percent, a ceiling on fiscal deficit, including grants of 3 percent of GDP, a

ceiling on Gross Public Debt of 50 percent of GDP in Net Present Value terms; and foreign exchange reserves cover of 4.5 months of imports.

Most EAC Partner States are on track towards attainment of the EAMU Convergence criteria on inflation, foreign exchange reserves, and Net Present Value of Debt to GDP. However, challenges remain in attaining the criterion on fiscal deficit largely due to increased spending on infrastructure development.

The COMESA Monetary Cooperation Programme

The overarching objective of the COMESA Monetary Cooperation Programme is the establishment of a Monetary Union by the year 2025. This entails creation of a common area of monetary and financial system, which will facilitate integration of financial markets and promote economic growth. Toward this end, partner states are expected to maintain a number of primary (preconditions for convergence) and secondary (reinforcement conditions) convergence criteria (**Table 3.1**).

Primary Criteria	Secondary Criteria
<ul style="list-style-type: none"> Overall budget deficit to GDP ratio (excluding grants) of not more than 4 percent 	<ul style="list-style-type: none"> Achievement and maintenance of stable real exchange rates
<ul style="list-style-type: none"> Annual average inflation rate not exceeding 5 percent 	<ul style="list-style-type: none"> Achievement and maintenance of market based positive real interest rates
<ul style="list-style-type: none"> Minimize central bank financing of the budget towards 0 percent target 	<ul style="list-style-type: none"> Achievement of sustainable real GDP growth rate of not less than 7 percent
<ul style="list-style-type: none"> External reserves of equal to or more than 5 months of imports of goods and non-factor services. 	<ul style="list-style-type: none"> Maintain current account deficit (excluding grants) as a percent of GDP at a sustainable level
	<ul style="list-style-type: none"> Total domestic revenue to GDP ratio of not less than 20 percent
	<ul style="list-style-type: none"> Maintain total debt as a ratio of GDP at a sustainable level
	<ul style="list-style-type: none"> Achievement and maintenance of domestic investment rate of at least 20 percent

3.0 REGIONAL INTEGRATION DEVELOPMENTS

Kenya is on track to meeting the Macroeconomic Convergence Criteria. However, challenges remain in attaining the criteria on fiscal deficit, real GDP growth, debt reduction initiatives, total domestic revenue to GDP ratio and the desired level of domestic investment.

The Association of African Central Banks (AACB)

The AACB is mandated to implement the African Monetary Cooperation Programme (AMCP) whose aim is to establish a harmonized monetary system, and ultimately establish a single monetary zone by 2021.

Twenty-two of the forty-nine countries met all AACB primary convergence criteria in 2018 (**Table 3.2**). Improved performance was mainly in terms of budget deficit and central bank financing of the budget deficit that had compliance ratios of 82.4 percent and 81.6 percent, respectively. Inflation rate criterion recorded the lowest compliance ratio (68.6 percent) in 2018. Only one out of 46 countries met all the secondary criteria in 2018. The tax revenue collection (required to be greater than 20 percent of GDP) recorded the poorest compliance rate of 23.5 percent.

Kenya met the criteria on inflation, central bank credit to government and on external reserves.

Primary Criteria	Secondary Criteria
<ul style="list-style-type: none"> Overall budget deficit/GDP ratio of not more than 5 percent (Target \leq 3 percent by 2033). 	<ul style="list-style-type: none"> General Government debt to GDP ratio of not more than 65 percent.
<ul style="list-style-type: none"> Annual average inflation rate not exceeding 7 percent (Target \leq 3 percent by 2038). 	<ul style="list-style-type: none"> Total tax revenue to GDP ratio of not less than 20 percent
<ul style="list-style-type: none"> Minimize the central bank financing of the budget to below 5 percent target (Target 0 percent by 2038). 	<ul style="list-style-type: none"> Nominal Exchange Rate Variability \pm10 percent (Target \pm 5 percent).
<ul style="list-style-type: none"> External reserves of equal to or more than 3 months of imports of goods and non-factor services (Target \geq 6 months by 2038). 	<ul style="list-style-type: none"> Ratio of Government Capital Investment to Tax Revenue of not less than 30 percent

4.0 CENTRAL BANK OPERATIONS

4.0 CENTRAL BANK OPERATIONS

4.1 Monetary Operations

Monetary Policy

Monetary policy formulation and implementation at the Central Bank aimed at maintaining overall inflation at the target of 5.0 percent with a flexible margin of 2.5 percent on either side. Overall inflation remained within the target range during the year, averaging 5.2 percent. Non-food-non-fuel inflation remained below 5.0 percent, indicating muted demand pressures.

The Monetary Policy Committee (MPC) held bi-monthly meetings during the year. In its first meeting during the financial year in July, the MPC reduced the Central Bank Rate (CBR) to 9.00 percent from 9.50 percent, noting that there was room for an accommodative monetary policy as inflation expectations were well anchored within the target range, economic growth prospects were improving and the economic output was below its potential. In its subsequent meetings, the MPC retained the CBR at 9.0 percent noting that the policy stance remained appropriate.

Money Supply

The 12-month growth in money supply, M3, declined to 9.2 percent in FY 2018/19 from 10.4 percent in FY2017/18, largely reflecting the slowdown in net domestic assets (NDA) of the banking system. The contraction in NDA of the banking system was mainly on account of net lending to other public sector, and other items net, in part reflecting an increase in capital and reserves (**Table 4.1**).

On the liabilities side, the decline in growth of money supply was reflected in slower growth in deposits, primarily the foreign currency deposits. The sharp decline in annual growth of foreign currency deposits to 6.8 percent in FY2018/19 from 25.8 percent in FY2017/18, largely reflected the significant increase in the households' bank balances of foreign currency in the previous financial year, partly due to increased diaspora remittances.

Net Foreign Assets

Net Foreign Assets (NFA) of the banking system grew by 24.2 percent in FY2018/19 compared to 17.8 percent in FY2017/18, largely reflecting the buildup of NFA of the Central bank. The increase in NFA of the CBK, which grew by 20.1 percent, was mainly due to Government external financing (**Table 4.1**).

Domestic Credit

Net domestic credit increased by 7.8 percent in FY2018/19 compared to 6.7 percent in the previous financial year, largely due to a pickup in banks' lending to private sector and net lending to the government (**Table 4.2**). Net lending to government grew by 19.5 percent in FY 2018/19 compared to 15.3 percent in FY 2017/18, reflecting increased drawdown of government deposits at CBK following repayment of the maturing Eurobond and accelerated Government payments towards the end of the FY2018/19. Net credit to Other Public Sector declined by 13.8 percent in FY 2018/19 from an increase of 4.7 percent in FY 2017/2018, partly due to increased deposits by the public entities.

Growth in banks' credit to the private sector improved to 5.2 percent from 4.3 percent, supported by strong lending to manufacturing, consumer durables, private households, trade and transport and communication (**Table 4.2**). Lending to manufacturing sector improved in the last quarter of 2018/19, with the credit mainly channeled to the food and beverage sub-sector. Lending to the household sector, which comprises private households and consumer durables was strong particularly in the second half of FY2018/19, reflecting increased marketing efforts by banks including rollout of new innovative credit products.

4.0 CENTRAL BANK OPERATIONS

	End Month Level (KSh Billions)			Annual Growth Rate			Annual Absolute Change (KSh Billions)			
	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19	
Components of M3										
1. Money supply, M1 (1.1+1.2+1.3)	1,380.0	1,425.6	1,575.5	22.6	3.3	10.5	254.6	45.5	149.9	
1.1 Currency outside banks	207.1	218.3	196.9	10.0	5.4	-9.8	18.8	11.2	-21.3	
1.2 Demand deposits	1,092.4	1,126.8	1,212.8	25.5	3.1	7.6	221.9	34.4	86.0	
1.3 Other deposits at CBK 1/	81.2	81.2	165.8	21.8	-0.0	104.2	14.6	-0.0	84.6	
2. Money supply, M2 (1+2.1)	2,494.2	2,681.9	2,943.7	4.8	7.5	9.8	113.6	187.7	261.9	
2.1 Time and saving deposits	1,116.1	1,258.3	1,372.7	-11.1	12.7	9.1	-139.2	142.2	114.4	
3. Money supply, M3 (2+3.1)	2,955.9	3,262.6	3,564.2	5.3	10.4	9.2	148.7	306.7	301.6	
3.1 Foreign Currency Deposits	461.7	580.8	620.5	8.2	25.8	6.8	35.1	119.1	39.7	
Sources of M3										
1. Net foreign assets 2/	642.6	756.9	939.9	14.6	17.8	24.2	81.7	114.3	183.0	
Central Bank	738.3	783.6	941.0	6.3	6.1	20.1	43.8	45.3	157.4	
Banking Institutions	-95.8	-26.7	-1.1	-28.4	-72.1	-95.9	37.9	69.1	25.6	
2. Net domestic assets (2.1+2.2)	2,313.3	2,505.7	2,624.3	3.0	8.3	4.7	67.1	192.4	118.6	
2.1 Domestic credit	3,035.4	3,237.3	3,491.0	5.4	6.7	7.8	156.8	201.9	253.7	
2.1.1 Government (net)	646.2	745.1	890.5	15.3	15.3	19.5	85.8	98.8	145.5	
2.1.2 Private sector	2,282.3	2,380.4	2,504.0	1.9	4.3	5.2	42.7	98.0	123.6	
2.1.3 Other public sector	106.9	111.9	96.4	36.0	4.7	-13.8	28.3	5.0	-15.4	
2.2 Other assets net	-722.1	-731.6	-866.7	14.2	1.3	18.5	-89.7	-9.5	-135.1	
Memorandum items										
4. Overall liquidity, L (3+4.1)	3,954.8	4,434.2	4,896.0	8.5	12.1	10.4	311.5	479.4	461.8	
4.1 Non-bank holdings of government securities	998.9	1,171.6	1,331.7	19.5	17.3	13.7	162.7	172.7	160.2	

Absolute and percentage changes may not necessarily add up due to rounding

1/ Includes county deposits and special projects deposit

2/ Net Foreign Assets at current exchange rate to the US dollar.

Source: Central Bank of Kenya

Reserve Money

Growth in reserve money declined to 2.5 percent in FY2018/2019 from 7.4 percent in FY2017/18. In absolute terms, reserve money increased by KSh 10.6 billion, which was significantly lower than the KSh 29.6 billion increase in the previous year. The decline was largely

due to a reduction in currency outside banks and excess reserves, resulting from open market operations, which sterilized excess liquidity. Excess liquidity resulted from accelerated government spending towards the end of the FY 2018/2019, including payments of pending bills (**Table 4.3**).

4.0 CENTRAL BANK OPERATIONS

	End Month Level (KSh Billions)			Annual Growth Rate			Annual Absolute Change (KSh Billions)		
	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19
1. Credit to Government	646.2	745.1	890.5	15.3	15.3	19.5	85.8	98.8	145.5
Central Bank	-178.9	-204.4	-189.6	14.6	14.3	-7.2	-22.8	-25.5	14.8
Commercial Banks & NBFIs	825.1	949.5	1,080.2	15.2	15.1	13.8	108.6	124.4	130.7
2. Credit to other public sector	106.9	111.9	96.4	36.0	4.7	-13.8	28.3	5.0	-15.4
Local government	3.9	4.4	3.8	8.8	11.9	-13.7	0.3	0.5	-0.6
Parastatals	103.0	107.5	92.7	37.3	4.4	-13.8	28.0	4.5	-14.8
3. Credit to private sector	2,282.3	2,380.4	2,504.0	1.9	4.3	5.2	42.7	98.0	123.6
Agriculture	87.1	83.0	86.2	-11.7	-4.7	3.9	-11.6	-4.1	3.2
Manufacturing	286.2	321.1	357.6	-6.8	12.2	11.4	-20.8	34.9	36.5
Trade	390.6	423.9	447.1	10.9	8.5	5.5	38.3	33.3	23.2
Building and construction	102.8	116.5	109.2	-0.1	13.3	-6.3	-0.1	13.7	-7.4
Transport & communications	189.1	165.1	174.7	3.8	-12.7	5.8	6.9	-24.0	9.6
Finance & insurance	85.4	88.6	92.8	-4.3	3.8	4.7	-3.8	3.2	4.2
Real estate	359.9	373.7	377.4	10.4	3.8	1.0	33.8	13.8	3.8
Mining and quarrying	15.3	13.9	13.3	-36.5	-9.1	-4.3	-8.8	-1.4	-0.6
Private households	388.2	399.4	429.6	11.0	2.9	7.6	38.5	11.3	30.2
Consumer durables	168.3	181.4	220.1	7.5	7.8	21.3	11.8	13.1	38.7
Business services	141.9	151.4	146.6	-14.5	6.7	-3.2	-24.0	9.5	-4.8
Other activities	67.6	62.3	49.2	-20.6	-7.9	-21.0	-17.5	-5.3	-13.1
4. Total (1+2+3)	3,035.4	3,237.3	3,491.0	5.4	6.7	7.8	156.8	201.9	253.7

Source: Central Bank of Kenya

	End Month Level			Annual Growth Rate			Annual Absolute Change (KSh Billions)		
	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19	2016/17	2017/18	2018/19
1. Net Foreign Assets	738.3	783.6	941.0	6.3	6.1	20.1	103.5	45.3	157.4
2. Net Domestic Assets	-338.7	-354.4	-501.2	11.3	4.6	41.4	-65.3	-15.7	-146.8
2.1 Government Borrowing (net)	-178.9	-204.4	-189.6	14.6	14.3	-7.2	-79.2	-25.5	14.8
2.2 Commercial banks (net)	23.6	28.7	-21.3	695.0	21.7	-174.3	45.6	5.1	-50.1
2.3 Other Domestic Assets (net)	-186.8	-182.1	-293.7	20.8	-2.6	61.3	-31.6	4.8	-111.6
3. Reserve Money	399.6	429.2	439.8	2.4	7.4	2.5	38.2	29.6	10.6
3.1 Currency outside banks	207.1	218.3	196.9	10.0	5.4	-9.8	32.5	11.2	-21.3
3.2 Bank reserves	192.5	210.9	242.8	-4.7	9.6	15.1	5.7	18.4	31.9
3.2.1 Required Reserves	143.9	156.9	175.0	9.2	9.1	11.5	27.6	13.0	18.0
3.2.2 Cash in Till	46.7	44.2	52.6	0.4	-5.3	18.9	0.7	-2.5	8.3
3.2.3 Excess Reserves	1.9	9.8	15.3	-92.0	412.4	56.7	-22.6	7.9	5.5

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.2 Interest Rates

Central Bank Rate

The MPC lowered the CBR to 9.0 percent in July 2018 from 9.5 percent in May 2018. The MPC, however, retained the CBR at 9.0 percent during the subsequent meetings noting that the policy stance was appropriate, as inflation expectations remained well anchored within the target range. The MPC also continued to closely monitor any perverse response to its previous decisions.

Short Term Rates

Short term interest rates declined during FY2018/2019, in line with the policy stance adopted by the MPC, and improved liquidity conditions towards the end of the financial year (**Table 4.4**). The average interbank interest rate fell to 4.5 percent in FY2018/19 percent from 6.3 percent in FY2017/18, partly reflecting increased liquidity, particularly towards the end of FY 2018/2019 on account of increased government spending. However, the average

interbank rate remained below the CBR, and was relatively volatile partly reflecting market segmentation along bank tiers.

Similarly, interest rates on government securities declined in the FY2018/19, partly reflecting ample liquidity conditions and the resultant competitive bidding for securities. The average 91-day Treasury bill rate declined to 7.3 percent from 8.1 percent, while the average 182-day Treasury bill rate decreased to 8.5 percent from 10.4 percent.

Commercial bank rates

Commercial banks' average interest rates remained stable within the interest rate caps. The average commercial bank lending rate declined to 12.5 percent in June 2019 from 13.2 percent in June 2018, in line with the reduction in the CBR in July. Average commercial banks' deposit rate declined to 7.2 percent in June 2019 from 8.0 percent in June 2018. Consequently, the interest spread increased slightly from 5.2 percent to 5.3 percent.

Table 4.4 Interest Rates in Per Cent

	2017				2018				2019					
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun
91-day Treasury bill rate	8.69	8.42	8.13	8.01	8.02	7.87	7.64	7.34	7.19	7.02	7.08	7.41	7.17	6.90
182-day Treasury bill rate	10.53	10.38	10.32	10.53	10.39	9.99	8.82	8.40	8.92	8.55	8.28	8.11	7.85	7.64
Interbank rate	4.46	3.99	5.52	7.27	4.90	5.03	4.28	8.15	3.32	2.51	3.72	4.12	5.61	2.98
Repo rate	7.23	4.13	7.24	7.75	-	6.16	4.77	7.72	3.70	3.15	3.49	3.03	-	4.23
Reverse Repo rate	10.04	10.05	10.12	10.10	9.95	9.56	9.03	11.34	-	9.03	-	9.13	9.18	-
Central Bank Rate (CBR)	10.00	10.00	10.00	10.00	9.50	9.50	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
Average lending rate (1)	13.61	13.66	13.69	13.64	13.49	13.22	12.66	12.51	12.50	12.47	12.51	12.50	12.47	12.47
Overdraft rate	13.30	13.38	13.65	13.54	13.40	13.23	12.52	12.17	12.15	12.13	12.13	12.15	12.13	12.12
1-5years	13.81	13.80	13.87	13.83	13.67	13.39	12.85	12.70	12.68	12.62	12.70	12.68	12.62	12.64
Over 5years	13.55	13.64	13.51	13.46	13.31	13.00	12.51	12.47	12.47	12.48	12.49	12.48	12.47	12.46
Average deposit rate (2)	7.44	7.61	7.66	8.22	8.16	8.04	7.76	7.41	7.34	7.28	7.22	7.17	7.20	7.19
0-3months	7.28	7.76	7.71	8.43	8.48	8.41	8.22	7.83	7.73	7.69	7.62	7.56	7.58	7.55
Over 3 months deposit	8.17	8.04	8.02	8.39	8.26	8.14	7.64	7.67	7.58	7.49	7.43	7.48	7.50	7.53
Savings deposits	5.89	5.63	6.43	6.91	6.85	6.60	6.33	5.13	5.14	5.16	5.05	4.75	4.71	4.77
Spread (1-2)	6.18	6.06	6.04	5.41	5.33	5.18	4.91	5.09	5.16	5.19	5.29	5.34	5.27	5.28

Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

4.3 Foreign Exchange Operations and Reserves Management

Exchange Rates

Kenya's foreign exchange market remained relatively stable during the FY 2018/19, mainly supported by higher foreign exchange receipts and an adequate reserve buffer. The Kenya shilling strengthened against major international and regional currencies (**Table 4.5 and Chart 4.1**). The appreciation was largely supported by higher foreign exchange receipts from agriculture exports, travel and remittance inflows, and lower forex demand for food imports relative to the FY 2017/18.

Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 10.5 percent during the FY 2018/19. The increase was largely in the official reserves held by the Central Bank, which constituted 76 percent of gross reserves and stood at USD 9,656 million, equivalent to 6.0 months of import cover as at end June 2019 compared to USD 8,954 million (5.9 months of import cover) as at end June 2018 (**Table 4.6**).

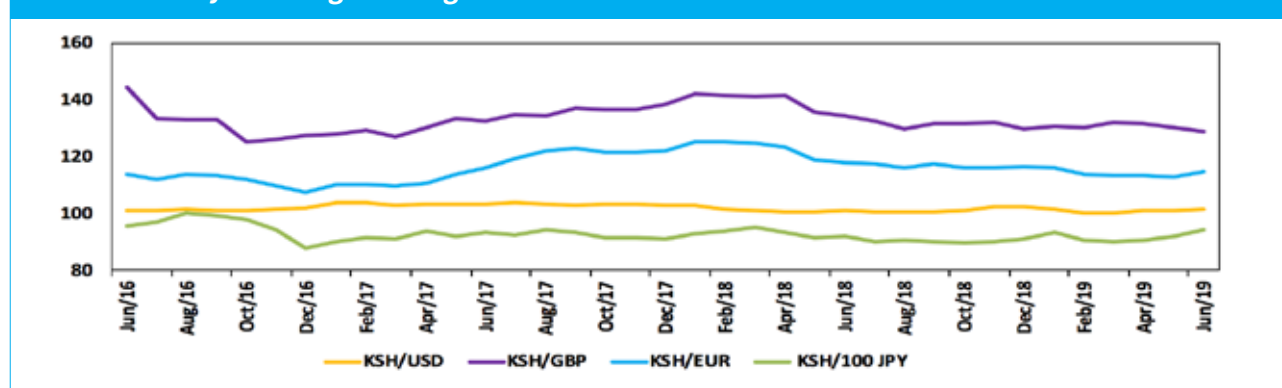
Table 4.5: Kenya Shilling Exchange Rates

	2016/17	2017/18	2018/19				Annual Average	% change 2018/19_2017/18
			Q1	Q2	Q3	Q4		
			Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	2018/19	
US Dollar	102.45	102.37	100.71	101.91	100.73	101.30	101.16	-1.2
Pound Sterling	129.97	137.86	131.30	131.14	131.11	130.22	130.94	-5.0
Euro	111.71	122.14	117.17	116.33	114.42	113.82	115.44	-5.5
100 Japanese Yen	94.13	92.84	90.40	90.32	91.44	92.21	91.09	-1.9
South Africa Rand	7.55	7.99	7.16	7.16	7.18	7.03	7.14	-10.7
Uganda Shilling*	34.42	35.74	37.39	36.75	36.67	36.97	36.94	3.4
Tanzania Shilling*	21.55	22.01	22.67	22.54	23.11	22.74	22.76	3.4
Rwanda Franc*	7.86	8.29	8.71	8.71	8.90	8.94	8.82	6.3
Burundi Franc*	16.46	17.15	17.57	17.50	17.88	18.10	17.76	3.6

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

Chart 4.1 Kenya Shilling Exchange Rates



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

USD Million (End of Period)	Jun-17	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19
1. Gross Reserves	10,984	12,100	12,262	12,097	11,861	11,668	11,531	11,516	11,387	11,738	11,772	11,654	13,369	13,187
of which:														
Official	8,580	8,954	9,103	9,013	8,545	8,554	8,281	8,230	8,242	8,574	8,468	8,090	10,122	9,656
import cover*	5.7	6.0	6.0	5.9	5.6	5.6	5.4	5.3	5.3	5.5	5.4	5.1	6.4	6.0
Commercial Banks	2,405	3,145	3,159	3,084	3,316	3,114	3,250	3,286	3,146	3,164	3,304	3,563	3,246	3,531
2. Residents' foreign currency deposits	4,733	5,986	5,959	5,858	5,952	5,670	5,917	6,078	6,161	6,197	6,068	6,045	6,054	6,415

**Based on 36 month average of imports of goods and non-factor services*

Source: Central Bank of Kenya

4.4 Banking Sector

Structure of the Kenyan Banking Sector

During the financial year ended June 30, 2019, the Kenyan banking industry comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 9 representative offices of foreign banks, 70 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus.

The Central Bank of Kenya (CBK) revoked licences of five forex bureaus, namely: Metropolitan Bureau De Change Ltd, Tower Forex Bureau Ltd, Safari Forex Bureau Ltd, Dalmar Exchange Bureau Ltd, and Penguin Forex Bureau Ltd; and One money remittance provider, Continental Money Transfer Limited. In addition, CBK licensed one forex bureau, Springs Forex Bureau Limited and granted approval to SBM Bank (Kenya) Limited to acquire certain assets and assume certain liabilities of Chase Bank Limited (In Receivership).

Structure of the Balance Sheet

The banking industry balance sheet expanded by 10.5 percent from KSh 4.27 trillion in June 2018 to KSh 4.72 trillion in June 2019 attributed to increase in loans and advances and government securities, which accounted for 51.8 percent and 27.2 percent of total assets, respectively. Customer deposits was the main component on the liabilities side accounting for 74.3 percent of the total liabilities (**Table 4.7**).

Financial Performance of the Kenyan Banking Industry

Overview

The banking industry registered improved financial position in the year with:

- Net assets increasing by 10.5 percent to KSh 4.72 trillion from KSh 4.27 trillion as at June 30, 2018 attributed to a KSh 0.14 trillion increased investment in government securities and KSh 0.11 trillion increase in net loans.
- Gross loans and advances grew by 6.6 percent to KSh 2.65 trillion by June 30, 2019 compared to KSh 2.49 trillion as at June 30, 2018.
- The total deposit base increased to KSh 3.51 trillion from KSh 3.16 trillion as at June 30, 2018 as a result of increased deposit mobilisation especially through mobile phone technologies.
- Profit before tax increased to KSh 85.76 billion in the period to June 30, 2019 from KSh 76.18 billion in the period ended June 30, 2018. The increase was attributed to KSh 6.0 billion and KSh 1.4 billion increase in interest income from government securities, and loans and advances respectively (**Table 4.8**).
- The banks overall liquidity ratio in June 2019 was 50.6 percent compared to 49.0 percent recorded in June 2018, well above the minimum statutory level of 20 percent. The liquid assets increased by 13.4 percent compared to 8.7 percent increase in short term liabilities between June 2018 and June 2019.

4.0 CENTRAL BANK OPERATIONS

Sectoral Distribution of Loans and Advances

Apart from personal loans and lending to households, the sectors that received the highest proportion of loans include trade, manufacturing, restaurant and hotels and real estate. The growth in loans and advances was recorded in nine (9) economic sectors (**Table 4.9**).

Item	Jun-18	Jun-19	Change
Total income	246.9	263.9	6.89%
Expenses before provisions	158.7	189.7	19.53%
Profit before provisions	88.2	97.3	10.32%
Provisions for bad debts	12	11.6	-3.33%
Profit before tax	76.2	85.8	12.60%
Return on Assets	2.80%	2.79%	-0.01%
Return on Shareholders' Funds	23.70%	23.81%	0.46%

Source: Central Bank of Kenya

	Jun-18	Jun-19	Percent Change	Ratio of Total (%) Jun-2019
Personal/Household	635.2	712.4	12.2	26.8
Trade	476.4	511.4	7.3	19.3
Manufacturing	320.4	345.3	7.8	13.0
Tourism,Restaurant and Hotels	65	79.8	22.8	3.0
Transport and Communication	168.5	179.2	6.4	6.8
Financial Services	92.9	102.7	10.6	3.9
Agriculture	88.1	95.6	8.6	3.6
Real Estate	392.7	394	0.3	14.8
Mining and Quarrying	10.2	10.7	4.9	0.4
Building and Construction	118.1	110.9	-6.1	4.2
Energy and Water	121.5	111.6	-8.1	4.2
Gross Loans	2,489.0	2,653.8	6.6	100.0

Source: Central Bank of Kenya

Capital Adequacy

Banks are required to adhere to the minimum prescribed Prudential Capital Adequacy ratios of Core Capital and Total Capital to Total Risk Weighted Assets (TRWA) of 10.5 percent and 14.5 percent, respectively. The banks ratio of core capital to TRWA decreased slightly from 16.6 percent in June 2018 to 16.5 percent in June 2019 mainly due to 11.4 percent growth in TRWA that outpaced the 11.1 percent increase in core capital. Total Capital to TRWA increased by

0.2 percent between June 2018 and June 2019 following a 12.6 percent increase in Total Capital compared to 11.4 percent increase in TRWA. Banks are also required to maintain a core capital to total deposits ratio of not less than 8 percent. This increased to 17.3 percent in June 2019 from 17.2 percent in June 2018.

Asset Quality

The banks gross Non-Performing Loans (NPLs) increased by 12.6 percent from KSh 298.4 billion in June 2018 to KSh 335.9 billion in June 2019. During this period, 10 out of 11 economic sectors registered increased NPLs (**Chart 4.2**). The increase in NPLs was mainly attributed to delayed payments by the public and private sectors; slow uptake of developed housing and commercial units in the real estate sector; delays in cash inflows attributed to low business turnover; and, cash flow constraints. The NPLs to Gross Loans ratio increased from 12.0 percent in June 2018 to 12.7 percent in June 2019. The top three sectors with highest increases in NPLs were transport and communication, personal/household, and real estate.

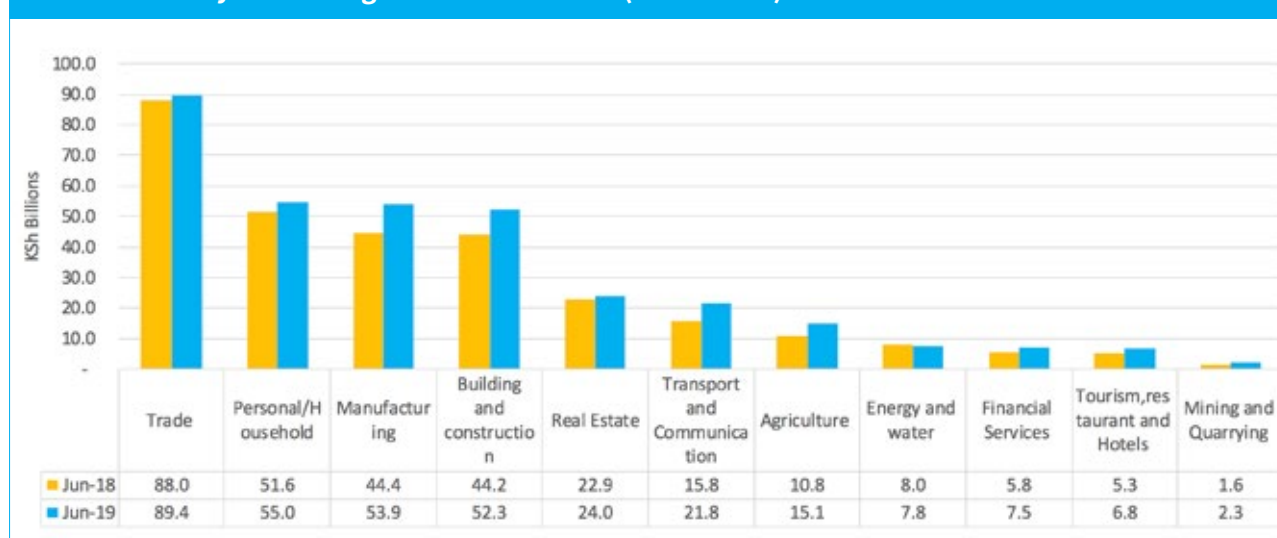
4.0 CENTRAL BANK OPERATIONS

Performance of Microfinance Banks

The losses registered by Microfinance banks (MFBs) decreased by 80.4 percent to KSh 183.0 million compared to a loss of KSh 935.1 million in the period ended June 2018 (**Table 4.10**). The MFBs' core capital and total capital to risk weighted assets ratio decreased from 17 percent and

19 percent in June 2018 to 15 percent and 16 percent in June 2019 against the minimum statutory requirement of 10 and 12 percent, respectively. The decline in the ratios was mainly attributed to the decrease in core and total capital by 11.1 percent and 12.8 percent, respectively.

Chart 4.2: Kenyan Banking Sector Gross NPLs (KSh Billion)



Source: Central Bank of Kenya

Table 4.10: Performance of MFBs (Ksh.Million)

Parameter	Jun-18	Jun-19	% Change
Pre-Tax Profits	-935	-183	-80.4%
Customer Deposits	38,563	43,142	11.9%
Loan Portfolio (Net)	46,142	47,031	1.9%
Core Capital/Total Risk Weighted Assets	17.0%	14.8%	-2.2%
Total Capital/Total Risk Weighted Assets	18.6%	15.9%	-2.7%

Source: Central Bank of Kenya

Agency Banking

The use of agency banking by banks and microfinance banks continued to enhance access to financial services since its launch in 2010. As at June 2019, 17 commercial banks and 3 microfinance banks contracted 61,226 and 2,222 active agents compared to 18 and 3 commercial banks and microfinance banks with 64,345 and 1,974

active agents as at June 2018. The number and value of banking transactions undertaken through agents increased from 80.6 million and KSh 620.6 billion in the year ended June 2018 to 175.6 million and KSh 1.2 trillion in the year ended June 2019, respectively.

4.0 CENTRAL BANK OPERATIONS

Credit Information Sharing Mechanism

The CBK licensed three (3) Credit Reference Bureaus (CRBs) to provide a credit information sharing mechanism in Kenya aimed at strengthening credit standards and mitigate risks associated with information asymmetry. The credit reports requested by banks, microfinance banks and customers increased to 13.9 million, 231, 644 and 1.5 million in June 2019 from 4.6 million, 195, 623 and 138, 026 in June 2018, respectively. The high increased access of credit reports by customers is an indication of the requirement for vetting of potential employees by the public and private sectors.

Issuance of Banking Charter

The CBK issued the Kenya Banking Sector Charter on February 28, 2019 to address increased consumer protection concerns. The Charter applies to all institutions carrying out banking business, financial business, mortgage finance business and microfinance business

under the Banking and Microfinance Acts. The Charter is premised on four pillars, namely:

- Adoption of customer-centric business models by banks.
- Risk-based credit pricing.
- Enhanced transparency and information disclosure.
- Entrenching an ethical culture in banks – doing the right thing.

The Charter required banks to develop and submit to CBK a time bound plan approved by the institution's Board by May 31, 2019 and comply with the Charter adopted by their Boards. Banks are also required to submit quarterly reports to CBK on the progress of implementation of the Charter within 10 days after the end of every quarter. The Charter represents a commitment from all the institutions to entrench a responsible and disciplined banking industry that is cognizant of, and responsive to the needs of their customers and the Kenyan populace.

4.5 Currency Developments

Currency in Circulation

Currency in circulation decreased by KSh 12.9 billion in the year, a reduction of 4.9 percent compared to a growth of 3.4 percent in the previous financial year (**Table 4.11**).

Cash Inflows and Outflows

Deposits by banks during the financial year increased by 9.2 percent to KSh 548.3 billion while withdrawals increased by 4.9 percent to KSh 535.4 billion. This represents a net inflow of KSh 12.9 billion (**Table 4.12**).

Table 4.11: Value of Currency in Circulation

	Jun-18		Jun-19	
	Ksh bn.	%	Ksh bn.	%
Total Currency in Circulation	262.44	100%	249.51	100%
Banknotes	253.55	97%	240.26	96%
Coins	8.89	3%	9.25	4%

Source: Central Bank of Kenya

Table 4.12: Value of Currency Inflows and Outflows (KSh Million)

Inflow by banks	2017/2018	2018/2019
Bank Notes	501,808	548,106
Coins	95	151
Total	501,903	548,257
Outflows to banks		
Bank Notes	509,793	534,841
Coins	792	508
Total	510,585	535,349
Net Outflows	-8,682	12,908

Source: Central Bank of Kenya

Currency Centres

The three currency centres i.e. Nyeri, Nakuru and Meru account for a total of 19 percent of all Currency activities in the Country. The centres serve a total of 224 commercial bank branches.

4.0 CENTRAL BANK OPERATIONS

4.6 Banking Services and National Payments

Kenya Electronic Payment and Settlement System (KEPSS)

Kenya Electronic Payment and Settlement System (KEPSS) is Kenya's Real Time Gross Settlement System (RTGS). The RTGS activities increased in 2018/19 compared to 2017/18 in terms of volume and value of transactions. KEPSS processed 4.75 million transaction messages valued at KSh 30.04 trillion in 2018/19 compared to 4.38 million transaction messages worth KSh 29.12 trillion in 2017/18 (**Chart 4.3**).

Regional Payment Systems

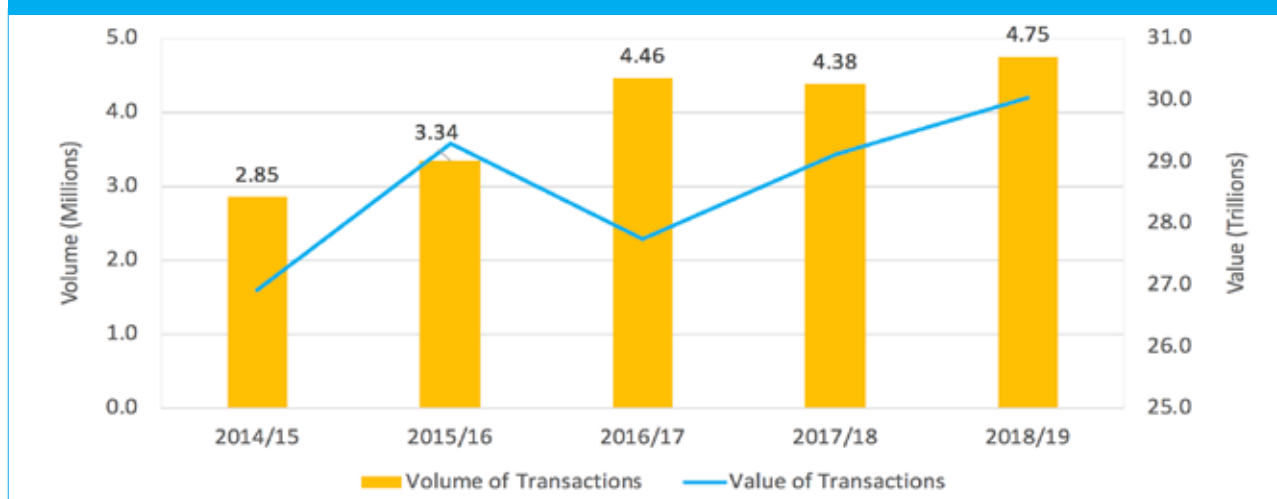
East African Payment System (EAPS) facilitates payments across the East African community (EAC) using the 5 EAC currencies while Regional Payment and Settlement System (REPSS) enables users to make payments within the 19 Common Market for Eastern and Southern Africa (COMESA) countries in USD and Euro. EAPS and REPSS processed 23,725 and 607 transactions in FY 2018/2019 as compared to 15,895 and 460 transactions processed in FY 2017/2018. This reflects an increase in volume by 49.20 percent and 31.96 percent, respectively. The increase in volume of transactions reflects increased trade in the EAC and COMESA regions as well as confidence in the payment systems.

Developments in Payment Services

Kenya payments environment continued to improve in terms of inclusiveness, efficiency and stability against the backdrop of legal and regulatory reforms and initiatives. The improvements are propelled by technological and operational innovations from Mobile Networks Operators (MNOs) and FinTech firms. The developments during the year were:

- Interoperability was introduced in April 2018 to allow money transfers across different MNOs customers.
- In April 2018, the CBK issued a Circular to Payment Service Providers (PSPs) on Business Continuity Plan (BCP) and Escalation Procedures.
- In June 2019, the CBK issued Cyber Security Guidelines to PSPs setting the minimum standards that PSPs should adopt to develop effective cybersecurity governance and risk management frameworks in order to maintain a sound, secure and efficient National Payment System.
- CBK continues to facilitate compliance by the industry with the SWIFT Customer Security Programme (CSP) that describes a set of mandatory and advisory security controls for SWIFT users to safeguard against and respond to cyber-attacks when they occur.

Chart 4.3: Volume and Value of KEPSS Transactions



Source: Central Bank of Kenya

4.0 CENTRAL BANK OPERATIONS

Future of Payment Systems and Services

Technology trends continue to shape the future of payment services in three core elements: security, usability and automation. PSPs are considering a number of FinTech innovations to enhance the payments industry including;

- Mobile Point of Sale (mPOS) devices: To help businesses take their payment needs on the go, thereby availing merchants with modern, flexible opportunities to interact with their customers anytime and anywhere.
- Digital Authentication: To ensure secure multi-factor identity authentication for payments by incorporating biometrics including fingerprints, faces and even iris scans.
- ISO 20022 Standards: SWIFT has mandated all financial institutions to migrate from the current

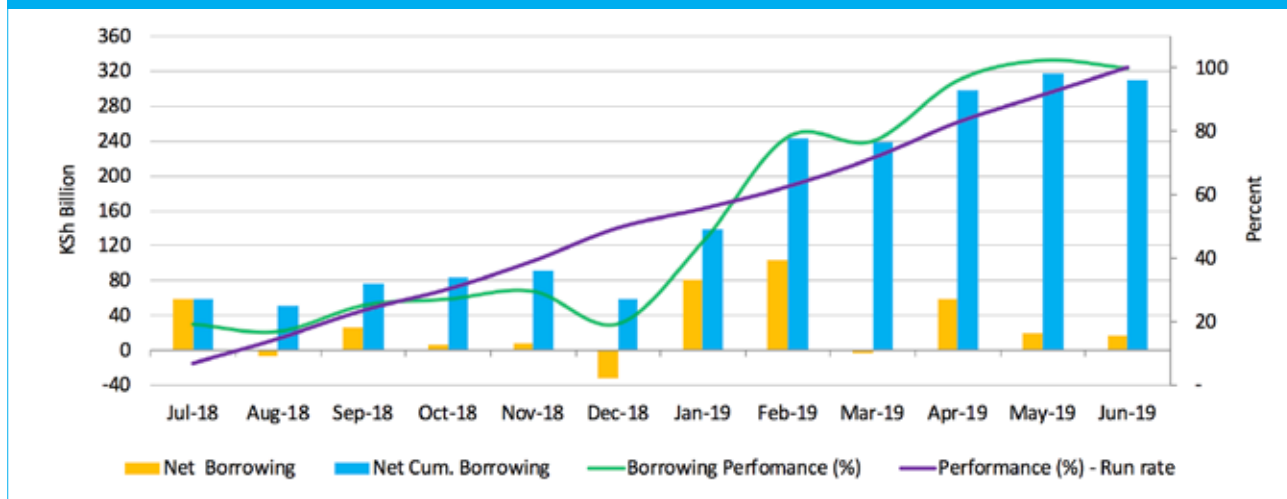
Message Type (MT) Standards to the ISO 20022 standard by 2021 to enable faster payment processing and improved reconciliation resulting in increased efficiency and enhanced customer satisfaction.

4.7 Domestic Debt Operations

Domestic Government Borrowing Programme

During the FY2018/19, the Bank raised net cumulative borrowing of KSh 310.1 billion which was the target for the year through issuance of Treasury Bills and Bonds (Chart 4.4). During the year, five Treasury Bonds were reopened and 7 new Treasury Bonds were issued with the bulk of the issuances being on the medium and long-term maturity spectrum. Two new Infrastructure bonds were issued during the period.

Chart 4.4: Domestic Borrowing Programme Performance in FY 2018-2019



Source: Central Bank of Kenya

Treasury Bills Auctions

Treasury bills auctions were mainly oversubscribed in the second half of the financial year recording an average performance of 125.7 percent. Average interest rates on government securities declined during the year. In June 2019, the average 91-day Treasury bill rate was 6.9 percent, 182-day at 7.6 percent and 364-day at 9.2 percent compared to 7.9 percent, 10.0 percent and 10.9 percent by end June 2018, respectively.

Treasury Bonds Auctions

Treasury bonds auctions were oversubscribed in the last quarter of the financial year recording an average performance of 175.7 percent as at end June 2019.

4.0 CENTRAL BANK OPERATIONS

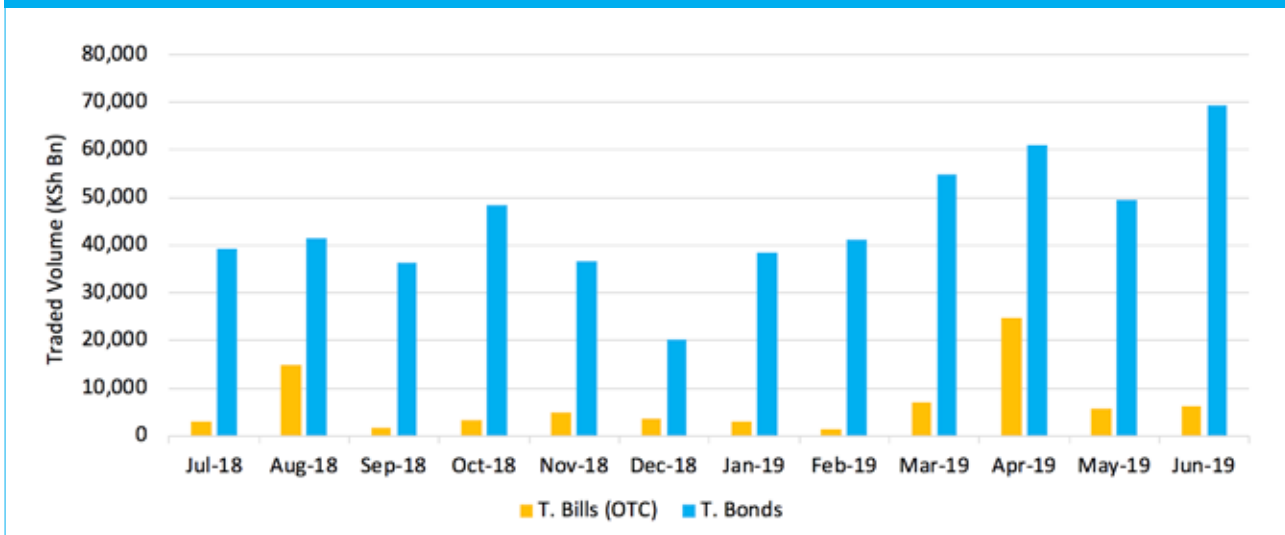
Secondary Market for Government Securities

Treasury Bonds secondary trading turnover amounted to KSh 536.5 billion in 2018/19 compared to KSh 455.2 billion in 2017/18. Over The Counter (OTC) trading for Treasury bills during the financial year amounted to Ksh 81.1 billion compared to 66.2 billion in 2017/18 (Chart 4.5).

The Kenya Government Securities Yield Curve

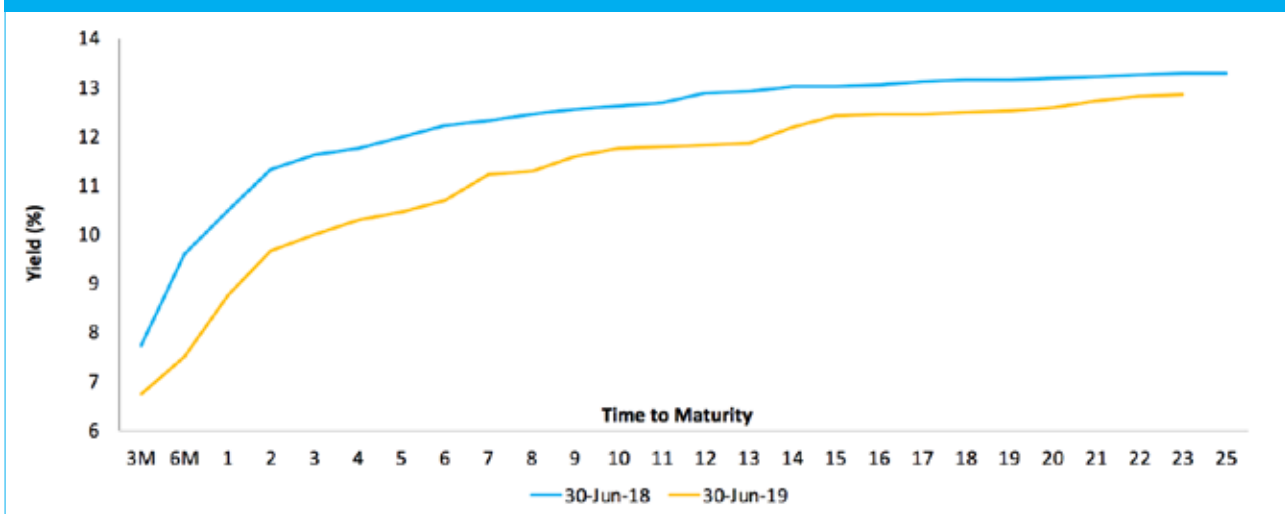
The Government securities yield curve was stable during the year, shifting downwards by June 2019 compared to the level in June 2018, indicating reduced cost of borrowing (Chart 4.6).

Chart 4.5: Trading of Government Securities



Source: Central Bank of Kenya

Chart 4.6: Kenya Government Securities Yield Curve



Source: Central Bank of Kenya

5.0 ISSUANCE OF NEW GENERATION CURRENCY

5.0 ISSUANCE OF NEW GENERATION

One of the core functions of the CBK is the issuance of currency. Article 231 of Kenya's Constitution requires that "Notes and coins issued by the Central Bank of Kenya may bear images that depict or symbolise Kenya or an aspect of Kenya but shall not bear the portrait of any individual". Complying with this constitutional provision required issuance of new currency notes and coins.

Therefore, the CBK issued new generation of currency coins and banknotes on December 11, 2018 and May

31, 2019, respectively. The new generation currency were designed to conform to the requirements of the Constitution and took into consideration views and recommendations received from the public. The new coins were launched by H. E. Hon. Uhuru Kenyatta, the President of the Republic of Kenya, in the CBK Building on December 11, 2018 and the notes in Narok Stadium on June 1, 2019. The main images in the new coins are the "big 5" as shown in **Table 5.1** below:

Denomination	Colour		Edge Style	Main Image
	Outer	Inner		
KSh 1	Silver		Alternate plain and milled	Giraffe
KSh 5	Silver	Yellow	Milled	Rhino
KSh 10	Yellow	Silver	Milled	Lion
KSh 20	Silver	Yellow	Alternate plain and milled	Elephant

For the banknotes, CBK adopted concepts to symbolize the drivers of a prosperous Kenya. The front of the banknotes bear the image of Kenyatta International Conference Centre, one of the most iconic and recognizable landmarks in our country. A dove is shown to symbolize a peaceful Kenya. The

images on the back of the banknotes symbolize green energy, agriculture, social services, tourism and governance, which are the pillars of a prosperous Kenya. A summary of the features depicted on the new generation banknotes are as follows:

Denomination	Colour	Dominant Theme	Image	Big Five Animal
KSh 50	Reddish/Pink	Green Energy	Wind Power, Geothermal Power and Solar Panels	Buffalo
KSh 100	Purple	Agriculture	Maize, Tea and Livestock Farming	Leopard
KSh 200	Blue	Social Services	Medical Services, Education and Athletics	Rhino
KSh 500	Green	Tourism	Kenyan Beach, Wild Animals and Simba	Lion
KSh 1000	Brown	Governance	Parliament Building	Elephant

The new generation banknotes incorporate new security features in addition to being designed to be more accessible to the visually impaired persons. The security features are broadly categorized under the banner Feel, Look and Tilt.

5.0 ISSUANCE OF NEW GENERATION CURRENCY

Feel

The feel effect incorporates raised print on the words Kenya as well as on the large value. For the visually impaired persons, the edge of the notes has one bar for fifty, two bars for one hundred, three bars for two hundred, four bars for five hundred and five bars for one thousand shillings denomination.

Look

When the banknotes are held up to the light, a watermark of a lion's head, the text CBK below the lion and the value of the banknote is seen. The security thread also appears as a continuous line.

Tilt

When viewed at an angle, the security thread changes colour from red to green on all the banknotes. Additionally for the 200, 500 and 1000 banknotes, a rainbow colour appears on the thread. On the back of the banknote, a golden band showing the value of the banknote appears.

Demonetisation of Old Generation KSh 1000 Banknotes

The CBK issued a gazette notice number 4849 dated May 31, 2019 withdrawing all the old series KSh 1,000 banknotes by September 30, 2019. This action was taken to deal conclusively with concern of this denomination being used for illicit financial flows in Kenya and other countries in the region.

In addition, it had been noted that there was an emergence of some counterfeits on this particular denomination. The gazette notice specified that the older currency will be exchanged at face value at the CBK Branches, Currency Centres and any Branch of a Commercial Bank.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

BOARD OF DIRECTORS

Mr. Mohammed Nyaoga	Chairman – Reappointed on 18 June 2019
Dr. Patrick Njoroge	Governor – Reappointed on 18 June 2019
Mr. Samson Cherutich	Member
Mrs. Rachel Nzombo	Member
Mrs. Nelius W. Kariuki	Member
Mr. Ravi J. Ruparel	Member
Ms. Charity S. Kisotu	Member - Resigned on 10 January 2019
Dr. Kamau Thugge	Principal Secretary, The National Treasury

SENIOR MANAGEMENT

Dr. Patrick Njoroge	Governor – Reappointed on 18 June 2019
Ms. Sheila M'Mbijjewee	Deputy Governor – Reappointed on 18 June 2019

HEADS OF DEPARTMENT

Mr. Kennedy Abuga	Director - Governors' Office (Board Secretary)
Ms. Rose Detho	Director - Strategic Management Department
Mr. William Nyagaka	Director - Financial Markets Department
Mr. Charles Koori	Director - Research Department – Retired on 3 September 2018
Mr. Gerald Nyaoma	Director - Bank Supervision Department
Mr. Antony Gacanja	Director - Information Technology Department - Appointed on 17 April 2019
Ms. Terry Nganga	Acting Director - Human Resource and Administration Department
Mr. Paul Wanyagi	Acting Director - Currency Operations and Branch Administration Department
Mr. Mwenda Marete	Acting Director - Banking, National Payments Department
Mr. Peter Kigondu	Acting Director - General Services Department - Retired on 23 June 2019
Mr. Moses Ngotho	Acting Director - Finance Department
Mr. Raphael Otieno	Acting Director - Research Department – Appointed on 21 September 2018
Mrs. Matilda Onyango	Acting Director – Internal Audit Department and Risk Management
Mrs. Zipporah Thambu	Acting Director – General Services Department - Appointed on 27 June 2019
Mr. Joshua Kimoro	Acting Director - Kenya School of Monetary Studies

REGISTERED OFFICE AND PRINCIPAL PLACE OF BUSINESS

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00200 Nairobi, Kenya
Tel. (+254) (020) 2860000

**Prepared Under International Financial Reporting Standards framework*

BRANCHES

Mombasa Branch	Kisumu Branch	Eldoret Branch
Central Bank of Kenya Building	Central Bank of Kenya Building	Kiptagich House
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P.O. Box 86372	P.O. Box 4	P.O. Box 2710
80100 Mombasa	40100 Kisumu	30100 Eldoret

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

CURRENCY CENTRES

Nyeri Currency Centre
Kenya Commercial Bank Building
Kenyatta Street
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10100 Nyeri

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

Nakuru Currency Centre
Kenya Commercial Bank Building
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20100 Nakuru

SUBSIDIARY

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00618 Nairobi

PRINCIPAL LAWYERS

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

PRINCIPAL AUDITOR

The Auditor General
Anniversary Towers
P.O. Box 30084
00100 Nairobi

DELEGATED AUDITOR

Ernst & Young LLP
Kenya-Re Towers, Upper Hill, Off Ragati Road
P.O. Box 44286
00100 Nairobi

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

1. Statement of Corporate Governance

The Central Bank of Kenya (the “Bank”/“CBK”) is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and 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, Principal Secretary to The National Treasury who is a non-voting member and eight Non-Executive Directors. The law requires that the President appoints the Chairman and Governor after a competitive process and approval of Parliament. Other than the Principal Secretary to The National Treasury who is an ex-officio member, all the Non-Executive Directors of the Board are also appointed by the President with the approval of Parliament. All the Board members are

appointed for a term of four (4) years each and are eligible for reappointment provided that no Board member holds office for more than two (2) 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 oversight.

The Board meets once every two (2) months and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to enable them to provide and maintain full and effective direction and control over strategic, financial and operational issues of the Bank. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by law. It however, retains responsibility for determining the policies of the Bank.

The table below shows the Board of Directors’ appointment dates and contract end dates.

No.	Name	Position	Discipline	Date of Appointment	Contract end date
1.	Mr. Mohammed Nyaoga	Chairman	Lawyer	Reappointed on 18 June 2019	17 June 2023
2.	Dr. Patrick Njoroge	Governor	Economist	Reappointed on 18 June 2019	17 June 2023
3.	Principal Secretary/ The National Treasury	Executive Officer	Economist	Permanent	Permanent
4.	Mrs. Nelius Kariuki	Member	Economist	Appointed on 4 November 2016	3 November 2020
5.	Mr. Ravi Ruparel	Member	Financial Sector Expert	Appointed on 4 November 2016	3 November 2020
6.	Ms. Charity Kisotu	Member	Accountant	Appointed on 4 November 2016	Resigned on 10 January 2019
7.	Mr. Samson Cherutich	Member	Accountant	Appointed on 5 December 2016	4 December 2020
8.	Mrs. Rachel Dzombo	Member	Management Expert	Appointed on 5 December 2016	4 December 2020

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

The Members of the Board (all Kenyans) in the year ended 30 June 2019 and their attendance and the number of meetings held in the year were as follows:

No.	Name	Position	Discipline	Meetings Attended
1.	Mr. Mohammed Nyaoga	Chairman	Lawyer	8
2.	Dr. Patrick Njoroge	Governor	Economist	8
3.	Principal Secretary/ The National Treasury	Executive Officer	Economist	3
4.	Mrs. Nelius Kariuki	Member	Economist	7
5.	Mr. Ravi Ruparel	Member	Financial Sector Expert	8
6.	Ms. Charity Kisotu	Member	Accountant	4
7.	Mr. Samson Cherutich	Member	Accountant	8
8.	Mrs. Rachel Dzombo	Member	Management Expert	8

The remuneration paid to the Directors for services rendered during the financial year 2018/2019 is disclosed in Note 28 to the financial statements. The Non-Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for staff loans.

1.2. Secretary to the Board

The Board Secretary provides technical and secretarial services as well as corporate governance and logistical support to the Board. He facilitates efficient policy making interface with policy implementation. The Board Secretary also advises the Board on legal matters. In conjunction with the Chairman, the Board Secretary ensures good and timely information flow among the Board members, the Board Committees and Management. All members of the Board and Management have access to the Board Secretariat services.

1.3. Audit Committee

The members of the Audit Committee in the year ended 30 June 2019 were Mr. Samson K. Cherutich (Chairman), Mr. Ravi J. Ruparel, Ms. Charity S. Kisotu, Mrs. Nelius W. Kariuki and Mrs. Rachel B. Dzombo. The members are all Non-Executive Directors

with experience in Accounting, Auditing, and Financial Management. The Committee meets once every two (2) months and as necessary. The Terms of Reference of the Audit Committee cover two (2) major areas, namely; Internal Control System (internal audit, risk management & compliance) and Financial Reporting and Related Reporting Practices.

The audit committee ensures the integrity of the financial statements prior to review and approval by the Board. This is achieved by reviewing the accounting policies, financial reporting and regulatory requirements. The committee reviews internal and external auditors' reports to ensure appropriate corrective actions are taken to improve the Bank's internal control environment. The committee meets at least once per annum with the external auditors without senior staff of the Bank. Each year, the committee reviews and approves the overall scope and plan of the internal audit activities.

The committee has oversight over the Bank's internal control system, which includes ensuring that the Bank has a solid risk management system in place in terms of policies, people, systems, and processes. The Audit Committee reviews the Bank's risk management practices and monitors compliance with the policies, relevant frameworks and programs.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

The Committee members' positions, disciplines and number of meetings attended for the year ended 30 June 2019 were as follows:

No.	Name	Position	Discipline	Meetings Attended
1.	Mr. Samson Cherutich	Chairman	Accountant	8
2.	Mr. Ravi Ruparel	Member	Financial Sector Expert	8
3.	*Ms. Charity Kisotu	Member	Accountant	4
4.	Mrs. Nelius Kariuki	Member	Economist	8
5.	Mrs. Rachel Dzombo	Member	Management Expert	8

* Ms. Charity Kisotu resigned from the Audit Committee of the Board on 10 January 2019.

1.4. Human Resources Committee (HRC)

The members of the HRC in the year ended 30 June 2019 were Mrs. Nelius Kariuki, Mr. Samson Cherutich, Ms. Charity Kisotu, Mrs. Rachel Dzombo and Mr. Ravi Ruparel. The members are all Non-Executive Directors with experience in Accounting, Management and Business.

The HRC of the Board performs an advisory role to the Bank's Board in the fulfilment of the following oversight responsibilities:

- Oversee the formulation and implementation of Human Resource Policies in the Bank;
- In relation to staff matters, they oversee the Bank's compliance with the Kenyan Constitution, Laws of Kenya, CBK regulations and its own code of conduct;
- Perform any other Human Resource related functions as assigned by the Board.
- Oversee the implementation of Board resolutions relating to the HRC of the Board.

The goal is to ensure that the staff of the Bank are motivated and recognized in order to retain staff of the highest calibre.

The members of the Human Resources Committee in the year ended 30 June 2019 and their attendance of the meetings held in the year were as follows:

No.	Name	Position	Discipline	Meetings attended
1.	Mrs. Nelius Kariuki	Chairman	Economist	6
2.	Mr. Samson Cherutich	Member	Accountant	5
3.	*Ms. Charity Kisotu,	Member	Accountant	3
4.	Mrs Rachel Dzombo	Member	Management Expert	6
5.	Mr. Ravi Ruparel	Member	Financial Sector Expert	6

* Ms. Charity Kisotu resigned from Human Resource Committee of the Board 10 January 2019

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

1.5. Monetary Policy Committee (MPC)

Section 4D of the Central Bank of 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 every two (2) months. The MPC comprises the Governor who is the Chairman, the Deputy Governor who is the Deputy Chairperson, two (2) members appointed by the Governor from the CBK, four (4) external members appointed by the Cabinet Secretary for the National Treasury, and the Principal Secretary for the National Treasury or his Representative. External members of the MPC are appointed for an initial period of three (3) years each and may be reappointed for another final term of three (3) years. The quorum for MPC meetings is five (5) members, one of whom must be the Chairman or Deputy Chairperson.

During the FY2018/19, the MPC formulated monetary policy aimed at achieving and maintaining overall inflation within the target of 5 percent with a flexible margin of 2.5 percent on either side. The period was characterised by sustained domestic macroeconomic stability and confidence in the economy. Overall inflation remained within the target range during the year, despite a short-term increase in food prices attributed to depressed supply of key food crops following the delayed onset of rains in the first quarter of 2019. The inflation rate stood at 5.7 percent in June 2019 compared to 4.3 percent in June 2018. Non-food-non-fuel (NFNF) inflation remained stable below 5 percent, indicating that demand pressures were muted. The stability of the foreign exchange market minimized the threat of imported inflation.

Risks in the global financial markets remained elevated during the period, mainly due to escalation in trade tensions between the U.S. and China, increased uncertainties on Brexit, geo-political tensions and slowdown in global growth. Nevertheless, the foreign exchange market remained stable in the period supported by a narrowing in the current account deficit. The current account deficit narrowed to 4.2 percent of GDP in the 12 months to June 2019 from 5.4 percent in June 2018 reflecting strong growth in diaspora remittances, improved inflows from horticultural exports, and higher receipts from tourism and transport services. Additionally, lower imports of food and SGR-related equipment offset the increase in the petroleum products import bill. The CBK's foreign exchange reserves, which stood at USD 9,108.6 million (equivalent to 5.8 months of import cover) at the end of June 2019, continued to provide an adequate buffer against short-term shocks.

After every MPC Meeting, the Governor held meetings with Chief Executive Officers of banks to discuss the background to the MPC decisions and to obtain feedback from the market. Additionally, the Governor held press conferences with the media to brief them on the background of the MPC decisions and developments in the financial sector and the economy. These forums continued to improve the public's understanding of monetary policy decisions.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

The MPC held six (6) meetings in the year ended 30 June 2019, and attendance was as follows:

No.	Name	Position	Discipline	Meetings Attended
1.	Dr. Patrick Njoroge	Chairman	Economist	6
2.	Ms. Sheila M'Mbijjewe	Deputy Chairperson	Finance/ Accountancy	6
3.	Dr. Margaret Chemengich	Member (External)	Economist	5
4.	Prof. Jane Kabubo-Mariara	Member (External)	Economist	4
5.	Dr. Benson Ateng'	Member (External)	Economist	5
6.	Mr. Humphrey Muga	Member (External)	Economist	5
7.	Mr. Musa Kathanje	Representative of the Principal Secretary, The National Treasury	Economist	5
8.	Mr. William Nyagaka	Member (Internal)	Finance/ Accountancy	6
9.	Mr. Charles Koori	Member (Internal)	Economist	1
10.	Mr. Raphael Otieno*	Member (Internal)	Economist	5

* Mr. Otieno replaced Mr. Koori in September 2018, following his retirement from the Bank.

1.6. 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 36, to review the overall performance of the Bank.

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

1.7. Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests, which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct embedded in the Staff Rules and Regulations and the Employment Act 2007 apply to the entire Bank's staff.

1.8. Internal Controls

The Management of the Bank has put in place a system of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2015. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.9. Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of the Bank policies and procedures. There is an annual Budget approved by the Board and a Procurement Plan approved by the Senior Management 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

1.10. Internal Audit and Risk Management

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

1.11. Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statements. 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 of the Bank are published in the Kenya Gazette and are also placed in the Bank's website.

2.0 Financial Performance

The Bank's financial performance is affected by the Monetary Policy stance undertaken, interest rates and exchange rate changes. The Bank's financial performance is presented on page 51 of these financial statements.

During financial year ended 30 June 2019, the Bank recorded a net surplus of KShs 26,138 million compared to a net deficit of KShs 4,662 million in financial year ended 30 June 2018. The surplus is included as part of the General Reserve Fund.

During the financial year ended 30 June 2019, the Bank's operating surplus before unrealized gains / (losses) was KShs 21,016 million (2018:

KShs 16,101 million). Interest income of KShs 23,347 million (2018: KShs 20,097 million) rose due to the higher interest rates on US Dollar denominated reserves instruments plus higher reserve levels. As a result of a weaker Kenya Shilling to the US Dollar an unrealized foreign exchange gain of KShs 5,122 million was recorded during the year ended 30 June 2019 (2018: loss of KShs 18,690 million). The Bank also recorded a fair value gain on fixed income securities of KShs 7,005 million (2018: loss of KShs 2,073 million). The gain recorded during the year has been presented in other comprehensive income.

In addition, an actuarial loss of KShs 2,928 million (2018: KShs 2,629 million) was also incurred. There was no revaluation gain on land and buildings recorded during the year. This valuation is performed every 3 years in line with the Bank's Fixed assets management policy.

The Bank's assets increased to KShs 1,239,158 million (2018: KShs 1,083,892 million) mainly attributed to the Eurobond proceeds of USD 2.1 billion (KShs 210 billion) which was further enhanced by advances of loans to banks amounting to KShs 67 billion (2018: KShs 39 billion). The Government overdraft facility closed at the almost same level of KShs 57,327 million (2018: KShs 56,849 million).

Liabilities increased to KShs 1,080,683 million (2018: KShs 954,129 million) as a result of an increase in deposits from banks and government largely attributed to Eurobond funds received towards the year-end.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

CENTRAL BANK OF KENYA REPORT OF THE DIRECTORS FOR THE YEAR ENDED 30 JUNE 2019

The Directors submit their report together with the audited financial statements for the year ended 30 June 2019, which shows performance of the Bank during the year and the state of affairs of Central Bank of Kenya (the "Bank"/"CBK") as at the year end.

1. INCORPORATION

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

2. 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 at achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

3. RESULTS AND SURPLUS

The total comprehensive income for the year was KShs 30,217 million (2018: Deficit of KShs 4,280 million) made up of KShs 21,016 million (2018: KShs 16,101 million) realized surplus and KShs 9,201 million unrealized surplus (2018: Unrealized deficit of KShs 20,381 million). The realized surplus has been included as part of the General Reserve Fund. The Directors recommend a transfer of KShs 4,000 million to the Consolidated Fund from the General Reserve Fund (2018: KShs 800 million).

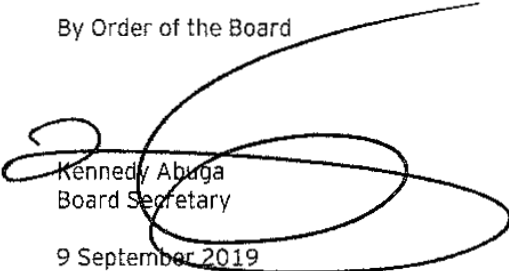
4. BOARD OF DIRECTORS

The members of the Board of Directors who served during the year and up to the date of this report are listed on page 36

5. AUDITOR

The Auditor - General is responsible for statutory audit of the Bank's Financial Statements in accordance with Section 35 of the Public Audit Act, 2015. Section 23(1) of Act empowers the Auditor-General to appoint other auditors to carry out the audit on his behalf. Accordingly, Ernst & Young LLP were appointed to carry out audit for the year ended 30 June 2019 and report to the Auditor - General.

By Order of the Board


Kennedy Abuga
Board Secretary

9 September 2019

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

CENTRAL BANK OF KENYA STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE YEAR ENDED 30 JUNE 2019

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 financial performance. 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 as at 30 June 2019 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*.

These financial statements were prepared on a going concern basis, taking cognizance of certain unique aspects relating to the bank's ability to create, distribute and destroy local currency, its role as a lender of last resort, its responsibilities in the areas of price and financial stability, and its relationship with the Kenyan government concerning foreign exchange transactions.

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



Chairman, Board of Directors
Mr. Mohammed Nyaoga

9 September 2019



Governor
Dr. Patrick Njoroge

9 September 2019

REPUBLIC OF KENYA

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E-mail: info@oagkenya.go.ke
Website: www.oagkenya.go.ke



HEADQUARTERS
Anniversary Towers
Monrovia Street
P.O. Box 30084-00100
NAIROBI

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2019

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying consolidated financial statements of Central Bank of Kenya set out on pages 51 to 129, which comprise the consolidated statement of financial position as at 30 June 2019, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Ernst and Young LLP 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.

In my opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Central Bank of Kenya as at 30 June, 2019, and of its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRSs) and comply with the Central Bank of Kenya Act, Cap 491 of the Laws of Kenya.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Central Bank of Kenya in accordance with ISSAI 130 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of the financial statements. There were no key audit matters to report in the year under review.

Other Matter

1. Failure to Maintain the Required Number of Non-Executive Directors

The Central Bank Act Cap 491 of 2014, Part IV - Management, Section 11(1) (d) provides that there shall be eight (8) other non-executive directors of the Board. During the year under review, the Bank had in place five (5) non-executive directors transacting business on its behalf.

2. Lack of the Second Deputy Governor

In addition, the Central bank of Kenya Act Cap 491 Section 13B (1) states, "There shall be two Deputy Governors who shall be appointed by the President through a transparent and competitive process and with the approval of Parliament". During the year under review, only one Deputy Governor was in office.

Other Information

The Directors are responsible for the other information, which comprises the statement of corporate governance, directors' report and the statement of directors' responsibilities. The other information does not include the financial statements and my auditor's report thereon.

My opinion on the consolidated financial statements does not cover the other information and I do not express any form of assurance or conclusion thereon.

REPORT ON COMPLIANCE WITH LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, I confirm that, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way.

Basis for Conclusion

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

As required by Section 7(1)(a) of the Public Audit Act, 2015, I confirm that nothing has come to my attention to cause me to believe that internal controls were not operating in an effective way.

Basis for Conclusion

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and governance were operating effectively. In all material respects, I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Responsibilities of Management and Those Charged with Governance

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs), and for maintaining effective internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error and for its assessment of the effectiveness of internal control.

In preparing the consolidated financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public resources are applied in an effective manner.

Those charged with governance are responsible for overseeing the financial reporting process, reviewing the effectiveness of how the bank monitors compliance with relevant legislative and regulatory requirements, ensuring that effective processes and systems are in place to address key roles and responsibilities in relation to governance and risk management, and ensuring the adequacy and effectiveness of the control environment.

Report of the Auditor-General on the Financial Statements of Central Bank of Kenya for the year ended 30 June 2019

Auditor-General's Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

In addition to the audit of the financial statements, a compliance audit is planned and performed to express a conclusion about whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them in accordance with the provisions of Article 229(6) of the Constitution and submit the audit report in compliance with Article 229(7) of the Constitution.

Further, in planning and performing the audit of the financial statements and audit of compliance, I consider internal control in order to give an assurance on the effectiveness of internal controls, risk management and governance processes and systems in accordance with the provisions of Section 7(1)(a) of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. My consideration of the internal control would not necessarily disclose all matters in internal control that might be material weaknesses under the ISSAIs. A material weakness is a condition in which the design or operation of one or more of the internal control components, does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Because of its inherent limitations, internal control may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion,

forgery, intentional omissions, misrepresentations, or the override of internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Bank to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

I also provide management with a statement that I have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.


Nancy Gathungu
AUDITOR-GENERAL

Nairobi

30 July 2020

Report of the Auditor-General on the Financial Statements of Central Bank of Kenya for the year ended 30 June 2019

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	Notes	2019 KShs' million	2018 KShs' million
Interest income	4	23,347	20,097
Interest expense	5	(1,492)	(881)
Net interest income		21,855	19,216
Fees and commission income	6(a)	3,000	3,000
Net trading income	6(b)	10,099	4,245
Other income	7	1,371	646
Operating income		36,325	27,107
Credit loss expense on financial assets	8	(2,365)	(35)
Operating expenses	9(a)	(12,944)	(10,971)
Operating surplus before unrealized gains/(losses)		21,016	16,101
Unrealised gains and losses:			
Foreign exchange gain/(loss)		5,122	(18,690)
Fair value loss on financial assets held for trading	10(a)	-	(2,073)
Surplus/(deficit) for the year		26,138	(4,662)
Other comprehensive income			
Other comprehensive income that will be reclassified to profit or loss:			
Debt instruments at fair value through other comprehensive income:			
Net change in fair value during the year	10(b)	7,005	-
Changes in allowance for expected credit losses	8	2	-
Net gains on debt instruments at fair value through other comprehensive income		7,007	-
Total items that will be reclassified to profit or loss		7,007	-
Other comprehensive income that will not be reclassified to profit or loss:			
Actuarial loss in retirement benefit asset	20	(2,928)	(2,629)
Land and building valuation	18	-	3,011
Total items that will not be reclassified to profit or loss		(2,928)	382
Other comprehensive income for the year		4,079	382
Total comprehensive income for the year		30,217	(4,280)

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	Notes	2019 KShs' million	2018 KShs' million
ASSETS			
Balances due from banking institutions	11	542,849	522,987
Funds held with International Monetary Fund (IMF)	12(a)	1,008	2,012
Securities and advances to banks	13	66,909	38,503
Loans and advances	14	3,363	2,585
Debt instruments at fair value through other comprehensive income	15(a)	504,533	-
Financial assets at fair value through profit or loss	15(b)	-	400,333
Equity instruments at fair value through other comprehensive income	16(a)	9	-
Investment securities - available-for-sale	16(b)	-	9
Other assets	17(a)	5,684	3,302
Gold holdings	17(b)	81	71
Property and equipment	18	30,001	27,153
Intangible assets	19	837	165
Retirement benefit asset	20	4,328	6,584
Due from Government of Kenya	21	<u>79,556</u>	<u>80,188</u>
TOTAL ASSETS		<u>1,239,158</u>	<u>1,083,892</u>
LIABILITIES			
Currency in circulation	22	249,509	262,439
Deposits from Banks and Government	23	741,000	584,287
Due to IMF	12(b)	83,653	100,284
Other liabilities	24	<u>6,521</u>	<u>7,119</u>
TOTAL LIABILITIES		<u>1,080,683</u>	<u>954,129</u>
EQUITY			
Share capital	25(a)	20,000	5,000
General reserve fund	25(b)	109,608	106,162
Fair value reserve	25(c)	7,066	-
Revaluation reserve	25(d)	17,801	17,801
Consolidated fund	25(e)	<u>4,000</u>	<u>800</u>
TOTAL EQUITY		<u>158,475</u>	<u>129,763</u>
TOTAL LIABILITIES AND EQUITY		<u>1,239,158</u>	<u>1,083,892</u>

The financial statements were authorised for issue by the Board of Directors on 9 September 2019 and signed on its behalf by:


 Chairman of the Board
 Mr. Mohammed Nyaoga


 Governor
 Dr. Patrick Njoroge

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	Notes	Share capital KShs' million	General reserve KShs' million	Revaluation reserve KShs' million	Fair value reserve KShs' million	Consolidated fund KShs' million	Total KShs' million
Year ended 30 June 2019							
At 1 July 2018							
- As previously stated		5,000	106,162	17,801	-	800	129,763
- Impact of adopting IFRS 9	2(c)	—	(764)	—	59	—	(705)
Restated opening balance under IFRS 9		<u>5,000</u>	<u>105,398</u>	<u>17,801</u>	<u>59</u>	<u>800</u>	<u>129,058</u>
Surplus for the year		-	26,138	-	-	-	26,138
Net change in fair value of debt instrument at FVOCI		-	-	-	7,005	-	7,005
Net change in allowance for expected credit losses on debt instruments at FVOCI		-	-	-	2	-	2
Actuarial loss on retirement benefit asset	20	—	(2,928)	—	—	—	(2,928)
Total comprehensive income for the year		-	23,210	-	7,007	-	30,217
Additional share capital	25(a)	15,000	(15,000)	-	-	-	-
Transactions with owners							
-Transfer to consolidated fund	25(e)	-	(4,000)	-	-	4,000	-
-Payments out of consolidated fund	25(e)	—	—	—	—	(800)	(800)
At 30 June 2019		<u>20,000</u>	<u>109,608</u>	<u>17,801</u>	<u>7,066</u>	<u>4,000</u>	<u>158,475</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	Notes	Share capital KShs' million	General reserve KShs' million	Revaluation reserve KShs' mil- lion	Consolidated fund KShs' million	Total KShs' million
Year ended 30 June 2018						
At 1 July 2017		5,000	114,253	14,790	-	134,043
Deficit for the year		-	(4,662)	-	-	(4,662)
Actuarial loss on retirement benefit asset	20	-	(2,629)	-	-	(2,629)
Land and building valuation gain	18	-	-	<u>3,011</u>	-	<u>3,011</u>
Total comprehensive (loss)/income for the year		-	(7,291)	3,011	-	(4,280)
Transactions with owners						
Transfer to consolidated fund	25(e)	-	(800)	-	<u>800</u>	-
At 30 June 2018		<u>5,000</u>	<u>106,162</u>	<u>17,801</u>	<u>800</u>	<u>129,763</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	Notes	2019 KShs' million	2018 KShs' million
OPERATING ACTIVITIES			
Cash generated from operations	26	146,941	56,444
Interest received		23,347	20,097
Interest paid		(1,492)	(881)
Net cash generated from operating activities		<u>168,796</u>	<u>75,660</u>
INVESTING ACTIVITIES			
Purchase of property and equipment	18	(4,098)	(2,314)
Purchase of intangible assets	19	(806)	(136)
Proceeds from disposal of property and equipment		14	8
Net change in financial assets at fair value through profit or loss		-	(67,526)
Net change in debt instruments at fair value through other comprehensive income		(93,786)	-
Net change in securities and advances to Banks		(2,263)	1,686
Net change in funds held with International Monetary Fund (IMF)		<u>1,004</u>	<u>(135)</u>
Net cash used in investing activities		<u>(99,935)</u>	<u>(68,417)</u>
FINANCING ACTIVITIES			
Repayments to the International Monetary Fund (IMF)	27(b)	<u>(16,615)</u>	<u>(14,311)</u>
Net cash used in financing activities		<u>(16,615)</u>	<u>(14,311)</u>
Net increase/(decrease) in cash and cash equivalents		52,246	(7,068)
Cash and cash equivalents at the beginning of the year		577,327	584,395
Effect of IFRS 9 on cash and cash equivalents balances		<u>(740)</u>	<u>-</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	27(a)	<u>628,833</u>	<u>577,327</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

1. GENERAL INFORMATION

Central Bank of Kenya (the “Bank”/”CBK”) is established under Article 231 of the Constitution of Kenya. The Central Bank of Kenya is responsible for formulating monetary policy, promoting price stability, issuing currency and performing other functions conferred on it by the Act of Parliament. 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 (KShs), rounded to the nearest million.

(b) Changes in accounting policies and disclosures

New and amended standards and interpretations

In these financial statements, the Bank has applied IFRS 9 and IFRS 7R, effective for annual periods beginning on or after 1 January 2018, for the first time.

Several other amendments and interpretations apply for the first time in 2018, but do not have an impact on the financial statements of the Bank. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

The new standards and amendments effective of as of 1 July 2018 are listed below:

- IFRS 15 Revenue from Contracts with Customers
- IFRS 9 Financial Instruments
- IFRS 2 Classification and Measurement of Share-based Payment Transactions- Amendments to IFRS 2
- Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts - Amendments to IFRS 4
- Transfers of Investment Property (Amendments to IAS 40)
- IFRIC Interpretation 22 Foreign Currency Transactions and Advance Consideration
- AIP IFRS 1 First-time Adoption of International Financial Reporting Standards - Deletion of short-term exemptions for first-time adopters
- AIP IAS 28 Investments in Associates and Joint Ventures - Clarification that measuring investees at fair value through profit or loss is an investment - by - investment choice.

The standards that had an impact on the bank are discussed below:

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2018 for financial instruments in the scope of IFRS 9.

Therefore, the comparative information for 2018 is reported under IAS 39 and is not comparable with the information presented for 2019. Differences arising from the adoption of IFRS 9 have been recognised directly in the General Reserve Fund and Fair Value Reserve as of 1 July 2018 and are disclosed in Note 2(c).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Changes in accounting policies and disclosures (continued)

New and amended standards and interpretations (continued)

IFRS 9 Financial Instruments (continued)

Changes to classification and measurement

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The IAS 39 measurement categories of financial asset (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:

- Debt instruments at amortised cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses in profit or loss on derecognition
- Financial assets at FVPL

The accounting for financial liabilities remains largely the same as it was under IAS 39, except for the treatment of gains or losses arising from an entity's own credit risk relating to liabilities designated at FVPL. Such movements are presented in OCI with no subsequent reclassification to profit or loss. The Bank's classification of its financial assets and liabilities is explained in Note 2(g). The quantitative impact of applying IFRS 9 as at 1 July 2018 is disclosed in Note 2(c).

Changes to the impairment calculation

The adoption of IFRS 9 has fundamentally changed the Bank's accounting for loan loss impairments by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECLs for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is based on the ECLs associated with the probability of default in the next twelve months unless there has been a significant increase in credit risk since origination. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset. Details of the Bank's impairment method are disclosed in Note 2(g). The quantitative impact of applying IFRS 9 as at 1 July 2018 is disclosed in Note 2(c).

IFRS 7R

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Bank has adopted it, together with IFRS 9, for the year beginning 1 July 2018. Changes include:

- Transition disclosures, as shown in Note 2(c).
- Detailed qualitative and quantitative information about the ECL calculations, such as the assumptions and inputs used are set out in Note 29.

Reconciliations from opening to closing ECL allowances are presented in Note 29.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Changes in accounting policies and disclosures (continued)

New and amended standards and interpretations (continued)

Standards issued but not yet effective

The list of standards, improvements and amendments that are effective for periods beginning on or after 1 July 2019 are listed below:

Effective for annual periods beginning on or after 1 January 2019

- IFRS 16 Leases
- IFRIC Interpretation 23 Uncertainty over Income Tax Treatments
- Prepayment Features with Negative Compensation – Amendments to IFRS 9
- Long-term Interests in Associates and Joint Ventures – Amendments to IAS 28
- AIP IFRS 3 Business Combinations – Previously held Interests in a joint operation
- AIP IFRS 11 Joint Arrangements – Previously held Interests in a joint operation
- AIP IAS 12 Income Taxes – Income tax consequences of payments on financial instruments classified as equity
- AIP IAS 23 Borrowing Costs – Borrowing costs eligible for capitalization
- Plan Amendment, Curtailment or Settlement - Amendments to IAS 19

Effective for annual periods beginning on or after 1 January 2020

- Definition of a Business - Amendments to IFRS 3
- Definition of Material - Amendments to IAS 1 and IAS 8
- The Conceptual Framework for Financial Reporting

Effective for annual periods beginning on or after 1 January 2021

- IFRS 17 Insurance Contracts

Deferred effective date

- Amendments to IFRS 10 and IAS 28: Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements which are relevant to the Bank are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

The nature and the effect of the standards issued but not yet effective, which the Bank reasonably expects to be applicable at a future date, are described below.

IFRS 16, 'Leases'

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases - Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). The Bank will make use of both exemptions.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Changes in accounting policy and disclosures (continued)

Standards issued but not yet effective (continued)

IFRS 16, 'Leases'(continued)

At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset, which will lead to a higher charge being recorded in the income statement compared to IAS 17. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

During the year, the Bank performed a detailed impact assessment of IFRS 16 and will apply the modified retrospective approach as permitted by the standard. The Bank will recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IAS 17. As permitted by the standard, this amount will be equal to the lease liability, adjusted for any prepayments or accrued lease payments relating to that lease. The lease liability will be measured at an amount equal to the outstanding lease payments at the date of initial application, considering extension and termination options, discounted at the Bank's incremental borrowing rate in the economic environment of the lease. The capitalised right-of-use asset will mainly consist of office property, namely the branches and currency centres.

In summary, the adoption of IFRS 16 is expected to have the following impact on 1 July 2019.

	KShs' Million
Assets	
Property and equipment (right-of-use assets)	<u>154</u>
Liabilities	
Lease liabilities	<u>161</u>
Net impact on equity	<u><u>(7)</u></u>

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement

The amendments to IAS 19 address the accounting when a plan amendment, curtailment or settlement occurs during a reporting period. The amendments specify that when a plan amendment, curtailment or settlement occurs during the annual reporting period, an entity is required to:

- Determine current service cost for the remainder of the period after the plan amendment, curtailment or settlement, using the actuarial assumptions used to remeasure the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

- Determine net interest for the remainder of the period after the plan amendment, curtailment or settlement using: the net defined benefit liability (asset) reflecting the benefits offered under the plan and the plan assets after that event; and the discount rate used to remeasure that net defined benefit liability (asset).

The amendments also clarify that an entity first determines any past service cost, or a gain or loss on settlement, without considering the effect of the asset ceiling. This amount is recognised in profit or loss. An entity then determines the effect of the asset ceiling after the plan amendment, curtailment or settlement.

Any change in that effect, excluding amounts included in the net interest, is recognised in other comprehensive income.

The amendments apply to plan amendments, curtailments, or settlements occurring on or after the beginning of the first annual reporting period that begins on or after 1 January 2019, with early application permitted.

These amendments will apply only to any future plan amendments, curtailments, or settlements of the Bank.

Amendments to IFRS 9: Prepayment Features with Negative Compensation

Under IFRS 9, a debt instrument can be measured at amortised cost or at fair value through other comprehensive income, provided that the contractual cash flows are 'solely payments of principal and interest on the principal amount outstanding' (the SPPI criterion) and the instrument is held within the appropriate business model for that classification. The amendments to IFRS 9 clarify that a financial asset passes the SPPI criterion regardless of the event or circumstance that causes the early termination of the contract and irrespective of which party pays or receives reasonable compensation for the early termination of the contract.

The amendments should be applied retrospectively and are effective from 1 January 2019, with earlier application permitted. These amendments have no impact on the consolidated financial statements of the Bank.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures

The following tables set out the impact of adopting IFRS 9 on the statement of financial position and General Reserve Fund including the effect of replacing IAS 39's incurred credit loss calculations with IFRS 9's ECLs.

A reconciliation between the carrying amounts under IAS 39 to the balances reported under IFRS 9 as of 1 July 2018 is as follows:

	Ref	IAS 39 measurement Category	Amount KShs' million	Re- Classification KShs' million	Re- measurement ECL KShs' million	IFRS 9 measurement Amount KShs' million	Category
Financial assets							
Balances due from banking institutions	A	L&R	522,987	-	(66)	522,931	AC
Funds held with IMF	A	L&R	2,012	-	-	2,012	AC
Securities and advances to banks	A	L&R	38,503	-	(674)	37,829	AC
Loans and advances	A	L&R	2,585	-	35	2,620	AC
Other assets (sundry debtors)	A	L&R	968	-	-	968	AC
Due from Government of Kenya	A	L&R	80,188	-	-	80,188	AC
			647,243	-	(705)	646,538	
Investment securities – AFS							
To: Equity instruments at FVOCI	C	AFS	9	(9)	-	-	N/A
Equity instruments at FVOCI							
From: Investment securities - AFS	C	N/A	-	9	-	9	FVOCI
Financial investments - Held for trading							
To: Debt instruments at FVOCI	B	FVTPL	400,333	(400,333)	-	-	N/A
Debt instruments at FVOCI							
From: Financial investments - Held for trading	B	N/A	-	400,333	-	400,333	FVOCI
Total assets			1,047,585	-	(705)	1,046,880	

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures

	Ref	Category	IAS 39 measurement Amount KShs' million	Re- classification KShs' million	Re- measurement ECL KShs' million	IFRS 9 measurement Amount KShs' million	Category
Financial liabilities							
Deposits from commercial banks	D	AC	217,357	-	-	217,357	AC
Due to IMF	D	AC	100,284	-	-	100,284	AC
Other liabilities	D	AC	6,908	-	-	6,908	AC
Deposits from Government institutions	D	AC	<u>366,930</u>	-	-	<u>366,930</u>	AC
Total liabilities			<u>691,479</u>	-	-	<u>691,479</u>	

L&R: Loans and receivables

AC: Amortised cost

AFS: Available-for-sale

FVTPL: Fair value through profit or loss

FVOCI: Fair value through other comprehensive income

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures

- A. Balances due from banking institutions, due from Government of Kenya, securities and advances to banks, loans and advances and funds held with IMF classified as loans and receivables as at 30 June 2018 are held to collect contractual cash flows and give rise to cash flows representing solely payments of principal and interest. These are classified and measured as debt instruments at amortised cost beginning 1 July 2018.
- B. Quoted debt instruments classified as financial assets at fair value through profit or loss as at 30 June 2018 were classified and measured as Debt instruments at fair value through other comprehensive income beginning 1 July 2018. The Bank expects not only to hold the assets to collect contractual cash flows, but also to sell a significant amount on a relatively frequent basis. The Bank's quoted debt instruments are internally managed fixed income securities and fixed income securities managed by World Bank that passed the SPPI test.
- C. Equity investments in non-listed companies classified as AFS financial assets as at 30 June 2018 were classified and measured as Equity instruments designated at fair value through other comprehensive income beginning 1 July 2018. The Bank elected to classify irrevocably its non-listed equity investments under this category at the date of initial application as it intends to hold these investments for the foreseeable future. There were no impairment losses recognised in profit or loss for these investments in prior periods.
- D. The Bank has not designated any financial liabilities as at fair value through profit or loss. There are no changes in classification and measurement for the Bank's financial liabilities.

The impact of transition to IFRS 9 on general reserve fund and other components of equity is as follows:

	1 July 2018 KShs' million
Assets	
Balances due from banking institutions	(66)
Securities and advances to banks	(674)
Loans and advances	<u>35</u>
	<u>(705)</u>
Total adjustment on equity:	
General reserve fund	(764)
Fair value reserve	<u>59</u>
	<u>(705)</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures

The following table reconciles the aggregate opening loan loss provision allowances under IAS 39 to the ECL allowances under IFRS 9. Further details are disclosed in Note 29 (i).

	Allowance for impairment under IAS 39 as at 30 June 2018		ECL under IFRS 9 as at 1 July 2018
	KShs' million	Remeasurement KShs' million	KShs' million
Loans and receivables under IAS 39/Debt instruments at amortised cost under IFRS 9:			
Balances due from banking institutions	-	66	66
Loans and advances	3,503	(35)	3,468
Other assets	4,929	-	4,929
Securities and advances to banks	-	674	674
Financial assets at fair value through profit or loss under IAS 39/Debt instruments at fair value through other comprehensive income under IFRS 9	-	59	59
	<u>8,432</u>	<u>764</u>	<u>9,196</u>

Classification of financial assets and financial liabilities under IFRS 9 on the 30 June 2019 is as follows:

	Notes	At fair value through OCI KShs' million	At amortised cost KShs' million	Total KShs' million
Financial assets				
Balances due from banking institutions	11	-	542,849	542,849
Due from Government of Kenya	21	-	79,556	79,556
Securities and advances to banks	13	-	66,909	66,909
Loans and advances	14	-	3,363	3,363
Funds with IMF	12(a)	-	1,008	1,008
Debts instruments at FVOCI	15(a)	<u>504,533</u>	-	<u>504,533</u>
Total financial assets		504,533	693,685	1,198,218
Financial liabilities				
Deposits from Banks and Government	23	-	741,000	741,000
Due to IMF	12(b)	-	83,653	83,653
Other liabilities	24	-	<u>6,324</u>	<u>6,324</u>
Total financial liabilities		-	830,977	830,977

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary, Kenya School of Monetary Studies, as at 30 June 2019. Kenya School of Monetary Studies is wholly owned by 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 Bank 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 on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(e) Functional currency and translation of foreign currencies

Functional and presentation currency

Items included in the financial statements 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 ("KShs") which is the Bank's functional currency.

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.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date.

All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/ (losses)'.

(f) Accounting for currency expenses

The cost of unissued bank note stocks is recognised in the statement of financial position as deferred currency expenses 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. The cost of new currency coins not yet issued is recognised as deferred currency expenses within 'other assets' consistent with the accounting for the cost of unissued bank note stocks.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments

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

Policy applicable from 1 July 2018

Financial assets

Initial recognition and measurement

Financial assets are classified, at initial recognition, as subsequently measured at amortised cost, fair value through other comprehensive income (OCI), and fair value through profit or loss.

The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Bank's business model for managing them. The Bank initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

In order for a financial asset to be classified and measured at amortised cost or fair value through OCI, it needs to give rise to cash flows that are 'solely payments of principal and interest (SPPI)' on the principal amount outstanding. This assessment is referred to as the SPPI test and is performed at an instrument level.

The Bank's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the settlement date, i.e., the date that the Bank receives the asset on purchase or delivers the asset on sale.

Subsequent measurement

For purposes of subsequent measurement, financial assets are classified in four categories:

- Financial assets at amortised cost (debt instruments)
- Financial assets at fair value through OCI with recycling of cumulative gains and losses (debt instruments)
- Financial assets designated at fair value through OCI with no recycling of cumulative gains and losses upon derecognition (equity instruments)
- Financial assets at fair value through profit or loss

Financial assets at amortised cost (debt instruments)

This category is the most relevant to the Bank. The Bank measures financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows; And
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at amortised cost are subsequently measured using the effective interest (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

The Bank's financial assets at amortised cost includes balances due from banking institutions, funds held with IMF, securities and advances to banks, loans and advances, other assets (sundry debtors) and due from Government of Kenya.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

Subsequent measurement (continued)

Financial assets at fair value through OCI (debt instruments)

The Bank measures debt instruments at fair value through OCI if both of the following conditions are met:

- The financial asset is held within a business model with the objective of both holding to collect contractual cash flows and selling; And
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

For debt instruments at fair value through OCI, interest income, foreign exchange revaluation and impairment losses or reversals are recognised in profit or loss and computed in the same manner as for financial assets measured at amortised cost. The remaining fair value changes are recognised in OCI. Upon derecognition, the cumulative fair value change recognised in OCI is recycled to profit or loss.

The Bank's debt instruments at fair value through OCI includes investments in fixed income securities.

Financial assets designated at fair value through OCI (equity instruments)

Upon initial recognition, the Bank can elect to classify irrevocably its equity investments as equity instruments designated at fair value through OCI when they meet the definition of equity under IAS 32 Financial Instruments: Presentation and are not held for trading. The classification is determined on an instrument-by-instrument basis.

Gains and losses on these financial assets are never recycled to profit or loss. Dividends are recognised as other income in profit or loss when the right of payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the financial asset, in which case, such gains are recorded in OCI. Equity instruments designated at fair value through OCI are not subject to impairment assessment.

The Bank elected to classify irrevocably its non-listed equity investments under this category.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets mandatorily required to be measured at fair value. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets

with cash flows that are not solely payments of principal and interest are classified and measured at fair value through profit or loss, irrespective of the business model. Notwithstanding the criteria for debt instruments to be classified at amortised cost or at fair value through OCI, as described above, debt instruments may be designated at fair value through profit or loss on initial recognition if doing so eliminates, or significantly reduces, an accounting mismatch.

Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value recognised in profit or loss.

The Bank does not have any financial assets classified under this category.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Classes of financial instruments

Category (as defined by IFRS 9)		Class (as determined by the Bank)		2019
				KShs' million
Financial assets	Financial assets at amortized cost	Securities and advances to banks		66,909
		Funds held with IMF		1,008
		Net advances to staff and banks under liquidation		3,363
		Other assets (classified as financial assets)		330
		Due from Government	Government term loan	22,229
	GOK Overdraft facility		57,327	
	Balances due from banking institutions	Foreign currency denominated term deposits and current account balances	542,849	
Financial assets at Fair value through other comprehensive income	Fixed income securities	World Bank managed and internally managed fixed income portfolios	504,533	
	Equity	Investment securities	9	
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	403,551
		Due to IMF		83,653
		Other liabilities		6,324
		Deposits from Government institutions		337,449

Impairment of financial assets

Overview of Expected Credit Loss (ECL) principles

The Bank recognizes loss allowances for expected credit losses "ECL" for financial assets that are debt instruments and are not measured at FVTPL.

The Bank measures loss allowances at an amount equal to lifetime ECL except for the following for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments for which credit risk has not increased significantly since initial recognition.

The Bank considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment-grade'. 12-month ECL is the portion of ECL that represents the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'. Life-time ECL are the ECLs that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

Impairment of financial assets (continued)

Measurement of ECL

ECL are a probability-weighted estimate of credit losses and are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;

Credit impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; and,
- the disappearance of an active market for a security because of financial difficulties.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors:

- The market's assessment of creditworthiness as reflected in the bond yields;
- The rating agencies' assessments of creditworthiness;
- The country's ability to access the capital markets for new debt issuance;
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness; and,
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the assets;
- debt instruments measured at FVOCI: no loss allowance is recognized in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognized in the fair value reserve.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

Derecognition

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Bank's consolidated statement of financial position) when:

- The rights to receive cash flows from the asset have expired

Or

- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement and either (a) the Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Bank continues to recognise the transferred asset to the extent of its continuing involvement. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in profit or loss.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs. The Bank's financial liabilities include deposits from bank and government, due to IMF and other liabilities.

Subsequent measurement

The measurement of financial liabilities depends on their classification, as described below:

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term.

Gains or losses on liabilities held for trading are recognised in profit or loss. Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IFRS 9 are satisfied.

The Bank has not designated any financial liability as at fair value through profit or loss.

Loans and borrowings

This is the category most relevant to the Bank. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in profit or loss.

This category generally applies to deposits from bank and government, due to IMF and other liabilities.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in profit or loss.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018

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 settlement date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

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

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

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

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

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

Loans and receivables

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

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

The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which generally below the prevailing market interest rates. Loans issued at non market rates are initially 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

Financial assets (continued)

Available-for-sale financial assets

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

Financial liabilities

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

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

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.

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 de-recognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2018
				KShs' million
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank managed and internally managed fixed income portfolios	400,333
		Loans and receivables	Advances to banks	38,503
		Funds with IMF	2,012	
		Net advances to staff and banks under liquidation	2,585	
		Other assets (classified as financial assets)	968	
		Due from Government	Government loan	23,339
			Overdraft facility to Government	56,849
		Balances due from banking institutions	Foreign denominated term deposits and current accounts	522,987
	Available-for-sale	Investment securities	SWIFT shares	9
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	217,357
		Due to IMF		100,284
		Other liabilities		6,908
		Deposits from Government institutions		366,930

Impairment of financial assets

(i) 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 an asset 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.

(ii) 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

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.

(h) 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'.

(i) 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.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of balances due from banking institutions, fixed income securities and securities and advances to banks with maturities of less than three months.

(j) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. Work in progress is stated at cost net of accumulated impairment losses, if any. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are measured at fair value less accumulated depreciation and impairment losses recognised after the date of revaluation. Valuations are performed with sufficient frequency to ensure that the carrying amount of a revalued asset does not differ materially from its fair value. Valuations are carried out every three years.

A revaluation surplus is recorded in OCI and credited to the asset revaluation surplus in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in the profit or loss, the increase is recognised in profit and loss. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation surplus.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

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%
Motor vehicles	4 years	25%
Furniture and equipment	5 - 10 years	10-20%
Computers	4 years	25%

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.

An item of property, plant and equipment and any significant part initially recognised is derecognised upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss when the asset is derecognised.

The residual values, useful lives and methods of depreciation of property, plant and equipment are reviewed at each financial year end and adjusted prospectively, if appropriate.

(k) 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Intangible assets (continued)

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 placed 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.

(l) 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 of disposal and value in use. In assessing the value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. 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 of disposal 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.

Impairment losses of continuing operations are recognised in profit or loss in expense categories consistent with the function of the impaired asset, except for properties previously revalued with the revaluation taken to OCI. For such properties, the impairment is recognised in OCI up to the amount of any previous revaluation. Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount or exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

(m) Employee benefits

The Bank operates a defined benefit scheme and a defined contribution pension scheme. 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Employee benefits (continued)

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.

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

Past-service costs are recognised immediately in profit or loss, 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 schemes are charged to 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.

(n) 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.

(o) 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) Provisions (Continued)

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

(p) Surplus funds

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% or any other amounts as the board, in consultation with the minister, may determine, of the net annual profit (surplus) of the bank after allowing for the expenses of operations and after provision has been made for bad and doubtful debts, depreciation in assets, contributions to staff benefit funds, and such other contingencies and accounting provisions as the Bank deems appropriate.

(q) Share capital

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

(r) Leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset (or assets) and the arrangement conveys a right to use the asset (or assets), even if that asset is (or those assets are) not explicitly specified in an arrangement.

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 profit or loss on a straight-line basis over the period of the lease.

Bank as lessor

The Bank 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 profit or loss on a straight-line basis over the period of the lease.

(s) 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 profit or loss. 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(s) Interest income and expense (continued)

If a financial asset is measured at FVOCI or FVTPL, the amounts that are recognised in profit or loss are the same as the amounts that would have been recognised in profit or loss if the financial asset had been measured at amortised cost.

The Bank calculates interest income on financial assets, other than those considered credit-impaired, by applying the EIR to the gross carrying amount of the financial asset.

When a financial asset becomes credit-impaired (and is therefore regarded as 'Stage 3'), the Bank calculates interest income by applying the EIR to the net amortised cost of the financial asset. If the financial asset cures and is no longer credit-impaired, the Bank reverts to calculating interest income on a gross basis.

(t) Fee and commission income

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 KShs 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.

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Fees and commission income are recognised at an amount that reflects the consideration to which the Bank expects to be entitled in exchange for providing the services.

The performance obligations, as well as the timing of their satisfaction, are identified, and determined, at the inception of the contract. The Bank has generally concluded that it is the principal in its revenue arrangements because it typically controls the services before transferring them to the customer.

(u) 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 an agent.

(v) 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(w) Deferred currency expenses

The Bank's inventory is comprised of new currency notes 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 profit or loss from the deferred costs account. The deferred amount is recognised as 'deferred currency expenses' in other assets and represents un-issued bank notes and coins stock.

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

The loan due from the Government of Kenya is categorised as a debt instrument at amortised cost (2018 - loan and receivables).

(y) 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The preparation of the Bank's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods. In the process of applying the Bank's accounting policies, management has made the following judgements and assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Existing circumstances and assumptions about future developments may change due to circumstances beyond the Bank's control and are reflected in the assumptions if and when they occur. Items with the most significant effect on the amounts recognised in the consolidated financial statements with substantial management judgement and/or estimates are collated below with respect to judgements/estimates involved.

Impairment losses on financial assets (Policy applicable after 1 July 2018)

The measurement of impairment losses both under IFRS 9 and IAS 39 across all categories of financial assets in scope requires judgement, particularly, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk.

These estimates are driven by a number of factors, changes in which can result in different levels of allowances.

The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Bank's internal credit grading model, which assigns PDs to the individual grades.
- The Bank's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime ECL basis and the qualitative assessment.
- The segmentation of financial assets when their ECL is assessed on a collective basis.
- Development of ECL models, including the various formulas and the choice of inputs.
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on PDs, EADs and LGDs (Explanation of the terms: PDs, EADs and LGDs are included in Note 29(i)).
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

It has been the Bank's policy to regularly review its models in the context of actual loss experience and adjust when necessary. Further details about the ECLs are provided in Notes 11, 13, 14, 17 and 29(i).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Impairment policy on loans and advances (Policy applicable before 1 July 2018)

The Bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in profit or loss.

The process involves an element of management's judgement, particularly for the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses. These estimates are driven by a number of factors, the changing of which can result in different levels of allowances. Further details are provided in Notes 14 and 17.

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 20 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

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. See Note 30 for additional disclosures.

Property and equipment

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers. See Notes 18 and 30 for additional disclosures.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

4. INTEREST INCOME	2019 KShs' million	2018 KShs' million
Interest income calculated using the effective interest method		
Financial assets – debt instruments at amortised cost	15,768	-
Financial assets – loans and receivables	-	16,159
Financial assets at fair value through other comprehensive income	7,579	-
Financial assets at fair value through profit or loss	<u>-</u>	<u>3,938</u>
	<u>23,347</u>	<u>20,097</u>
Interest income from debt instruments at amortised cost/ loans and receivables comprises:		
Interest on term deposits	8,048	8,284
Interest on Government of Kenya loan	695	725
Interest on Government of Kenya overdraft	2,523	2,494
Interest on staff loans and advances	104	191
Interest on advances to banks	3,373	3,055
Other interest income*	<u>1,025</u>	<u>1,410</u>
	<u>15,768</u>	<u>16,159</u>
Interest income from fixed income securities comprises:		
Internally managed portfolio	6,938	3,479
Externally managed portfolio – RAMP	<u>641</u>	<u>459</u>
	<u>7,579</u>	<u>3,938</u>

*Other interest income mainly comprises interest from overnight lending to banks.

Interest from fixed income securities went up by KShs 3,641 million due to a change in investment strategy from money market to fixed income securities and additional funds from Eurobond proceeds.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

	2019	2018
	KShs' million	KShs' million
5. INTEREST EXPENSE		
Interest expense calculated using the effective interest method		
Interest on monetary policy issues – investments by banks	1,089	452
Interest expense – IMF	<u>403</u>	<u>429</u>
	<u>1,492</u>	<u>881</u>
6. (a) FEES AND COMMISSION INCOME	<u>3,000</u>	<u>3,000</u>
Fees and commission relates to income the Bank earns from the Government of Kenya through its agency role in the issuance of Treasury bills and bonds.		
(b) NET TRADING INCOME	2019	2018
	KShs' million	KShs' million
Net gain on sale of foreign exchange currencies	8,933	4,547
Net gain on disposal of financial assets at fair value through other comprehensive income	1,166	-
Net loss on held for trading financial assets	<u>-</u>	<u>(302)</u>
	<u>10,099</u>	<u>4,245</u>
Net trading income increased by KShs 5,854 million to KShs 10,099 million (2018: KShs 4,245 million) due to increased Government payments during the year.		
7. OTHER INCOME	2019	2018
	KShs' million	KShs' million
Licence fees from commercial banks and foreign exchange bureaus	281	271
Penalties from commercial banks and foreign exchange bureaus	420	21
Rent income from Thomas De La Rue Kenya Limited	2	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	371	330
Gain on disposal of property and equipment	10	6
KEPSS Billing revenue	280	-
Miscellaneous income	<u>7</u>	<u>16</u>
	<u>1,371</u>	<u>646</u>
8. CREDIT LOSS EXPENSE		
The table below shows the ECL charges on financial instruments for the year:		
Impairment losses on staff loans (Note 14)	(12)	35
Impairment losses on balances due from banking institutions (Note 11)	49	-
Impairment losses on securities and advances to banks (Note 13)	2,326	-
Impairment losses on debt instruments at fair value through other comprehensive income	<u>2</u>	<u>-</u>
	<u>2,365</u>	<u>35</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

9. (a) OPERATING EXPENSES	2019 KShs' million	2018 KShs' million
Employee benefits (Note 9(b))	4,570	3,429
Currency production expenses	2,214	2,028
Property maintenance and utility expenses	1,602	1,361
Depreciation (Note 18)	1,246	873
Amortisation (Note 19)	134	23
Provision for impairment loss on other assets (Note 17(a))	16	15
Auditor's remuneration	11	11
Transport and travelling	229	146
Office expenses	303	274
Postal service expense	214	190
Legal and professional fees	517	437
Other administrative expenses	<u>1,888</u>	<u>2,184</u>
	<u>12,944</u>	<u>10,971</u>
(b) EMPLOYEE BENEFITS		
Wages and salaries	4,036	3,454
Pension costs – Defined contribution plan	388	315
Medical expenses	330	285
Other staff costs	313	223
Directors' emoluments (Note 28(ii))	79	69
Net income relating to the retirement benefit asset (Note 20)	<u>(576)</u>	<u>(917)</u>
	<u>4,570</u>	<u>3,429</u>
10. CHANGES IN FAIR VALUE OF INVESTMENTS		
(a) Fair value changes on financial assets held for trading		
Internally managed portfolio	-	(1,907)
Externally managed portfolio – RAMP	<u>-</u>	<u>(166)</u>
	<u>-</u>	<u>(2,073)</u>
(b) Fair value changes on debt instruments at fair value through other comprehensive income:		
Internally managed portfolio	6,468	-
Externally managed portfolio - RAMP	<u>537</u>	<u>-</u>
	<u>7,005</u>	<u>-</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

11. BALANCES DUE FROM BANKING INSTITUTIONS

Current accounts	67,162	29,877
Foreign currency denominated term deposits	354,329	450,641
Accrued interest on term deposits	743	1,148
Special project accounts	95,282	17,328
Domestic foreign currency cheque clearing	25,107	23,831
Repos clearing and regional central banks	<u>341</u>	<u>162</u>
	542,964	522,987
Allowance for impairment	<u>(115)</u>	<u>-</u>
	<u>542,849</u>	<u>522,987</u>

An analysis of changes in the impairment allowance of balances due from banking institutions is as follows:

	2019 KShs' million	2018 KShs' million
At the beginning of the year	-	-
IFRS 9 adjustment on 1 July 2018	66	-
Charge to the profit or loss (Note 8)	<u>49</u>	<u>-</u>
At 30 June	<u>115</u>	<u>-</u>

A reconciliation from the opening balance to the closing balance of the loss allowance based on year end stage classification is disclosed in Note 29 (i).

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 23).

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

	2019 SDR million	2019 KShs' million	2018 SDR million	2018 KShs' million
(a) Assets				
IMF balances (SDR asset account)	<u>8</u>	<u>1,008</u>	<u>15</u>	<u>2,012</u>
(b) Liabilities				
International Monetary Fund Account No. 1	20	2,766	20	2,841
International Monetary Fund Account No. 2	-	12	-	13
International Monetary Fund – PRGF Account	310	43,990	427	60,605
IMF - SDR Allocation account	<u>260</u>	<u>36,885</u>	<u>260</u>	<u>36,825</u>
	<u>590</u>	<u>83,653</u>	<u>707</u>	<u>100,284</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

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 542.8 million (2018: SDR 542.8 million) is not included in the financial statements of the Bank as these are booked in the National Treasury who are the Government of Kenya's Fiscal Agent. Allocations of SDR 260 million (2018: SDR 260 million) are included in the financial statements of the Bank as the custodian of the Government of Kenya. The repayment of IMF facilities is currently bi-annual and Poverty Reduction Growth Facility (PRGF) attracts nil interest until advised by IMF.

13. SECURITIES AND ADVANCES TO BANKS

	2019 KShs' million	2018 KShs' million
Treasury bonds discounted	8,454	9,470
Treasury bills discounted	2,524	28
Accrued interest bonds discounted	257	277
Repo treasury bills (Injection)	20,100	19,400
Accrued interest repo	46	43
Liquidity support framework	37,110	7,765
Due from commercial banks	<u>1,418</u>	<u>1,520</u>
	69,909	38,503
Allowance for impairment losses	<u>(3,000)</u>	-
	<u>66,909</u>	<u>38,503</u>

An analysis of changes in the impairment allowance of securities and advances to banks is as follows:

	2019 KShs' million	2018 KShs' million
At the beginning of the year	-	-
IFRS 9 adjustment on 1 July 2018	674	-
Charge to profit or loss (Note 8)	<u>2,326</u>	-
At 30 June	<u>3,000</u>	-

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

A reconciliation from the opening balance to the closing balance of the loss allowance based on year end stage classification is disclosed in Note 29 (i).

The carrying amount of securities and advances to banks has increased by KShs 28,406 million due to liquidity needs in the market.

Year ended 30 June 2019

	Maturity period			Total KShs' million
	1-3 months KShs' million	3-12 months KShs' million	Over 1 year KShs' million	
Treasury bills discounted	569	1,955	-	2,524
Treasury bonds discounted	911	100	7,443	8,454
Accrued interest bonds discounted	-	257	-	257
Repo treasury bills & bonds (Injection)	20,100	-	-	20,100
Accrued interest repo	46	-	-	46
Due from commercial banks	1,418	-	-	1,418
Liquidity support framework	<u>34,110</u>	<u>-</u>	<u>-</u>	<u>34,110</u>
	<u>57,154</u>	<u>2,312</u>	<u>7,443</u>	<u>66,909</u>

Year ended 30 June 2018

	Maturity period			Total KShs' million
	1-3 months KShs' million	3-12 months KShs' million	Over 1 year KShs' million	
Treasury bills discounted	15	6	7	28
Treasury bonds discounted	176	941	8,353	9,470
Accrued interest bonds discounted	-	277	-	277
Repo treasury bills & bonds (Injection)	19,400	-	-	19,400
Accrued interest repo	43	-	-	43
Due from commercial banks	1,520	-	-	1,520
Liquidity support framework	<u>7,765</u>	<u>-</u>	<u>-</u>	<u>7,765</u>
	<u>28,919</u>	<u>1,224</u>	<u>8,360</u>	<u>38,503</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

14. LOANS AND ADVANCES

	2019 KShs' million	2018 KShs' million
Due from banks under liquidation	3,400	3,400
Advances to employees	<u>3,419</u>	<u>2,688</u>
	6,819	6,088
Allowance for impairment losses	<u>(3,456)</u>	<u>(3,503)</u>
Net advances	<u>3,363</u>	<u>2,585</u>
The movement in the allowance for impairment losses is as follows:		
At the beginning of the year	3,503	3,468
Decrease in impairment losses on adoption of IFRS 9 on 1 July 2018	(35)	-
(Decrease)/increase in impairment allowance (Note 8)	<u>(12)</u>	<u>35</u>
At 30 June	<u>3,456</u>	<u>3,503</u>

15. (a) DEBT INSTRUMENTS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Fixed income securities – Internally managed portfolio	471,929	-
Fixed income securities under World Bank RAMP	<u>32,604</u>	<u>-</u>
	<u>504,533</u>	<u>=</u>

(b) FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Fixed income securities – Internally managed portfolio	-	369,733
Fixed income securities under World Bank RAMP	<u>-</u>	<u>30,600</u>
	<u>=</u>	<u>400,333</u>

Fixed income securities increased by KShs 104,200 million to KShs 504,533 million (2018: KShs 400,333 million) mainly due to a shift in investment strategy from money markets to fixed income securities during the year under review. The increase was further boosted by proceeds from Eurobond.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

16. UNLISTED EQUITY INVESTMENTS

	2019 KShs' million	2018 KShs' million
(a) Unquoted equity securities at fair value through other comprehensive income	<u>9</u>	<u>-</u>
(b) Unquoted equity securities - available-for-sale	<u>-</u>	<u>9</u>

“Unlisted equity securities” relate to the Bank’s investment in shares of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) which is a member owned co-operative with its headquarters in Belgium. The Bank held 24 (2018: 24) SWIFT shares at 30 June 2019.

17. (a) OTHER ASSETS	2019 KShs' million	2018 KShs' million
Prepayments	2,686	12
Deferred currency expenses	2,165	1,799
Sundry debtors	5,275	5,897
Items in the course of collection	467	498
Uncleared effects	<u>36</u>	<u>25</u>
	10,629	8,231
Provision for impairment	<u>(4,945)</u>	<u>(4,929)</u>
	<u>5,684</u>	<u>3,302</u>

All other assets balances are recoverable within one year.

The movement in the allowance for impairment losses is as follows:

At the beginning of the year	4,929	4,914
Increase in impairment allowance (Note 8)	<u>16</u>	<u>15</u>
At 30 June	<u>4,945</u>	<u>4,929</u>

(b) GOLD HOLDINGS

Gold holdings	<u>81</u>	<u>71</u>
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Movements in gold holdings are due to mark to market movements.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

18. PROPERTY AND EQUIPMENT

Year ended 30 June 2019	Freehold land and buildings KShs' million	Leasehold land and buildings KShs' million	Work in progress KShs' million	Motor vehicles KShs' million	Furniture and equipment KShs' million	Total KShs' million
AT COST OR VALUATION						
At 1 July 2018	12,337	4,006	8,227	498	6,039	31,107
Additions	427	907	420	-	2,344	4,098
Capitalization of work in progress	56	-	(68)	-	12	-
Disposals	-	-	-	(39)	(14)	(53)
At 30 June 2019	<u>12,820</u>	<u>4,913</u>	<u>8,579</u>	<u>459</u>	<u>8,381</u>	<u>35,152</u>
DEPRECIATION						
At 1 July 2018	63	15	-	388	3,488	3,954
Charge for the year	388	99	-	37	722	1,246
Disposals	-	-	-	(35)	(14)	(49)
At 30 June 2019	<u>451</u>	<u>114</u>	<u>-</u>	<u>390</u>	<u>4,196</u>	<u>5,151</u>
NET CARRYING AMOUNT						
At 30 June 2019	<u>12,369</u>	<u>4,799</u>	<u>8,579</u>	<u>69</u>	<u>4,185</u>	<u>30,001</u>

Work in progress relates to buildings under construction at Kenya School of Monetary Studies, integrated security management system and office modernisation Phase III at Head Office.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

18. PROPERTY AND EQUIPMENT (continued)

Year ended 30 June 2018	Freehold land and buildings KShs' million	Leasehold land and buildings KShs' million	Work in progress KShs' million	Motor vehicles KShs' million	Furniture and equipment KShs' million	Total KShs' million
AT COST OR VALUATION						
At 1 July 2017	12,492	2,203	7,289	388	4,794	27,166
Additions	-	-	1,175	116	1,023	2,314
Revaluation 2018	1,073	1,938	-	-	-	3,011
Transfer*	(1,228)	(135)	-	-	-	(1,363)
Capitalization of work in progress	-	-	(237)	-	237	-
Disposals	-	-	-	(6)	(15)	(21)
At 30 June 2018	<u>12,337</u>	<u>4,006</u>	<u>8,227</u>	<u>498</u>	<u>6,039</u>	<u>31,107</u>
DEPRECIATION						
At 1 July 2017	902	96	-	349	3,116	4,463
Charge for the year	389	54	-	44	386	873
Transfer*	(1,228)	(135)	-	-	-	(1,363)
Disposals	-	-	-	(5)	(14)	(19)
At 30 June 2018	<u>63</u>	<u>15</u>	<u>-</u>	<u>388</u>	<u>3,488</u>	<u>3,954</u>
NET CARRYING AMOUNT						
At 30 June 2018	<u>12,274</u>	<u>3,991</u>	<u>8,227</u>	<u>110</u>	<u>2,551</u>	<u>27,153</u>

* This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

18. PROPERTY AND EQUIPMENT (continued)

Land and buildings were revalued by independent professional valuers on 31 May 2018 on an open market basis and the revaluation surplus was included in the revaluation reserve. Land and buildings are included in the level 3 of the fair valuation hierarchy (that is, the fair value is not based on observable market data (unobservable inputs)).

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

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property is based on the 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 is in possession of all titles deeds and occupies all the properties.

19. INTANGIBLE ASSETS

	Software KShs' million	Work in progress KShs' million	Total KShs' million
Year ended 30 June 2019			
COST			
At 1 July 2018	1,817	-	1,817
Additions	<u>598</u>	<u>208</u>	<u>806</u>
At 30 June 2019	<u>2,415</u>	<u>208</u>	<u>2,623</u>
ACCUMULATED AMORTISATION			
At 1 July 2018	1,652	-	1,652
Charge for the year	<u>134</u>	<u>-</u>	<u>134</u>
At 30 June 2019	<u>1,786</u>	<u>-</u>	<u>1,786</u>
NET CARRYING AMOUNT			
At 30 June 2019	<u>629</u>	<u>208</u>	<u>837</u>
Year ended 30 June 2018			
COST			
At 1 July 2017	1,681	-	1,681
Additions	<u>136</u>	<u>-</u>	<u>136</u>
At 30 June 2018	<u>1,817</u>	<u>-</u>	<u>1,817</u>
ACCUMULATED AMORTISATION			
At 1 July 2017	1,629	-	1,629
Charge for the year	<u>23</u>	<u>-</u>	<u>23</u>
At 30 June 2018	<u>1,652</u>	<u>-</u>	<u>1,652</u>
NET CARRYING AMOUNT			
At 30 June 2018	<u>165</u>	<u>-</u>	<u>165</u>

Work in progress relates to implementation of enterprise data warehouse (EDW).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

20. RETIREMENT BENEFIT ASSET

	2019 KShs' million	2018 KShs' million
Present value of funded obligations	16,423	14,551
Fair value of plan assets	<u>(30,640)</u>	<u>(30,279)</u>
Net overfunding in funded plan	(14,217)	(15,728)
Limit on defined benefit asset	<u>9,889</u>	<u>9,144</u>
Asset in the statement of financial position	<u>(4,328)</u>	<u>(6,584)</u>
Movements in the net defined benefit asset recognised are as follows:		
At the beginning of the year	6,584	8,197
Net income recognised in profit or loss (Note 9(b))	576	917
Net expense recognized in other comprehensive income (OCI)	(2,928)	(2,629)
Employer contributions	<u>96</u>	<u>99</u>
At 30 June	<u>4,328</u>	<u>6,584</u>
Movements in the plan assets are as follows:		
At the beginning of the year	30,279	28,464
Interest income on plan assets	3,950	3,886
Employer contributions	96	99
Employee contributions	48	50
Benefits expenses paid	(1,299)	(1,165)
Return on plan assets excluding amount in interest income	<u>(2,434)</u>	<u>(1,055)</u>
At 30 June	<u>30,640</u>	<u>30,279</u>
Movements in the plan benefit obligation are as follows:		
At the beginning of the year	14,551	13,440
Current service cost net of employees' contributions	274	215
Interest cost	1,884	1,805
Employee contributions	48	50
Actuarial loss/(gain) due to experience	381	(559)
Actuarial loss due to change in assumptions	584	765
Benefits paid	<u>(1,299)</u>	<u>(1,165)</u>
At 30 June	<u>16,423</u>	<u>14,551</u>
The principal actuarial assumptions at the reporting date were:	2019	2018
Discount rate (p.a.)	12.90%	13.30%
Salary increase (p.a.)	7.00%	7.00%
Future pension increases	<u>3.00%</u>	<u>3.00%</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

20. RETIREMENT BENEFIT ASSET (continued)

Five-year summary	2019 KShs' million	2018 KShs' million	2017 KShs' million	2016 KShs' million	2015 KShs' million
Fair value of plan assets	30,640	30,279	28,464	27,161	27,156
Present value of funded obligations	(16,423)	(14,551)	(13,440)	(17,623)	(17,820)
Adjustment to retirement benefit asset	<u>(9,889)</u>	<u>(9,144)</u>	<u>(6,827)</u>	<u>(1,762)</u>	<u>(4,668)</u>
Net retirement benefit asset	<u>4,328</u>	<u>6,584</u>	<u>8,197</u>	<u>7,776</u>	<u>4,668</u>

Plan assets are distributed as follows:

	2019 KShs' million	%	2018 KShs' million	%
Quoted shares	6,992	22.8%	8,529	28.2%
Investment properties	7,573	24.7%	6,552	21.6%
Government of Kenya treasury bills and bonds	13,670	44.6%	11,488	37.9%
Commercial paper and corporate bonds	874	2.9%	1,226	4.1%
Offshore investments	109	0.4%	1,100	3.6%
Fixed and term deposits	1,107	3.6%	748	2.5%
Fixed assets	1	-	2	-
Net current assets	<u>314</u>	<u>1.0%</u>	<u>634</u>	<u>2.1%</u>
	<u>30,640</u>	<u>100%</u>	<u>30,279</u>	<u>100%</u>

Sensitivity of principal actuarial assumptions:

If the discount rate is 1% lower (higher), the present value of funded obligations would be KShs 18,050 million (increase by KShs 1,626 million). This sensitivity analysis has been determined based on reasonably possible changes of the assumption occurring at the end of 30 June 2019, while holding all other assumptions constant.

The other principal actuarial assumptions, that is salary increase and future pension increase are not expected to change materially because they are within the control of management and are approved in the Human Resource Policy on employee benefits. Additionally, any change is not expected to be material based historical trends and may not have a linear impact on the present value of the fund obligation.

The Bank does not have any asset-liability matching strategies used to manage risk. The retirement benefit scheme is funded and hence the assets under the scheme are used to meet benefit payments as and when they arise. The timing of the benefit payments from the scheme are unknown as the fund comprises active members, pensioners and deferred pensioners.

The scheme is funded by contributions from employer and employees. The average duration of the defined benefit plan obligation at the end of the reporting period is 9.9 years (2018: 9.9 years). The Bank expects to pay KShs 144 million to its defined benefit plan in financial year ended 30 June 2020.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

21. DUE FROM GOVERNMENT OF KENYA

	2019 KShs' million	2018 KShs' million
Overdraft	57,327	56,849
Government loan	<u>22,229</u>	<u>23,339</u>
	<u>79,556</u>	<u>80,188</u>

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit for the year ending 30 June 2019 is KShs 65,716 million (2018: KShs 57,579 million) based on the gross recurrent revenue for the year ended 30 June 2018, which are the latest audited financial statements at the date of approval of these financial statements. Interest is charged at the Central Bank Rate, currently at 10%.

The Bank converted the Government of Kenya overdraft facility that exceeded statutory limit in 1997 into a loan at 3% interest repayable by 2039 and is guaranteed by a deed executed by the Cabinet Secretary, The National Treasury. Principal repayments of KShs 555 million plus interest accruing are paid half yearly. The movement in the balance in the current year relates to the repayment of principal of KShs 1,110 million which was received by 30 June 2019.

22. CURRENCY IN CIRCULATION

	2019 KShs' million	2018 KShs' million
Kenya bank notes	240,264	253,550
Kenya coins	<u>9,245</u>	<u>8,889</u>
	<u>249,509</u>	<u>262,439</u>
Movement in the account was as follows:		
At 1 July	262,439	253,787
Deposits by commercial banks	(548,258)	(501,903)
Withdrawals by commercial banks	535,349	510,585
(Deposits)/withdrawals by CBK	<u>(21)</u>	<u>(30)</u>
At 30 June	<u>249,509</u>	<u>262,439</u>

23. DEPOSITS FROM BANKS AND GOVERNMENT

Local commercial banks clearing accounts and cash ratio reserve	270,262	166,772
Local banks foreign exchange settlement accounts	24,511	21,753
External banks foreign exchange settlement accounts	183	134
Other public entities and project accounts	108,595	28,698
Government of Kenya	<u>337,449</u>	<u>366,930</u>
	<u>741,000</u>	<u>584,287</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

24. OTHER LIABILITIES

Impersonal accounts	2,587	3,743
Sundry creditors	3,513	2,934
Refundable deposits	224	231
Leave accrual	177	156
Gratuity to staff members	<u>20</u>	<u>55</u>
	<u>6,521</u>	<u>7,119</u>

Impersonal accounts hold amounts due to ministries and departments of Government of Kenya.

25 (a) SHARE CAPITAL

	2019 KShs' million	2018 KShs' million
Authorised share capital:		
At 1 July	5,000	5,000
Additional share capital	<u>45,000</u>	—
At 30 June	<u>50,000</u>	<u>5,000</u>
Paid up share capital:		
At 1 July	5,000	5,000
Additional share capital	<u>15,000</u>	—
At 30 June	<u>20,000</u>	<u>5,000</u>

Ownership of the entire share capital is vested in the Principal Secretary to the National Treasury. During the year, the board of directors approved the increase of authorized share capital from KShs 5 billion to KShs 50 billion and paid up share capital from KShs 5 billion to KShs 20 billion. The increase was paid up from the general reserve fund.

(b) GENERAL RESERVE FUND

The general reserve fund represents accumulated surpluses comprising surplus arising from normal operations of the Bank and unrealized gains on exchange rate fluctuations. The distribution of these amounts is subject to the Bank retaining at least 10% of annual surplus for the year or any other amount as the Board in consultation with the Cabinet Secretary, The National Treasury may determine.

(c) FAIR VALUE RESERVE

The fair value reserve represents cumulative gains and losses arising from revaluation of debt instruments from cost to fair value based on the market values at the end of the reporting date.

(d) REVALUATION RESERVE

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

(e) CONSOLIDATED FUND

The Consolidated Fund represents amounts proposed for distribution to the Government of Kenya from the General Reserve Fund.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

26. CASH GENERATED FROM OPERATIONS

	2019 KShs' million	2018 KShs' million
Surplus/(deficit) for the year	26,138	(4,662)
Adjustments for:		
Depreciation (Note 18)	1,246	873
Amortisation (Note 19)	134	23
Gain on disposal of property and equipment (Note 7)	(10)	(6)
Credit loss expense on financial assets	2,082	35
Net interest income	(21,855)	(19,216)
Provision for impairment loss on other assets (Note 9(a))	16	15
Net credit relating to the retirement benefit asset (Note 20)	(576)	(917)
Employer contributions on defined benefit asset	(96)	(99)
Unrealised foreign exchange gain on due to IMF (Note 27(b))	(16)	(530)
Fair value loss on financial assets held for trading (Note 10(a))	<u>-</u>	<u>2,073</u>
Operating surplus / (deficit) before changes in working capital	7,063	(22,411)
Changes in working capital:		
Loans and advances	(731)	(45)
Other assets	(2,398)	7,249
Due from Government of Kenya	632	(55,739)
Currency in circulation	(12,930)	8,652
Deposits from banks and government	156,713	114,178
Gold holdings	(10)	-
Consolidated fund	(800)	-
Other liabilities	<u>(598)</u>	<u>4,560</u>
Cash generated from operations	<u>146,941</u>	<u>56,444</u>

27. CASH AND CASH EQUIVALENTS

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

	2019 KShs' million	2018 KShs' million
Balances due from banking institutions (Note 11)	542,849	522,987
Financial assets – FVOCI/FVPL (Note 29 (ii))	28,830	25,421
Securities discounted by banks and other advances (Note 13)	<u>57,154</u>	<u>28,919</u>
	<u>628,833</u>	<u>577,327</u>

(b) Changes in liabilities arising from financing activities

At 1 July	100,284	115,125
Cash flow items:		
Repayments	(16,615)	(14,311)
Foreign exchange changes	<u>(16)</u>	<u>(530)</u>
At 30 June	<u>83,653</u>	<u>100,284</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

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) which is 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 including the Governor of the Central Bank of Kenya.

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

(i) Loans

The Bank extends loan facilities to the key management staff of the Central Bank. The advances are at preferential rates of interest determined by the Bank. The repayment terms and collateral used are similar to those of loans and advances to other staff. Provisions on loans and advances to staff are arrived at using collective assessment approach. Provisions at 30 June 2019 are disclosed in Note 14. Collateral information is disclosed in Note 29. The repayment terms of the loans are between 2 years and 20 years.

	2019	2018
	KShs' million	KShs' million
Loans to key management staff		
At 1 July	75	44
Loans advanced during the year	12	53
Loan repayments	<u>(37)</u>	<u>(22)</u>
At 30 June	<u>50</u>	<u>75</u>
(ii) Directors' emoluments:		
Fees to non-executive directors	22	22
Directors' travelling expenses	24	14
Other remuneration to executive directors	<u>33</u>	<u>33</u>
	<u>79</u>	<u>69</u>
(iii) Remuneration to senior management	<u>185</u>	<u>165</u>
(iv) Post-employment pension to senior management	<u>4</u>	<u>4</u>
(v) Government of Kenya		
Due from Government of Kenya (Note 21)	79,556	80,188
Government of Kenya Deposits (Note 23)	337,449	366,930
Interest earned from Government of Kenya – Loan (Note 4)	695	725
Interest earned from Government of Kenya - Overdraft (Note 4)	2,523	2,494
Fees and commission income	3,000	3,000
Loan principal repayment	<u>1,110</u>	<u>1,110</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

28. RELATED PARTY TRANSACTIONS (continued)

(v) Government of Kenya (continued)

Transactions entered into with the Government include:

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

(vi) Kenya Deposit Insurance Corporation (KDIC)

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

The balance outstanding from the KDIC included in sundry debtors (Note 17(a)) as at year end was KShs 26 million (2018: KShs 26 million).

The deposits relating to KDIC included in deposits from banks and Government as at year end were KShs 71 million (2018: KShs 19 million).

The staff of the Corporation are contractually employees of 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 under review, salaries paid to the staff of the Corporation by the Central Bank amounted to KShs 218 million (2018: KShs 270 million).

(vii) Kenya School of Monetary Studies (KSMS)

The Kenya School of Monetary Studies (the "School") is primarily owned and managed by CBK and its financial statements have been consolidated in these financial statements.

The permanent staff working at KSMS are employees of CBK. Fixed assets 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 were significantly completed.

	2019 KShs' million	2018 KShs' million
CBK-KSMS related activities		
Grants from CBK	471	474
Buildings	2,317	2,317
Land	4,250	4,250
Receivable from KSMS	59	58
Accumulated deficit	<u>62</u>	<u>62</u>

(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 the Secretariat appointed by the sponsor. The costs of their operations are fully reimbursed to the Bank on a regular basis.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Bank'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 Bank'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 Banking 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 can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

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

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

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

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

(b) Risks facing the Bank

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

Financial risks include:

- Credit risk
- Market risk:
- Liquidity risk

Non-financial risks include:

- Operational risk
- Human resource risk
- Legal risk
- Reputation risk

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets (sundry debtors).

Management of credit risk is carried out through the choice of counterparties. The Bank's choice of counterparties is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A- or equivalent rating from Standard & Poor's, Moody's and Fitch), short-term credit rating (F1 or equivalent by the three internationally recognised credit rating agencies) and capital adequacy (8% and above by BIS).

The following table sets out the carrying amounts of the financial assets that are exposed to credit risk as at 30 June 2019 and 30 June 2018:

	2019 KShs' million	2018 KShs' million
Balances due from banking institutions	542,849	522,987
Funds held with International Monetary Fund (IMF)	1,008	2,012
Securities and advances to banks	66,909	38,503
Loans and advances	3,363	2,585
Debt instruments at fair value through other comprehensive income	504,533	-
Financial assets at fair value through profit or loss	-	400,333
Other assets – sundry debtors	330	968
Due from Government of Kenya	<u>79,556</u>	<u>80,188</u>
	<u>1,198,548</u>	<u>1,047,576</u>

The Bank assesses the credit quality of these assets. None of the balances have had their terms renegotiated as a result of non-performance. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Credit quality analysis

The following tables set out information about the credit quality of financial assets measured at amortised cost and FVOCI debt investments (2019) and financial assets through profit or loss assets (2018). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

Explanation of the terms: 'Stage 1', 'Stage 2' and 'Stage 3' are included in Note 2(g). The credit ratings show the best-two rating amongst Standard & Poor's, Moody's and Fitch.

	Stage 1	Stage 2	Stage 3	2019	2018
	KShs' million	KShs' million	KShs' million	Total KShs' million	Total KShs' million
Balance due from banking institutions					
Rated AAA	2	-	-	2	2
Rated AA- to AA+	248,830	-	-	248,830	292,684
Rated A- to A+	175,335	-	-	175,335	148,895
Unrated	<u>118,797</u>	<u>-</u>	<u>-</u>	<u>118,797</u>	<u>81,406</u>
Gross carrying amount	542,964	-	-	542,964	522,987
Impairment allowance	<u>(115)</u>	<u>-</u>	<u>-</u>	<u>(115)</u>	<u>-</u>
Net carrying amount	<u>542,849</u>	<u>-</u>	<u>-</u>	<u>542,849</u>	<u>522,987</u>
Debt instruments at fair value through OCI (2018: FVTPL)					
Rated AAA	496,925	-	-	496,925	391,932
Rated AA- to AA+	<u>7,608</u>	<u>-</u>	<u>-</u>	<u>7,608</u>	<u>8,401</u>
Carrying amount	<u>504,533</u>	<u>-</u>	<u>-</u>	<u>504,533</u>	<u>400,333</u>
Due from Government of Kenya					
Unrated	<u>79,556</u>	<u>-</u>	<u>-</u>	<u>79,556</u>	<u>80,188</u>
Funds with IMF					
Unrated	<u>1,008</u>	<u>-</u>	<u>-</u>	<u>1,008</u>	<u>2,012</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Credit quality analysis (continued)

	Stage 1	Stage 2	Stage 3	2019	2018
	KShs' million	KShs' million	KShs' million	Total	Total
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
Securities and advances to banks					
Unrated	68,698	-	1,211	69,909	38,503
Gross carrying amount	68,698	-	1,211	69,909	38,503
Impairment allowance	(2,092)	-	(908)	(3,000)	-
Net carrying amount	66,606	-	303	66,909	38,503
Loans and advances					
Unrated	3,237	25	3,557	6,819	6,088
Gross carrying amount	3,237	25	3,557	6,819	6,088
Impairment allowance	(7)	-	(3,449)	(3,456)	(3,503)
Net carrying amount	3,230	25	108	3,363	2,585
Other assets					
Unrated	-	-	5,275	5,275	5,897
Gross carrying amount	-	-	5,275	5,275	5,897
Impairment allowance	-	-	(4,945)	(4,945)	(4,929)
Net carrying amount	-	-	330	330	968

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Collateral and other credit enhancements

The Bank holds collateral and other credit enhancements against certain credit exposures. The following table sets out the principal types of collateral held against different types of financial assets.

	Notes	Percentage of exposure that is subject to collateral requirements		Principal type of collateral held
		30 June 2019	30 June 2018	
Advances to banks - Reverse repurchase arrangements and due from commercial banks	13	100	100	Kenya Government debt securities
Loans and advances - Loans to staff	14	100	100	Land and buildings, government securities, motor vehicles

At 30 June 2019, the Bank held advances to banks of KShs 21,518 million (2018: KShs 20,920 million), for which no loss allowance is recognised because of full collateral coverage. The fair value of the collateral held for Advances to banks was KShs 26,268 million (2018: KShs 21,352 million). These have been determined based on market price quotations at the reporting date.

Inputs, assumptions and techniques used for estimating impairment

Significant increase in credit risk

When determining whether the risk of default of the invested amount on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and credit risk specialist's assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Credit risk grades/ratings

For assessing the risk of default, at initial recognition, the Bank assigns to each exposure in foreign currency the credit rating that shows the best-two rating amongst Standard & Poor's, Moody's and Fitch for that particular counterparty.

The Bank, at initial recognition, allocates each exposure to banks a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applies experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower. Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates.

Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade/rating. The monitoring typically involves use of the following data.

Foreign currency exposures	Domestic currency exposures	Other assets
Data from credit rating agencies, press articles, changes in external credit ratings	Internally collected data on banks and supervisory indicators	Repayment history – this includes overdue status and financial situation of the borrower.
Quoted bond prices for the counterparty, where available	Existing and forecast changes in business, financial and economic conditions	Existing and forecast changes in financial and economic conditions
Actual and expected significant changes in the political, regulatory and technological environment of the counterparty or in its business activities		

PD estimation process

Credit risk grades/ratings are a primary input into the determination of the term structure of PD for exposures. The Bank collects performance and default information about its credit risk exposures analysed by counterparty as well as by credit risk grading/ratings. The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

The methodology for determining PDs for domestic commercial banks is based on the risk assessment techniques used for supervisory purposes. Factors considered by these techniques include the capital adequacy, credit risk, liquidity and profitability of the counterparty. The PDs are calculated as the average weighted PDs for each factor, where the weights are determined based on the importance of the factor.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Credit risk grades/ratings (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

For the assets denominated in foreign currency, the Bank uses 12-month PDs for sovereign and non-sovereign issuances, estimated based on Bloomberg's probability of default model which indicate a possibility of bankruptcy over 12 months for issuers per each respective rating category.

For exposures to the Kenyan Government in domestic currency, the estimated PD considers the short-term maturity of such exposures, the absence of historical defaults and detailed assessments of the ability of the Kenyan Government to fulfil its contractual cash flow obligations in the short-term which consider also the macroeconomic indicators over the assessment period.

Determining whether credit risk has increased significantly

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in PDs and qualitative factors, including a backstop based on delinquency.

The credit risk of a particular exposure in foreign currency is deemed to have increased significantly since initial recognition if:

- the credit rating from all the three rating agencies (Standard & Poor's, Moody's and Fitch) falls below A- (or its equivalent); or
- the credit rating from one of the above agencies is downgraded to A-; or
- there is a delay in the repayment of an obligation to the Bank by more than or equal to 2 days. In this case, the credit risk will be deemed to have significantly increased for all exposures to that issuer.

The credit risk of a particular exposure in domestic currency for commercial banks is deemed to have increased significantly since initial recognition if one of the following criteria is met:

- Internal rating of the borrower indicating default or near-default
- Borrower requesting emergency funding from the Bank, the borrower having past due liabilities to public creditors or employees
- Material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection
- Debtor's listed debt or equity suspended at the primary exchange because of facts about financial difficulties
- The borrower having past due liabilities to public creditors or employees

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Determining whether credit risk has increased significantly (continued)

Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

The Bank monitors the effectiveness of the criteria used to identify significant increases in credit risk by regular reviews to confirm that the criteria are capable of identifying significant increases in credit risk before an exposure is in default.

Definition of default

The Bank considers a financial asset to be in default when:

- the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Bank.

In assessing whether a borrower is in default, the Bank considers indicators that are:

- qualitative – e.g. breaches of covenants;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Bank; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and its significance may vary over time to reflect changes in circumstances.

Incorporation of forward-looking information

The Bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL.

For non-sovereign issuances in foreign currency, forward-looking information is incorporated in the assessment of the probability of defaults, as the probability of the normal scenario and alternative scenario is calculated based on the probability of recession of major economies (as one of the main indicators of increased probability of default for non-sovereign issuers), to which additional quality factors may be applied. For sovereign issuances in foreign currency, forward-looking economic variables are incorporated in the determination of the PD through respective rating in transition matrices published by external rating agencies. These variables are reviewed periodically by credit rating agencies in case of significant changes in the market.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- Probability of default (PD);
- Loss given default (LGD);
- Exposure at default (EAD).

These parameters are derived from internally developed statistical models, globally recognized external developed statistical models and other historical data. They are adjusted to reflect forward-looking information as described above.

Probability of default (PD); PD estimates are estimates at a certain date, which are calculated based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally and externally compiled data comprising both quantitative and qualitative factors. Transition matrixes data are used to derive the PD for foreign counterparties. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD.

Loss given default (LGD); LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates, or parameters calculated by rating agencies and regulatory institutions such as BIS Basel, of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset.

Exposure at default (EAD); EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortisation.

The EAD of a financial asset is its gross carrying amount. EAD estimates are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Bank measures ECL considering the risk of default over the maximum contractual period over which it is exposed to credit risk, even if, for risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Inputs, assumptions and techniques used for estimating impairment (continued)

Measurement of ECL (continued)

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk grading;
- collateral type;
- date of initial recognition;
- remaining term to maturity;
- industry; and,
- geographic location of the borrower

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

For portfolios in respect of which the Bank has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL comprise financial assets in foreign currency as follows:

	Exposure	External benchmarks used	
	KShs' million	PD	LGD
Balances due from banking institutions	542,849	Bloomberg PD rating model	Basel II recovery studies
Debt instruments at fair value through other comprehensive income	504,533	Bloomberg PD rating model	Basel II recovery studies

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Loss allowance

An analysis of changes in the gross carrying amount and the corresponding ECL allowances in relation to the relevant financial assets is as follows:

	Stage 1 Individual KShs' million	Stage 2 Individual KShs' million	Stage 3 Individual KShs' million	Total KShs' million
Debt instruments at fair value through other comprehensive income				
Gross carrying amount as at 1 July 2018	400,333	-	-	400,333
New assets originated or purchased	418,501	-	-	418,501
Asset derecognized or repaid	(328,580)	-	-	(328,580)
Changes to contractual cashflows due to modifications not resulting in derecognition	<u>14,279</u>	<u>-</u>	<u>-</u>	<u>14,279</u>
At 30 June 2019	<u>504,533</u>	<u>-</u>	<u>-</u>	<u>504,533</u>
Balances due from banking institutions				
Gross carrying amount as at 1 July 2018	522,987	-	-	522,987
Changes to contractual cashflows due to modifications not resulting in derecognition	<u>19,977</u>	<u>-</u>	<u>-</u>	<u>19,977</u>
At 30 June 2019	<u>542,964</u>	<u>-</u>	<u>-</u>	<u>542,964</u>
Securities and advances to banks				
Gross carrying amount as at 1 July 2018	37,609	-	894	38,503
New assets originated or purchased	528,899	-	-	528,899
Asset derecognized or repaid	(497,133)	-	(360)	(497,493)
Transfer to Stage 3	<u>(677)</u>	<u>-</u>	<u>677</u>	<u>-</u>
At 30 June 2019	<u>68,698</u>	<u>-</u>	<u>1,211</u>	<u>69,909</u>
Other assets				
Balance as at July 18	960	-	4,937	5,897
New assets originated or purchased	46	-	-	46
Transfer to Stage 3	(16)	-	16	-
Changes to contractual cashflows due to modifications not resulting in derecognition	<u>(668)</u>	<u>-</u>	<u>-</u>	<u>(668)</u>
As at 30 June 19	<u>322</u>	<u>-</u>	<u>4,953</u>	<u>5,275</u>
	Stage 1 Collective KShs' million	Stage 2 Collective KShs' million	Stage 3 Collective KShs' million	Total KShs' million
Loans and advances				
Gross carrying amount as at 1 July 2018	2,501	11	3,587	6,099
New assets originated or purchased	1,208	-	-	1,208
Asset derecognized or repaid	(455)	(3)	(30)	(488)
Transfer to Stage 2	<u>(17)</u>	<u>17</u>	<u>-</u>	<u>-</u>
At 30 June 2019	<u>3,237</u>	<u>25</u>	<u>3,557</u>	<u>6,819</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Loss allowance (continued)

The following tables show reconciliations from the opening to the closing balance of the loss allowance by class of financial instrument. Explanation of the terms: 'Stage 1', 'Stage 2' and 'Stage 3' are included in Note 2(g).

	Stage 1 KShs' million	Stage 2 KShs' mil- lion	Stage 3 KShs' mil- lion	2019 Total KShs' mil- lion	2018 Total KShs' million
Balances due from banking institutions					
At 1 July	-	-	-	-	-
Net remeasurement of loss allowance	<u>115</u>	<u>-</u>	<u>-</u>	<u>115</u>	<u>-</u>
At 30 June	<u>115</u>	<u>-</u>	<u>-</u>	<u>115</u>	<u>-</u>
Other assets					
At 1 July	-	-	4,929	4,929	4,914
Net remeasurement of loss allowance	<u>-</u>	<u>-</u>	<u>16</u>	<u>16</u>	<u>15</u>
At 30 June	<u>-</u>	<u>-</u>	<u>4,945</u>	<u>4,945</u>	<u>4,929</u>
Securities and advances to banks					
At 1 July	-	-	-	-	-
Net remeasurement of loss allowance	<u>2,092</u>	<u>-</u>	<u>908</u>	<u>3,000</u>	<u>-</u>
At 30 June	<u>2,092</u>	<u>-</u>	<u>908</u>	<u>3,000</u>	<u>-</u>
Loans and advances					
At 1 July	-	-	3,503	3,503	3,468
Net remeasurement of loss allowance	<u>7</u>	<u>-</u>	<u>(54)</u>	<u>(47)</u>	<u>35</u>
At 30 June	<u>7</u>	<u>-</u>	<u>3,449</u>	<u>3,456</u>	<u>3,503</u>
Debt instruments at FVOCI (2018: FVTPL)					
At 1 July	-	-	-	-	-
Net remeasurement of loss allowance	<u>61</u>	<u>-</u>	<u>-</u>	<u>61</u>	<u>-</u>
At 30 June	<u>61</u>	<u>-</u>	<u>-</u>	<u>61</u>	<u>-</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk

The Bank monitors concentrations of credit risk by geographic location and by counterparty type. An analysis of concentrations of credit risk is shown below.

Concentration by geographical location is based on the country of domicile of the issuer of the security. Concentration by counterparty type is based on the nature of the institution such as foreign governments, central banks and supranational institutions.

A segregation of the financial assets by geography is set out below:

Year ended 30 June 2019

	United States of America KShs' million	Germany KShs' million	United Kingdom KShs' million	Singapore KShs' million	Canada KShs' million	Kenya KShs' million	Others KShs' million	Total KShs' million
Balances due from banking institutions	163,493	59,155	14,206	74,180	29,914	6,137	195,764	542,849
Funds held with IMF	1,008	-	-	-	-	-	-	1,008
Securities and advances to banks	-	-	-	-	-	66,909	-	66,909
Loans and advances	-	-	-	-	-	3,363	-	3,363
Debt instruments at fair value through OCI	352,824	53,335	-	-	2,665	-	95,709	504,533
Other assets - Sundry debtors	-	-	-	-	-	330	-	330
Due from Government of Kenya	-	-	-	-	-	79,556	-	79,556
Total financial assets	517,325	112,490	14,206	74,180	32,579	156,295	291,473	1,198,548

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

A segregation of the financial assets by geography is set out below:

Year ended 30 June 2018

	United States of America	Germany	United Kingdom	Singapore	Canada	Kenya	Others	Total
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
Balances due from banking institutions	39,702	49,365	22,955	47,054	40,442	6,062	317,407	522,987
Funds held with IMF	2,012	-	-	-	-	-	-	2,012
Securities and advances to banks	-	-	-	-	-	38,503	-	38,503
Loans and advances	-	-	-	-	-	2,585	-	2,585
Financial assets at fair value through profit or loss	322,155	26,994	-	-	1,934	-	49,250	400,333
Other assets - Sundry debtors	-	-	-	-	-	968	-	968
Due from Government of Kenya	-	-	-	-	-	80,188	-	80,188
Total financial assets	<u>363,869</u>	<u>76,359</u>	<u>22,955</u>	<u>47,054</u>	<u>42,376</u>	<u>128,306</u>	<u>366,657</u>	<u>1,047,576</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

A segregation of the financial assets by geography is set out below:

Year ended 30 June 2018

	Balances due from financial institutions KShs' million	Securities and advances KShs' million	Fund held with IMF KShs' million	Loans and advances KShs' million	Fixed income securities KShs' million	Due from GOK KShs' million	Other assets KShs' million	Total KShs' million
Central Banks	63,778	-	-	-	-	-	-	63,778
Foreign Governments	-	-	-	-	354,585	-	-	354,585
Supranational Institutions	54,137	-	1,008	-	89,492	-	-	144,637
Commercial Banks	424,934	55,674	-	-	-	-	-	480,608
Foreign Agencies	-	-	-	-	60,456	-	-	60,456
Government of Kenya	-	11,235	-	-	-	79,556	-	90,791
Others	-	-	-	3,363	-	-	330	3,693
	<u>542,849</u>	<u>66,909</u>	<u>1,008</u>	<u>3,363</u>	<u>504,533</u>	<u>79,556</u>	<u>330</u>	<u>1,198,548</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

A segregation of the financial assets by geography is set out below:

Year ended 30 June 2018

	Balances due from financial institutions KShs' million	Securities and advances KShs' million	Fund held with IMF KShs' million	Loans and advances KShs' million	Fixed income securities KShs' million	Due from GOK KShs' million	Other assets KShs' million	Total KShs' million
Central Banks	28,778	-	-	-	-	-	-	28,778
Foreign Governments	-	-	-	-	324,675	-	-	324,675
Supranational Institutions	42,282	-	2,012	-	41,778	-	-	86,072
Commercial Banks	451,927	28,728	-	-	-	-	-	480,655
Foreign Agencies	-	-	-	-	33,880	-	-	33,880
Government of Kenya	-	9,775	-	-	-	80,188	-	89,963
Others	-	-	-	2,585	-	-	968	3,553
	<u>522,987</u>	<u>38,503</u>	<u>2,012</u>	<u>2,585</u>	<u>400,333</u>	<u>80,188</u>	<u>968</u>	<u>1,047,576</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk

The Bank takes on exposure to market risk, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk arises 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 exposure to market risk into either trading or non-trading portfolios. Market risk 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 internally managed debt instruments at amortised cost 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 due from the Government of Kenya. 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

Interest rate risk (continued)

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

At 30 June 2019	1 – 3 months KShs' million	3-12 months KShs' million	1 - 5 years KShs' million	Over 5 years KShs' million	Non-interest bearing KShs' million	Total KShs' million
Assets						
Balances due from banking institutions	447,682	-	-	-	95,282	542,964
Securities and advances to banks	60,154	2,312	7,443	-	-	69,909
Financial assets at FVOCI	28,830	139,780	335,923	-	-	504,533
Funds held with International Monetary Fund (IMF)	-	-	-	-	1,008	1,008
Equity investments	-	-	-	-	9	9
Loans and advances	225	387	1,626	1,181	3,400	6,819
Other assets	-	-	-	-	5,275	5,275
Due from Government of Kenya	-	58,437	4,440	16,679	-	79,556
Total financial assets	536,891	200,916	349,432	17,860	104,974	1,210,073
Liabilities						
Deposits from banks and government	-	-	-	-	741,000	741,000
Other liabilities	-	-	-	-	6,324	6,324
Due to International Monetary Fund (IMF)	-	-	-	-	83,653	83,653
Total financial liabilities	-	-	-	-	830,977	830,977
Interest sensitivity gap	536,891	200,916	349,432	17,860	(726,003)	379,096

As at 30 June 2019, increase of 10 basis points would have resulted in a decrease/increase in profit of KShs 379 million (2018: KShs 365 million).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

Interest rate risk (continued)

At 30 June 2018	1 – 3 months KShs' million	3-12 months KShs' million	1 - 5 years KShs' million	Over 5 years KShs' million	Non-inter- est Bearing KShs' mil- lion	Total KShs' million
Assets						
Balances due from banking institutions	505,659	-	-	-	17,328	522,987
Securities and advances to banks	28,919	1,224	8,360	-	-	38,503
Financial assets at FVPL	25,421	100,066	274,846	-	-	400,333
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,012	2,012
Investments securities – Available-for-sale	-	-	-	-	9	9
Other assets	-	-	-	-	5,897	5,897
Loans and advances	151	454	1,672	411	3,400	6,088
Due from Government of Kenya	-	57,959	4,440	17,789	-	80,188
Total financial assets	<u>560,150</u>	<u>159,703</u>	<u>289,318</u>	<u>18,200</u>	<u>28,646</u>	<u>1,056,017</u>
Liabilities						
Deposits from banks and government	-	-	-	-	584,287	584,287
Other liabilities	-	-	-	-	6,908	6,908
Due to International Monetary Fund (IMF)	-	-	-	-	100,284	100,284
Total financial liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>691,479</u>	<u>691,479</u>
Interest sensitivity gap	<u>560,150</u>	<u>159,703</u>	<u>289,318</u>	<u>18,200</u>	<u>(662,833)</u>	<u>364,538</u>

As at 30 June 2018, increase of 10 basis points would have resulted in a decrease/increase in profit of KShs 365 million (2017: KShs 357 million).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

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 2019. Included in the table are the Bank's financial instruments categorised by currency:

At 30 June 2019	USD KShs' million	GBP KShs' million	EUR KShs' million	SDR KShs' million	Others KShs' million	Total KShs' million
Assets						
Balances due from banking institutions	332,164	25,362	13,560	-	171,878	542,964
Financial assets at FVOCI	504,533	-	-	-	-	504,533
Funds held with International Monetary Fund (IMF)	-	-	-	1,008	-	1,008
Total financial assets	836,697	25,362	13,560	1,008	171,878	1,048,505
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	83,653	-	83,653
Deposits from banks and government	15,906	2,310	6,295	-	128	24,639
Total financial liabilities	15,906	2,310	6,295	83,653	128	108,292
Net position	820,791	23,052	7,265	(82,645)	171,750	940,213

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

Foreign exchange risk (continued)

	USD KShs' million	GBP KShs' million	EUR KShs' million	SDR KShs' million	Others KShs' million	Total KShs' million
At 30 June 2018						
Assets						
Balances due from banking institutions	299,812	66,175	5,228	-	151,772	522,987
Financial assets at fair value	400,333	-	-	-	-	400,333
Funds held with International Monetary Fund (IMF)	-	-	-	2,012	-	2,012
Total financial assets	700,145	66,175	5,228	2,012	151,772	925,332
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	100,284	-	100,284
Deposits from banks and government	16,422	2,654	2,573	-	238	21,887
Total financial liabilities	16,422	2,654	2,573	100,284	238	122,171
Net position	683,723	63,521	2,655	(98,272)	151,534	803,161

As at 30 June 2019, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's surplus and equity would have been:

- USD KShs 41,040 million (2018: KShs 34,186 million)
- British Pound KShs 1,153 million (2018: KShs 3,176 million)
- Euro KShs 363 million (2018: KShs 133 million)
- SDR KShs 4,132 million (2018: KShs 4,914 million).

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

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 flows.

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 reporting 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 amounts, as the impact of discounting is not significant.

	On demand	1 – 3 months	3-12 months	1 - 5 years	Over 5 years	Total
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
At 30 June 2019						
Deposits from banks and government	632,405	-	108,595	-	-	741,000
Due to International Monetary Fund (IMF)	-	-	16,700	66,953	-	83,653
Other liabilities	-	-	6,324	-	-	6,324
Total financial liabilities	632,405	-	131,619	66,953	-	830,977
At 30 June 2018						
Deposits from banks and government	555,589	-	28,698	-	-	584,287
Due to International Monetary Fund (IMF)	-	-	16,699	-	83,585	100,284
Other liabilities	-	-	6,908	-	-	6,908
Total financial liabilities	555,589	-	52,305	-	83,585	691,479

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

30. FAIR VALUE OF ASSETS AND LIABILITIES

a) Comparison by class of the carrying amount and fair values of the financial instruments

The fair values of fixed income securities, equity investments and securities and advances to banks (rediscounted treasury bonds) are based on price quotations at the reporting date.

Management assessed that the fair value of balances due from banking institutions, funds held with International Monetary Fund, securities and advances to banks (Treasury bills discounted, accrued interest bonds discounted, repo treasury bills & bonds, accrued interest repo, liquidity support framework and due from commercial banks), other assets (sundry debtors), deposits from government and banks and other liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

Fair values of the Bank's staff loans and due from Government of Kenya and due to International Monetary Fund are determined by using Discounting Cash Flows (DCF) method using discount rate that reflects the issuer's borrowing rate as at the end of the reporting period. This is shown in the table below:

	2019		2018	
	Carrying amount KShs' million	Fair value KShs' million	Carrying amount KShs' million	Fair Value KShs' million
Financial assets				
Securities and advances to banks (rediscounted treasury bonds)	8,454	9,158	9,470	9,888
Loans and advances	3,363	2,377	2,585	2,688
Due from Government of Kenya	<u>79,556</u>	<u>71,419</u>	<u>80,188</u>	<u>71,430</u>
Financial liabilities				
Due to International Monetary Fund	<u>83,653</u>	<u>65,996</u>	<u>100,284</u>	<u>74,394</u>

b) Fair value hierarchy

The table below shows an analysis of all assets and liabilities measured at fair value in the financial statements or for which fair values are disclosed in the financial statements by level of the fair value hierarchy. These are grouped into levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes 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.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

30. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

b) Fair value hierarchy (continued)

Year ended 30 June 2019	Level 1 KShs' million	Level 2 KShs' million	Level 3 KShs' million
Assets measured at fair value:			
Property and equipment			
-Land and buildings	-	-	17,168
Debt instruments at fair value through other comprehensive income	504,533	-	-
Equity instruments at fair value through other comprehensive income	-	-	9
Gold holdings	<u>81</u>	<u>=</u>	<u>=</u>
Assets for which fair values are disclosed:			
Securities and advances to banks (rediscounted treasury bonds)	9,158	-	-
Loans and advances	-	2,377	-
Due from Government of Kenya	<u>-</u>	<u>71,419</u>	<u>=</u>
Liabilities for which fair values are disclosed:			
Due to International Monetary Fund	<u>-</u>	<u>65,996</u>	<u>=</u>
	Level 1	Level 2	Level 3
Year ended 30 June 2018	KShs' million	KShs' million	KShs' million
Assets measured at fair value:			
Property and equipment			
-Land and buildings	-	-	16,265
Financial assets at fair value through profit or loss	400,333	-	-
Investment securities - available-for-sale	-	-	9
Gold holdings	<u>71</u>	<u>=</u>	<u>=</u>
Assets for which fair values are disclosed:			
Securities and advances to banks (rediscounted treasury bonds)	9,888	-	-
Loans and advances	-	2,688	-
Due from Government of Kenya	<u>-</u>	<u>71,430</u>	<u>=</u>
Liabilities for which fair values are disclosed:			
Due to International Monetary Fund	<u>-</u>	<u>74,394</u>	<u>=</u>

There were no transfers between levels 1, 2 and 3 in the year.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

30. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

b) Fair value hierarchy (continued)

The Bank's land and buildings were last revalued in the year ended 30 June 2018. The valuations were based on market value as follows:

Comparable method for valuation of land and buildings

Fair value of the land and buildings was determined by using market comparable method. This means that valuations performed by the valuer are based on active market prices, significantly adjusted for difference in the nature, location or condition of the specific property.

Description of valuation techniques used and key inputs to valuation of assets and liabilities

LEVEL 2		Valuation technique	Significant observable inputs	Range (weighted average) Interest rate
Loans and advances	DCF		Interest rate	12%
Due from Government of Kenya	DCF		Interest rate	9%
Due to IMF	DCF		Interest rate	2%
LEVEL 3		Valuation technique	Significant unobservable inputs	Range (weighted average)
Land and buildings	Market comparable approach and Depreciated replacement cost		Comparable sales of similar properties in the neighbourhood	-

Reconciliation of the opening balances to the closing balances of the fair values of property and equipment: -

	Opening balance KShs' million	Additions KShs' million	Depreciation charge to profit or loss KShs' million	Closing balance KShs' million
Freehold land and buildings	12,274	483	(388)	12,369
Leasehold land and buildings	<u>3,991</u>	<u>907</u>	<u>(99)</u>	<u>4,799</u>
	<u>16,265</u>	<u>1,390</u>	<u>(487)</u>	<u>17,168</u>

The significant unobservable inputs used in the fair value measurement of the Bank's land and buildings are price per acre and estimated rental value per sqm per month. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

31. 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 2019, the Bank had capital commitments of KShs 7,833 million (2018: KShs 6,412 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2019 KShs' million	2018 KShs' million
Not later than 1 year	122	188
Later than 1 year and not later than 5 years	<u>64</u>	<u>95</u>
	<u>186</u>	<u>283</u>

All the commitments relate to future rent payable for various premises based on the existing contracts and projected renewals. The lease agreements are between the Bank and the landlords and have no provisions relating to contingent rent payable. The terms of renewal vary from one lease to another and may include a written notice to the lessors before the expiration of the leases and the lessors will grant to the lessee new leases of the said premises/properties for a further term as may be mutually agreed by the parties.

The escalation rate varies from property to property and is factored into the operating lease commitment values presented above.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled.

Year ended 30 June 2019	Within 12 months KShs' million	After 12 months KShs' million	Total KShs' million
ASSETS			
Balances due from banking institutions	542,849	-	542,849
Funds held with International Monetary Fund (IMF)	1,008	-	1,008
Securities and advances to banks	59,466	7,443	66,909
Loans and advances	612	2,751	3,363
Debt instruments at fair value through other comprehensive income	168,610	335,923	504,533
Equity instruments at fair value through other comprehensive income	-	9	9
Other assets	5,684	-	5,684
Gold holdings	-	81	81
Property and equipment	-	30,001	30,001
Intangible assets	-	837	837
Retirement benefit assets	-	4,328	4,328
Due from Government of Kenya	<u>57,327</u>	<u>22,229</u>	<u>79,556</u>
TOTAL ASSETS	<u>835,556</u>	<u>403,602</u>	<u>1,239,158</u>
LIABILITIES			
Currency in circulation	-	249,509	249,509
Deposits from Banks and Government	741,000	-	741,000
Due to IMF	16,700	66,953	83,653
Other liabilities	<u>6,521</u>	<u>-</u>	<u>6,521</u>
TOTAL LIABILITIES	<u>764,221</u>	<u>316,462</u>	<u>1,080,683</u>
NET ASSETS	<u>71,335</u>	<u>87,140</u>	<u>158,475</u>

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2019

32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

Year ended 30 June 2018	Within 12 months KShs' million	After 12 months KShs' million	Total KShs' million
ASSETS			
Balances due from banking institutions	522,987	-	522,987
Funds held with International Monetary Fund (IMF)	2,012	-	2,012
Securities and advances to banks	30,143	8,360	38,503
Loans and advances	605	1,980	2,585
Financial assets at fair value through profit or loss	125,487	274,846	400,333
Investment securities - available-for-sale	-	9	9
Other assets	3,302	-	3,302
Gold holdings	-	71	71
Property and equipment	-	27,153	27,153
Intangible assets	-	165	165
Retirement benefit assets	-	6,584	6,584
Due from government of Kenya	<u>56,849</u>	<u>23,339</u>	<u>80,188</u>
TOTAL ASSETS	<u>741,385</u>	<u>342,507</u>	<u>1,083,892</u>
LIABILITIES			
Currency in circulation	-	262,439	262,439
Deposits from banks and government	584,287	-	584,287
Due to IMF	16,699	83,585	100,284
Other liabilities	<u>7,119</u>	<u>-</u>	<u>7,119</u>
TOTAL LIABILITIES	<u>608,105</u>	<u>346,024</u>	<u>954,129</u>
NET ASSETS	<u>133,280</u>	<u>(3,517)</u>	<u>129,763</u>



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