

Central Bank of Kenya



ANNUAL REPORT

AND FINANCIAL STATEMENTS

2019/2020



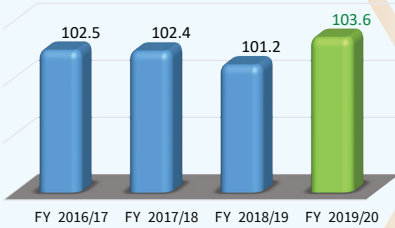
LETTER OF TRANSMITTAL

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 2019/20. 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, 2020.

Dr. Patrick Njoroge
Governor

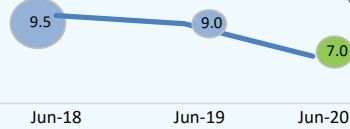
HIGHLIGHTS

Average Exchange Rate (KSh/US\$)



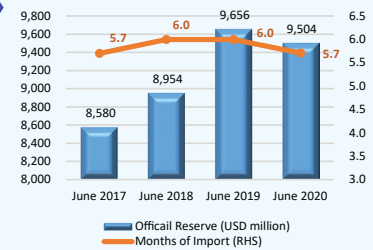
The exchange rate remained relatively stable.

Central Bank Rate (%)



CBR lowered to support the economy without compromising the price stability objective.

Official Foreign Exchange Reserves



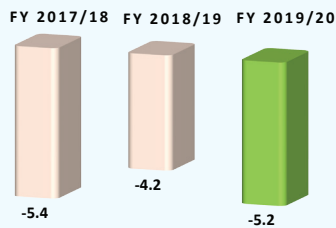
The official forex reserves remain adequate and above the statutory requirements.

Real GDP Growth (%)



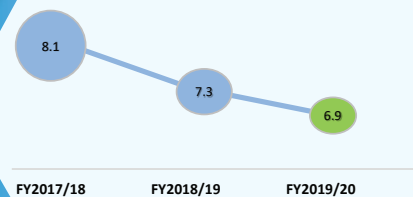
The economy remained resilient in 2019.

Current A/C Deficit (% of GDP)



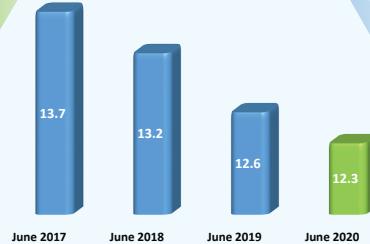
The current account weakened slightly due to the effect of COVID-19 in the last quarter of the financial year.

Average 91 - day T Bill Rate (%)

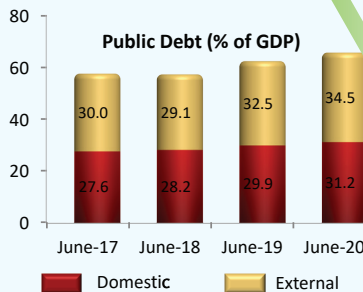


Decline in interest rates on government securities resulting in lower cost of domestic debt.

Average Lending Rate (%)

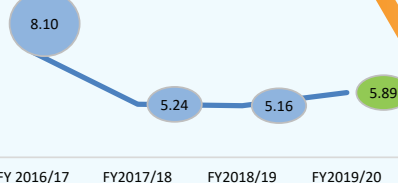


The lending rate declined thereby supporting access to affordable credit.



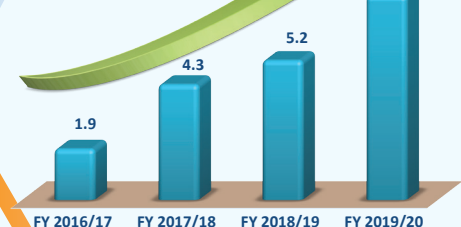
Some increase in public debt to support COVID-19 related expenditures.

Average Inflation Rate



Inflation remained within the Government target.

Private sector Credit Growth (%)



Recovery in growth of private sector credit.

VISION

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

MISSION

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

MANDATE

Article 231 of the constitution of Kenya and Sections 4 and 4A of the Central Bank of Kenya (CBK) Act outline the key mandate 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 CORE VALUES

Transparency, Accountability and Integrity

The Board, Management 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 Public Officers' Ethics Act, and observe high moral standards.

Commitment

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

Diversity and Inclusiveness

The Bank appreciates and embraces the differences in its employees' skill set and abilities and encourages consultations and inclusiveness in pursuit of its mandate across departments. This is aimed at maximizing productivity and enhancing the Bank's overall performances.

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.

Mutual Respect and Team Work

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.

Professionalism and Relevance

The Board, Management and staff will always endeavour to offer quality services to its internal and external stakeholders, 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.

Innovativeness

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

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ABBREVIATIONS AND ACRONYMS

AACB	Association of African Central Banks	KNBS	Kenya National Bureau of Statistics
AMCP	African Monetary Cooperation Programme	KSh	Kenya Shillings
CBK	Central Bank of Kenya	MFBs	Microfinance Banks
COMESA	Common Market for Eastern and Southern Africa	MNOs	Mobile Network Operators
COVID-19	Corona Virus Disease 2019	MPC	Monetary Policy Committee
CRBs	Credit Reference Bureaus	MSME	Micro, Small and Medium Enterprise
CRR	Cash Reserves Requirement	NDA	Net Domestic Assets
EAC	East African Community	NFA	Net Foreign Assets
EAMU	East African Monetary Union	NPL	Non-Performing Loan
EAPSS	East Africa Payments System	OPEC	Organization of the Petroleum Exporting Countries
EDW	Enterprise Data Warehouse	OTC	Over the Counter
EMDEs	Emerging Markets & Developing Economies	PSPs	Payment Service Providers
FinTech	Financial Technologies	REPSS	Regional Payment and Settlement System
FY	Financial Year	RTGS	Real Time Gross Settlement
GDP	Gross Domestic Product	SSA	Sub-Saharan Africa
IMF	International Monetary Fund	TRWA	Total Risk Weighted Assets
KEPSS	Kenya Electronic Payments and Settlement System	USD	United States Dollars
		VAT	Value Added Tax
		WEO	World Economic Outlook

FOREWORD BY THE GOVERNOR

It is a great pleasure to present the Central Bank of Kenya's (CBK) Annual Report for the Financial Year 2019/20, a challenging year both at the global and national level. In Kenya, the year began with strong domestic economic growth prospects, supported by macroeconomic stability, recovery in agriculture, resilient performance of service-oriented sectors and a resurgent manufacturing sector.

In the second half of the year, the global economy suffered a severe shock arising from the coronavirus (COVID-19) pandemic. Countries implemented stringent measures to contain the spread of the pandemic, leading to widespread business closures, severe disruptions to trade and supply chains, and collapse in global travel. The Government moved quickly to implement measures to prevent the pandemic from becoming a health and economic crisis. Even before the first COVID-19 case was reported in Kenya, in mid-March, the Government set up five Committees to deal with the pandemic. Thereafter, fiscal policy measures were put in place to cushion households and businesses from the adverse effects of the pandemic, while the CBK adopted accommodative monetary policy to support economic activity. The CBK also announced emergency banking sector measures to mitigate the adverse impact of the pandemic on the sector and on businesses. Additional measures were agreed with the money transfer service operators and commercial banks to promote use of digital transactions instead of cash. Internally, protocols to protect staff were rolled out including alternative working arrangements.

Despite the challenging environment, the CBK continued implementation of policies that fulfilled its core mandates of maintaining price stability and ensuring a stable market-based financial system. As a result, inflation remained anchored within the target range throughout the year. Other key milestones achieved during the year included the issuance of new generation banknotes in line with the 2010 Constitution, a successful demonetisation (withdrawal) of the old KSh 1,000 notes to address concerns about counterfeits and illicit financial flows, the repeal of interest rate caps in November 2019 thereby restoring the credibility and clarity of monetary policy decisions, the roll out of the Enterprise Data Warehouse (EDW) system which has greatly transformed data collection and analytics at the CBK, continued modernisation of the payments system leading to a major upgrade of the Kenya Electronic Payment and Settlement System, and the successful co-hosting of the inaugural Afro-Asia Fintech festival with the Monetary Authority of Singapore.

Going forward, Kenya is expected to remain resilient, supported by the diversified economy, macroeconomic stability, an innovative banking sector, and the measures put in place to support a post-COVID 19 economic recovery.

Dr. Patrick Njoroge
Governor

STATEMENT BY THE CHAIRMAN OF THE BOARD

The CBK concluded a very successful year in the face of uncertainties caused by COVID-19. The Board was happy to support the efforts by Management and the Government in implementing measures to mitigate the impact of the pandemic. Accordingly, the Board approved the transfer of KSh 7.4 billion to the Exchequer to support these measures. It also fully supported the internal measures taken by Management to protect staff, such as the alternative working arrangements and the safety protocols, in addition to the industry wide measures that greatly supported the economy.

During the year, the Bank continued implementation of its Strategic Plan, 2018–2021, anchored on the overall theme of “Leveraging Innovative Technologies and Systems to Drive CBK’s Mission”. The plan focuses on seven areas namely: Monetary Policy; Banking and Financial Markets; Human Capital; Information Communication Technology; Risk Management and Control Environment; Business Process Re-engineering and East Africa Community (EAC) Integration. The Board supported Management in pursuing appropriate interventions to address outstanding and emerging human resource gaps. Human Resource policies and frameworks were reviewed to ensure they are responsive to the rapidly changing global central banking environment. The Board also supported the upgrade of key operational systems to achieve a seamless, resilient and responsive information and communication system that drives operational excellence and delivers customer-centric services aligned to modern and dynamic business requirements. In addition, the CBK enhanced its capital base from KSh 20 billion to KSh 35 billion as part of the on-going strategy to strengthen its financial position.

On behalf of the Board, I thank Management and staff for their commitment and support to the Board’s endeavours towards achievement of the vision of becoming a ‘World Class Modern Central Bank’.

Mr. Mohamed Nyaoga
Chairman,
CBK Board of Directors

BOARD OF DIRECTORS



Mr. Mohamed Nyaoga
Chairman



Dr. Patrick Njoroge
Governor



Dr. Julius Muia
PS, National Treasury



Mrs. Nelius W. Kariuki
Member



Mr. Samson K. Cherutich
Member



Mr. Ravi J. Ruparel
Member



Mrs. Rachel Dzombo
Member

MEMBERS OF THE MONETARY POLICY COMMITTEE



Dr. Patrick Njoroge
Governor



Mrs. Sheila M'Mbijjew
Deputy Governor



Dr. Margaret Chemengich
External Member



Dr. Julius Muia
PS, The National Treasury



Prof. Jane K. Mariara
External Member



Mr. David Luusa
Director, Financial Markets



Mr. Humphrey Muga
External Member



Dr. Benson Ateng'
External Member



Mr. Raphael O. Otieno
Acting Director, Research

SENIOR MANAGEMENT



Dr. Patrick Njoroge
Governor



Mrs. Sheila M'Mbijewe
Deputy Governor



Mr. Kennedy K. Abuga
*Director, Governor's Office
(Board Secretary)*



Mr. David Luusa
*Director, Financial Markets
(Appointed on April 1, 2020)*



Mr. William Nyagaka
*Director, Financial Markets
(Until March 2, 2020)
Director, Kenya School of Monetary Studies
(From June 2, 2020)*



Mr. Anthony N. Gacanja
Director, Information Technology



Mr. Gerald Nyaoma
Director, Bank Supervision



Mr. Raphael O. Otieno
Acting Director, Research

SENIOR MANAGEMENT



Mr. Moses M. Ngotho
Acting Director, Finance



Ms. Terry W. Ng'ang'a
Acting Director, Human Resources



Mr. Stephen Muriu
Director, General Services
(Appointed on November 25, 2019)



Mrs. Matilda Onyango
Acting Director, Internal Audit and Risk Management



Mr. Paul K. Wanyagi
Acting Director, Currency Operations



Mrs. Rose A. Detho
Director, Strategic Management
(Retired on June 1, 2020)



Mr. Mwenda K. M'Marete
Acting Director, Banking and National Payments



Dr. Joshua N. Kimoro
Acting Director, Kenya School of Monetary Studies (Until June 1, 2020)



Mr. Patrice Odude
Acting Director, Strategic Management
(Appointed on June 2, 2020)



Mrs. Zipporah N. Thambu
Acting Director, General Services
(June 27, 2019 to November 25, 2019)

1.0 GLOBAL ECONOMY

1.0 GLOBAL ECONOMY

The COVID-19 pandemic has adversely affected the global economy by disrupting financial and commodity markets, global supply chains, trade, travel and economic activity. This has plunged the global economy into a severe recession akin to the great depression of 1930s. Consequently, the International Monetary Fund (IMF) has projected a contraction of 4.9 percent in 2020 from a growth of 2.9 percent in 2019.

Advanced economies are expected to contract by 8.0 percent in 2020 from a growth of 1.7 percent in 2019. The US and the Euro area are projected to contract by 8.0 percent and 10.2 percent in 2020 from a growth of 2.3 percent and 1.3 percent, respectively. The UK is set to contract by 10.2 percent in 2020 compared to a growth of 1.4 percent in 2019 while Japan would contract by 5.8 percent compared to a growth of 0.7 percent in 2019.

Similarly, emerging market and developing economies (EMDEs), which grew by 3.7 percent in 2019, are projected to contract by 3.0 percent in 2020. China is projected to grow by 1.0 percent in 2020 compared to 6.1 percent in 2019, while India would contract by 4.5 percent in 2020 after growing by 4.2 percent in 2019. Sub-Saharan African is projected to contract by 3.2 percent in

2020 compared to growth of 3.1 percent in 2019. Nigeria and South Africa, the main drivers of African growth, are projected to contract by 8.0 percent and 5.4 percent, respectively, in 2020 (**Table 1.1**).

Global trade is expected to decline by 11.9 percent in 2020. Furthermore tighter external financial conditions triggered sudden capital outflows from EMDEs with sharp currency depreciations. The commodity and oil markets have also been negatively impacted, experiencing significant reduction in prices in the first half of 2020. However, prices have gained some recovery with the global oil prices stabilizing at about US dollar 40 per barrel in the third quarter of 2020. Global financial conditions are also expected to ease as economies continue to lift COVID-19 related restrictions.

The key downside risks to the global economy, which could worsen the outlook, include resurgence of new infections and re-imposition of containment measures, escalation of the US-China tensions and disagreements among the OPEC+ countries. However, should a vaccine be found and recovery take a shorter time than anticipated, the global economy could rebound in the last quarter of 2020 and beyond.

Table 1.1: Output Growth in Selected Countries/Regions (Percent)

Country/Region	Actual			Projections	
	2017	2018	2019	2020	2021
World Output	3.7	3.6	2.9	-4.9	5.4
Advanced Economies	2.4	2.2	1.7	-8.0	4.8
United States	2.3	2.9	2.3	-8.0	4.5
Euro area	2.4	1.9	1.3	-10.2	6.0
Japan	1.7	0.3	0.7	-5.8	2.4
United Kingdom	1.7	1.3	1.4	-10.2	6.3
Emerging Market and Developing economies	4.7	4.5	3.7	-3.0	5.9
Emerging and Developing Asia	6.5	6.3	5.5	-0.8	7.4
China	6.9	6.7	6.1	1.0	8.2
India	6.7	6.1	4.2	-4.5	6.0
Emerging and Developing Europe	6.0	3.2	2.1	-5.8	4.3
Russia	1.5	2.5	1.3	-6.6	4.1
Latin America and the Caribbean	1.3	1.1	0.1	-9.4	3.7
Brazil	1.0	1.3	1.1	-9.1	3.6
Sub-Saharan Africa	2.8	3.2	3.1	-3.2	3.4
South Africa	1.3	1.9	2.2	-5.4	2.6
Nigeria	0.8	0.8	0.2	-8.0	3.5
Middle East, North Africa, Afghanistan and Pakistan	2.2	1.8	1.0	-4.7	3.3

Source: IMF, World Economic Outlook, July 2019 update

2.0 THE COVID-19 PANDEMIC

2.0 THE COVID-19 PANDEMIC

The coronavirus (COVID-19) was declared a global pandemic in March 2020 by the World Health Organization. The pandemic precipitated an unprecedented global health and economic crisis. In Kenya, the first COVID-19 case was confirmed on March 13, 2020 and the Central Bank of Kenya (CBK) immediately took a frontline position in ensuring that the Kenyan financial sector remained resilient despite the threats posed by the pandemic. CBK immediately instituted a series of emergency measures to mitigate the health and economic effects of the pandemic. The measures were informed by:

- The need to reduce cash transactions and facilitate online transactions, primarily to abate the risk of COVID-19 contact transmission.
- The need to cushion borrowers and especially Micro, Small and Medium Enterprises (MSMEs) through flexibility in loan repayments, loan provisioning and classification as well as suspending negative credit listing. This was aimed at alleviating the likely adverse economic effects on consumers while safeguarding banking system soundness.
- Supporting operations of the financial institutions by ensuring adequate liquidity for both banks and borrowers.
- Ensuring business continuity for both the financial institutions as well as ensuring that institutions have resilient frameworks to effectively address emerging pandemic risks in the banking sector.

Digital Finance: The first series of emergency measures were announced on March 16, 2020 by CBK in conjunction with commercial banks and Payment Service Providers. These were intended to encourage the use of digital financial platforms and mitigate the transmission risk posed by use of bank notes and coins. The measures included elimination of charges for mobile money transactions under KSh 1,000, and transfers between bank accounts and bank wallets. CBK also increased daily mobile money transaction limits from KSh 70,000 to KSh 150,000.

Following the implementation of the measures, a significant increase in the use of mobile money channels by individuals in both value and number of transactions was noted. Most of the increase was in low-value transactions of KSh 1,000 or less—this band accounts for over 80 percent of mobile money transactions. The elimination of charges helped cushion the most vulnerable households. Moreover, more than 1.6 million additional customers are now using mobile money channels. These measures were timely and highly effective in facilitating official and personal transfers at a time of great need.

Affordable credit: On March 23 and April 29 the Monetary Policy Committee lowered the Central Bank Rate to signal the banking sector to lower lending and deposit rates. By end June, the average commercial banks' lending rates had fallen to 11.89 percent, a 16-year low, supporting provision of affordable credit to Kenyans.

Banking Sector Measures: The emergency measures announced by CBK on March 18, 2020 on restructuring personal/household and other loans by banks were effective. As at June 30, the repayment period of personal/household loans amounting to KSh 240 billion or 30 percent of the banking sector personal/household gross loans had been extended. For other sectors, a total of KSh 604 billion had been restructured as at end June. The sectors that had recorded the highest levels of restructuring were Trade (23.5 Percent), Real Estate (20.5 percent), Transport and Communication (12.4 percent) and Manufacturing (11.4 percent). These are the sectors that bore the brunt of the slowdown occasioned by the pandemic. Total loans restructured of KSh 844 billion accounted for 29 percent of the total banking sector loan book of KSh 2.9 trillion.

The lowering of the Cash Reserve Ratio (CRR) from 5.25 percent to 4.25 percent on March 23 provided additional liquidity of KSh 35 billion to support the banks as they restructured performing loans adversely impacted by COVID-19.

2.0 THE COVID-19 PANDEMIC

The banking sector continued to operate smoothly during the pandemic period serving customers both from branches and digital channels. Building on business continuity and pandemic response guidance from CBK, the banking sector ‘kept the lights on’ during the pandemic. While ensuring the health and safety of customers and staff, over 90 percent of the approximately 1,500 bank branches across the country remained open. The over 30,000 bank staff were in the frontline serving Kenyans even in areas locked down to contain the pandemic.

To minimize the health risk and support Ministry of Health ‘stay at home’ protocols, banks enhanced the use of digital channels. Before the pandemic, on average, close to 90 percent of bank transactions were conducted outside branches. During the pandemic, this accelerated to over 94 percent of transactions. Most notably, over 67 percent of transactions were conducted on mobile phones up from 55 percent before the pandemic.

3.0 DOMESTIC ECONOMY

3.0 DOMESTIC ECONOMY

3.1 Real Sector

The Kenya economy remained resilient in 2019 and grew by 5.4 percent compared to 6.3 percent in 2018. The slowdown of growth was mainly attributed to reduced agricultural activity following delayed and inadequate rainfall in the first half of 2019. Service-oriented sectors remained resilient and supported economic activity (**Table 3.1 and Chart 3.1**).

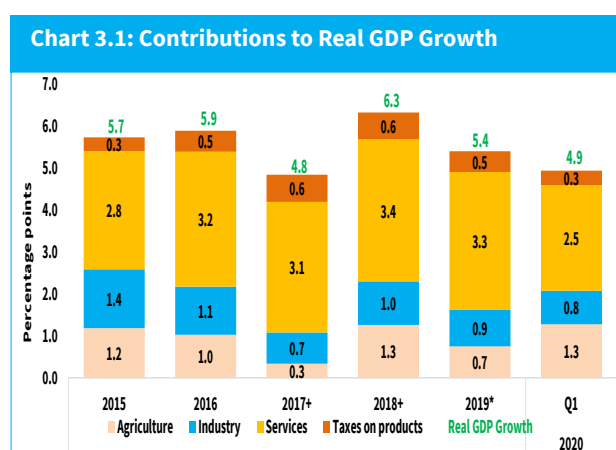
Agriculture sector growth slowed to 3.6 percent compared to 6.0 percent in 2018, as the delayed and below average rainfall adversely affected activity within the sector. As a result, its contribution to real GDP growth declined to 0.7 percentage points from 1.3 percentage points in 2018 (**Chart 3.1**).

Table 3.1: Real GDP Growth						
MAIN SECTORS	Growth Rates (Percent)					
	2016	2017+	2018+	2019*	Q1 2019	Q1 2020
1. Agriculture	4.7	1.6	6.0	3.6	4.7	4.9
2. Non-Agriculture (o/w)	6.2	5.7	6.4	5.9	5.8	4.9
2.1 Industry	5.9	3.9	5.5	4.7	4.7	4.4
Manufacturing	3.1	0.7	4.3	3.3	3.5	2.9
Electricity & water supply	8.4	7.0	8.0	7.0	7.8	6.3
Construction	9.9	8.4	6.9	6.4	6.1	5.3
2.2 Services	6.8	6.5	7.0	6.7	6.5	5.5
2.3 Taxes on products	4.4	5.7	5.6	4.4	4.7	3.4
Real GDP Growth	5.9	4.8	6.3	5.4	5.5	4.9
+ Revised						
*Provisional						
Source: KNBS						

The Services sector remained resilient and was the main driver of economic growth in 2019. It grew by 6.7 percent compared to 7.0 percent in 2018, supported by strong performance of Wholesale and Retail Trade, Accommodation and Restaurants, Transport and Storage, Information and Communication, Financial and Insurance, and Real Estate sectors.

Industrial activity slowed to 4.7 percent from 5.5 percent in 2018. The Manufacturing sector grew by 3.3 percent, slower than 4.3 percent in 2018. Growth in Electricity and Water Supply was 7.0 percent in 2019 compared to 8.0 percent in 2018, reflecting decreased hydroelectricity generation due to the unfavourable weather conditions in the first half of the year. However, Construction sector growth remained strong at 6.4 percent compared to 6.9 percent in 2018.

In the first quarter of 2020, growth stood at 4.9 percent on account of the impact of COVID-19 which affected the services sectors, mainly the accommodation and restaurants sector following the international travel restrictions and containment measures. The services sector growth declined to 5.5 percent.



Source: KNBS and CBK

3.2 Inflation

Overall inflation remained anchored within the target range in the FY 2019/20. It declined to 4.6 percent in June 2020 compared to 5.7 percent in June 2019, driven mainly by food prices (**Table 3.2 and Chart 3.2**).

Food inflation was elevated during the period. It was 8.1 percent in June 2020 compared to 6.6 percent in June 2019. The high food inflation was as a result of elevated prices of a few key food items such as tomatoes, onions, potatoes, maize products and kales, following crop destruction due to excess rainfall in the first half of 2020 and supply disruptions occasioned by the COVID-19 pandemic.

3.0 DOMESTIC ECONOMY

Non-Food-Non-Fuel (NFnF) inflation remained low and stable in FY 2019/20, reflecting muted demand pressures in the economy. It declined to 1.6 percent in June 2020 from 3.4 percent in June 2019, despite implementation of excise tax measures on airtime, narcotics and some alcoholic beverages. Fuel inflation remained relatively low, supported by low international oil prices.

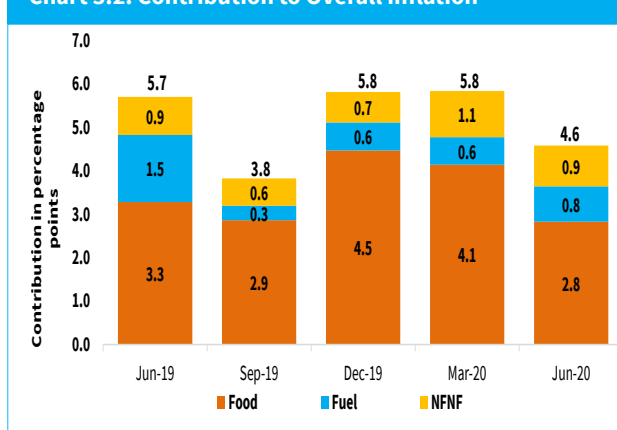
Table 3.2: Recent Developments in Inflation (%)

	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Overall 12-month inflation	5.7	3.8	5.8	5.8	4.6
Food Inflation	6.6	5.9	9.3	12.3	8.1
Fuel Inflation	6.3	1.3	2.5	4.5	5.4
Non-(Food & Fuel) Inflation	3.4	2.4	2.7	1.9	1.6
Average annual	5.2	5.2	5.2	5.6	5.9
Three months annualised	11.4	-5.3	6.5	6.0	3.0

Inflation rates from February 2020 are based on the new Consumer Price Index (CPI) whose base period is February 2019.

Source: KNBS and CBK

Chart 3.2: Contribution to Overall Inflation



Source: KNBS and CBK

3.3 Balance of Payments

The Current Account

During the FY 2019/20, the current account deficit remained stable at USD 4,786 million compared to USD 4,727 million in the FY 2018/19 mainly reflecting reduced imports despite lower receipts from services and secondary income transfers (**Table 3.3**).

Goods Account

The balance in the goods account improved by USD 715 million to a trade deficit of USD 9,450 million in the FY 2019/20, due to lower merchandise imports. The decline in merchandise imports largely reflected savings in the oil import bill due to low oil prices that prevailed in the first half of 2020. Merchandise exports remained resilient reflecting improvements in tea and re-exports.

Imports from China accounted for 22.3 percent of total imports to Kenya during the year to June 2020 making it the largest source of imports. During the period, imports from the European Union accounted for 13.4 percent of total imports and decreased to USD 2,066 million while the share of imports from Africa decreased to 12.5 percent, equivalent to USD 1,929 million.

The resilience in merchandise exports was mainly attributed to re-exports of goods and oil products. Furthermore, despite a drop in April 2020 due to COVID-19, horticultural exports normalized in May as the sector benefited from the cessation of restrictions in key destination markets and increased cargo capacity.

Kenya's exports to Africa improved by USD 98 million to USD 2,213 million reflecting increases in exports to EAC and COMESA regions. The share of exports to EAC increased to 23.5 percent in FY 2019/20 from 21.7 percent in FY 2018/19. However, there was a reduction in exports to the rest of the world, majorly to the U.S.A, Netherlands and India (**Table 3.4**).

Services Account

Receipts from transport and travel services remained subdued in the first half of 2020 due to the cessation of international travel on account of COVID-19. As a result, the balance in the services account worsened by USD 593 million to a surplus of USD 1,293 million in FY 2019/20 from USD 1,886 million in 2018/19. The reduction was due to lower receipts from transport, travel and other services mainly insurance and finance, financial services and telecommunication.

3.0 DOMESTIC ECONOMY

Table 3.3: Balance on Current Account (USD Million)

Item	FY 2018/19*	FY 2019/20				FY 2019/20**	FY 2019/20-2018/19	
		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun		Change	% Change
		Q1	Q2	Q3	Q4			
Current Account	-4,727	-1,527	-1,675	-1,085	-499	-4,786	-59	1.2
Goods	-10,165	-2,642	-2,907	-2,152	-1,750	-9,450	715	-7.0
Exports (fob)	5,931	1,424	1,429	1,764	1,310	5,927	-4	-0.1
o.w Coffee	222	43	33	52	74	203	-20	-8.8
Tea	1,198	249	305	335	327	1,216	18	1.5
Horticulture	1,056	221	228	273	210	931	-125	-11.8
Oil products	36	26	15	14	8	63	27	73.8
Manufactured Goods	384	109	98	94	69	369	-15	-4.0
Raw Materials	344	79	78	101	89	347	3	0.8
Chemicals and Related Products	460	116	106	122	100	445	-15	-3.3
Miscellaneous Man.Articles	589	145	137	145	103	531	-58	-9.8
Re-exports	693	204	173	331	108	816	123	17.8
Other	912	224	247	285	212	968	55	6.1
Imports (fob)	16,096	4,066	4,336	3,916	3,060	15,377	-719	-4.5
o.w Oil	3,459	772	781	778	362	2,693	-765	-22.1
Chemicals	2,532	576	618	653	606	2,453	-79	-3.1
Manufactured Goods	2,875	802	721	649	607	2,779	-96	-3.4
Machinery	2,868	791	944	746	535	3,016	148	5.2
Transport Equipment	1,627	360	525	315	245	1,445	-182	-11.2
Food	1,620	457	433	437	398	1,725	106	6.5
Other	3,433	924	910	955	807	3,596	164	4.8
Services	1,886	398	375	200	320	1,293	-593	-31.5
Transport Services (Net)	706	185	190	163	119	656	-51	-7.2
Travel Services (Net)	818	194	227	179	149	749	-69	-8.5
Other Services (Net)	362	20	-41	-142	52	-111	-473	-130.8
Primary Income (Net)	-1,678	-527	-446	-359	-300	-1,633	45	-2.7
Secondary Income (Net)	5,230	1,244	1,303	1,225	1,231	5,003	-227	-4.3
* Revised								
**Provisional								
fob - free on board								
Source: CBK								

The balance on the primary income account worsened by USD 45 million to a deficit of USD 1,633 million. The surplus on the secondary income account declined from USD 5,230 million in FY 2018/19 to USD 5,003 million in the FY 2019/20. The reduction was mainly in transfers to non-governmental organizations.

Remittances

Remittances remained resilient against the backdrop of COVID-19. In the year to June 2020, total remittance

inflows stood at USD 2,809 million, 1.5 percent higher than the USD 2,768 million in the year to June 2019, reflecting significant increases in inflows from the US and South Africa.

Capital and Financial Account

The capital account recorded reduced inflows by USD 66 million in the FY 2019/20, due to a decrease in project grants. The financial account recorded lower net inflows by USD 585 million in FY 2019/20 (**Table 3.5**).

3.0 DOMESTIC ECONOMY

Table 3.4: Kenya's Direction of Trade

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	2019	2020	2019	2020	Region/Country	2019	2020	2019	2020
Africa	2,046	1,929	12.7	12.5	Africa	2,116	2,213	35.7	37.3
<i>Of which</i>					<i>Of which</i>				
South Africa	679	547	4.2	3.6	Uganda	608.88	623.11	10.3	10.5
Egypt	369	419	2.3	2.7	Tanzania	303.78	309.84	5.1	5.2
Others	998	963	6.2	6.3	Egypt	192.17	182.04	3.2	3.1
					Sudan	61.68	71.64	1.0	1.2
EAC	564	568	3.5	3.7	South Sudan	114.41	176.13	1.9	3.0
COMESA	1,080	1,092	6.7	7.1	Somalia	132.72	100.39	2.2	1.7
Rest of the World	14,050	13,461	87.3	87.5	DRC	140.58	128.76	2.4	2.2
<i>Of which</i>					Rwanda	184.78	231.25	3.1	3.9
India	1,782	1,766	11.1	11.5	Others	376.74	390.32	6.4	6.6
United Arab Emirates	1,528	1,169	9.5	7.6					
China	3,373	3,430	21.0	22.3	EAC	1,286	1,395	21.7	23.5
Japan	1,017	893	6.3	5.8	COMESA	1,455	1,481	24.5	25.0
USA	526	555	3.3	3.6	Rest of the World	3,816	3,714	64.3	62.7
United Kingdom	330	293	2.1	1.9	<i>Of which</i>				
Singapore	56	70	0.3	0.5	United Kingdom	388.95	433.84	6.6	7.3
Germany	449	407	2.8	2.6	Netherlands	467.42	419.37	7.9	7.1
Saudi Arabia	1,587	915	9.9	5.9	USA	511.36	473.48	8.6	8.0
Indonesia	508	580	3.2	3.8	Pakistan	489.70	490.67	8.3	8.3
Netherlands	309	211	1.9	1.4	United Arab Emirates	367.16	368.32	6.2	6.2
France	246	229	1.5	1.5	Germany	111.99	116.47	1.9	2.0
Bahrain	51	6	0.3	0.0	India	71.85	43.46	1.2	0.7
Italy	218	203	1.4	1.3	Afghanistan	37.73	37.17	0.6	0.6
Oman	98	65	0.6	0.4	Others	55.27	24.45	0.9	0.4
Others	1,970	2,668	12.2	17.3	Others	1,314	1,307	22.2	22.0
Total	16,096	15,390	100.0	100.0	Total	5,931	5,927	100.0	100.0
EU	2,225	2,066	13.8	13.4	EU	1,299	1,296	21.9	21.9
China	3,373	3,430	21.0	22.3	China	141	151	2.4	2.6

Source: CBK

Table 3.5: Balance on the Capital and Financial Account (USD Million)

ITEM	FY FY 2018/19*	FY 2019/20				FY 2019/20**	FY 2019/20-2018/19	
		Jul-Sep Q1	Oct-Dec Q2	Jan-Mar Q3	Apr-Jun Q4		Change	% Change
Capital account credit	215	27	52	24	46	150	-66	-30.5
Capital account credit	215	27	52	24	46	150	-66	-30.5
Capital account: debit	0	0	0	0	0	0	0	0
Financial Account	-6,635	-1,167	-1,322	-419	-3,142	-6,050	585	-8.8
Direct investment: assets	208	33	48	71	51	203	-5	-2.4
Direct investment: liabilities	1,611	284	359	104	118	865	-746	-46.3
Portfolio investment: assets	1,004	227	272	309	319	1,127	123	12.3
Portfolio investment: liabilities	2,006	42	89	-101	-91	-61	-2,068	-103.1
Financial derivatives: net	-13	4	1	3	-5	4	17	-130.3
Other investment: assets	427	125	184	-8	122	424	-3	-0.7
Other investment: liabilities	4,642	1,230	1,380	791	3,602	7,003	2,361	50.9

* Revised

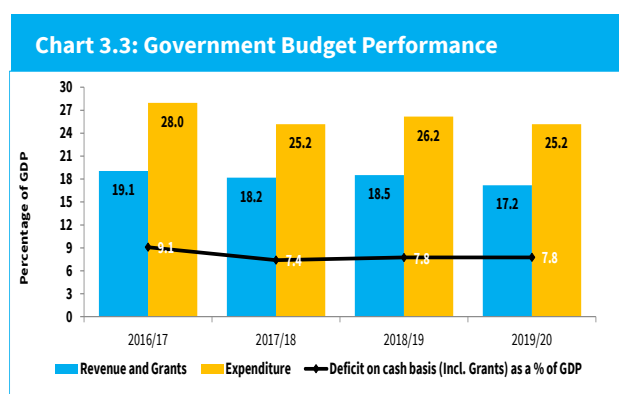
**Provisional

Source: CBK

3.0 DOMESTIC ECONOMY

3.4 Government Budget

Government budgetary operations in the Financial Year 2019/20 resulted in a deficit on cash basis including grants of KSh 791.2 billion (7.8 percent of GDP) compared to KSh 721.1 billion (7.8 percent of GDP) in the previous year.



Source: The National Treasury-Provisional Budget Outturn, June 2020

However, it was below the target of 9.0 percent of GDP in the supplementary III budget despite the shortfall in revenue collection amidst increased expenditures to mitigate the effects of COVID-19 (**Table 3.6 and Chart 3.3**).

Government Revenue

Government revenue (including grants) increased by 1.9 percent to KSh 1,753.5 billion (17.2 percent of GDP) compared to the previous fiscal year. Non-tax revenue increased by 91.2 percent on account of funds mobilised from parastatal deposits. However, Appropriations-in-Aid and tax revenues declined by 20.7 percent and 1.2 percent, respectively. Tax revenue accounted for 79.8 percent of revenues (**Table 3.6**).

Expenditure and Net Lending

Government expenditure and net lending increased by 5.4 percent to KSh 2,565.4 billion (25.2 percent of GDP), but was below the programmed target (**Chart 3.3**).

Table 3.6: Statement of Central Government Operations in KSh Billion

	FY 2017/18	FY 2018/19	FY 2019/20	SUPP III	Over(+) / Below (-)
	Actual	Actual	Provisional		
1. REVENUE & GRANTS	1,550.1	1,721.4	1,753.5	1,899.8	-146.4
Revenue	1,522.5	1,701.7	1,733.6	1,864.8	-131.2
Tax Revenue	1,280.0	1,400.7	1,383.9	1,466.2	-82.3
Non Tax Revenue	105.9	99.1	189.5	149.2	40.3
Appropriations-in-Aid	136.6	201.9	160.2	249.4	-89.2
External Grants	27.6	19.7	19.8	35.0	-15.2
2. EXPENDITURE AND NET LENDING	2,146.7	2,433.7	2,565.4	2,817.8	-252.4
Recurrent Expenditure	1,349.9	1531.1	1,645.2	1,777.0	-131.7
Development Expenditure	469.5	534.9	594.9	678.5	-83.5
County Transfers	327.3	360.7	325.3	362.4	-37.1
Other	0.0	7.0	0.0	0.0	0.0
3. DEFICIT (incl Grants) on a commitment basis (1-2)	-596.6	-712.3	-812.0	-918.0	106.0
Deficit (incl Grants) on a commitment basis (% of GDP)	-7.00	-7.7	-8.0	-9.0	1.0
4. ADJUSTMENT TO CASH BASIS	-34.7	8.7	-20.8	0.0	-20.8
5. DEFICIT ON A CASH BASIS	-631.3	-721.1	-791.2	-918.0	126.8
Deficit on a cash basis (% of GDP)	-7.4	-7.8	-7.8	-9.0	1.2
6. DISCREPANCY: Expenditure (+) / Revenue (-)	0.0	0.0	0.0	0.0	0.0
7. FINANCING	631.3	721.1	791.2	918.0	-126.8
Domestic (Net)	273.7	303.7	448.3	441.9	6.4
External (Net)	355.0	414.5	340.8	324.0	16.8
Capital Receipts (net of restructuring costs)	0.0	0.0	0.0	0.0	0.0
Others	2.6	2.9	2.0	152.1	-150.1

Source: The National Treasury-Provisional Budget Outturn, June 2020

3.0 DOMESTIC ECONOMY

Development expenditure and recurrent expenditures rose by 11.2 percent, and 7.5 percent, respectively. Recurrent expenditure accounted for 64.1 percent of total government expenditure (**Table 3.6**).

Financing

Net domestic financing during FY 2019/20 amounted to KSh 450.4 billion. The financing comprised KSh 41.9 billion from the CBK, KSh 235.4 billion from Commercial Banks, KSh 165.8 billion from Non-Bank Financial Institutions, KSh 5.2 billion from Non-residents and KSh 2.0 billion net receipts from domestic loan repayments (**Table 3.7**).

Table 3.7: Domestic Financing (KSh Billion)

	FY 2016/17	FY 2017/18	FY 2018/19	FY 2019/20
1. From CBK	(22.4)	(26.3)	13.6	41.9
2. From commercial banks	169.5	124.3	126.9	235.4
3. From Non-banks	160.7	172.8	160.3	165.8
4. From Non-Residents	1.9	3.0	2.8	5.2
Domestic Loan Repayments (Net Receipts)	2.3	2.6	2.9	2.0
5. Total Change in Dom. Credit (From 30th June 2019)	312.0	276.3	306.5	450.4

NB. Treasury Bills are reflected at Cost

Source: CBK and National Treasury June 2020 QEBR

Outlook for FY 2019/20

In the budget estimates for the FY 2020/21 total revenue is projected at KSh 1.9 trillion (16.8 percent of GDP) while Government expenditure and net lending is projected at KSh 2.8 trillion (24.7 percent of GDP). The overall budget deficit including grants on commitment basis is, therefore, projected at KSh 841.1 billion (7.5 percent of GDP), to be financed through net external borrowing of KSh 347.0 billion (3.1 percent of GDP) and net domestic borrowing of KSh 494.4 billion (4.4 percent of GDP).

3.5 Public Debt

Kenya's public and publicly guaranteed debt increased by 15.2 percent during the FY 2019/20, with domestic and external debt increasing by 14.1 percent and 16.3 percent, respectively. Public debt comprised 47.5 percent and 52.5 percent of domestic and external debt, respectively. The ratio of public debt to GDP rose to 65.6 percent in June 2020 from 62.4 percent in June 2019 (**Table 3.8**).

Domestic Debt

The increase in domestic debt was mainly driven by a 27.0 percent increase in Treasury bonds. This is in line with the Government's objective of achieving 70:30 ratio of Treasury bonds to Treasury bills in order to reduce the refinancing risk. This goal was accomplished through issuance of medium and long-term Treasury bonds as well as 364-day Treasury bill switch to a 6-year Infrastructure bond. Consequently, Treasury bills decreased by 6.9 percent to KSh 907.7 billion in June 2020 from KSh 975.3 billion in June 2019 (**Table 3.8**). In addition, the domestic debt maturity for all securities improved from 4.94 years in June 2019 to 5.46 years in June 2020, with the average maturity of bonds rising to 7.9 years.

External Debt

Kenya's public and publicly guaranteed external debt increased to KSh 3,515.8 billion (**Table 3.8**). This was majorly on account of two Development Policy Operations (DPO) in July 2019 (USD 750 million) and May 2020 (USD 1.0 billion) from World Bank and the IMF Rapid Credit Facility (RCF) in support of COVID-19 interventions. The proportion of debt owed to multilateral lenders increased by 7.3 percentage points while that of commercial creditors and bilateral lenders decreased by 4.9 percentage points and 2.4 percentage points, respectively, as the Government sought to restructure external debt through concessionality and reducing its refinancing risk.

Public Debt Service

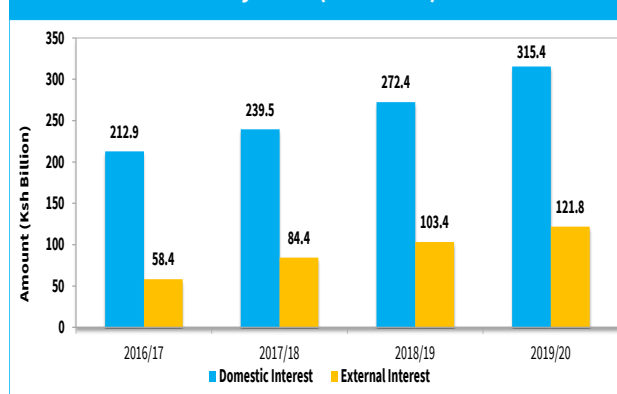
Cumulative interest and other charges on domestic and external debt for the FY 2019/20 increased by 15.8 percent and 17.9 percent, respectively (**Chart 3.4**). Despite increase in external interest payments, total external debt service decreased during the FY 2019/20 due to a significant reduction in principal repayments as there were no one-off repayments of commercial loans during the FY (**Chart 3.5**).

3.0 DOMESTIC ECONOMY

Table 3.8: Public Debt

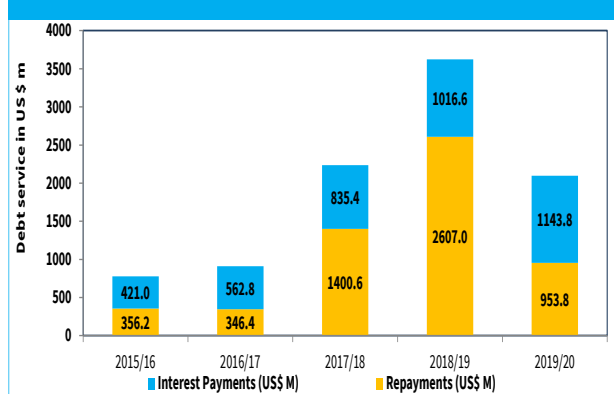
	June 2017		June 2018		June 2019		June 2020*	
	KSh bn	%	KSh bn	%	KSh bn	%	KSh bn	%
DOMESTIC DEBT								
Securitised debt	2,100.5	99.4	2,413.8	97.4	2,723.5	97.8	3,127.1	98.4
Treasury Bills	768.5	36.4	901.9	36.4	975.3	35.0	907.7	28.6
Of which Repo Treasury bills	24.4	1.2	23.3	0.9	21.1	0.8	20.5	0.6
Treasury Bonds	1,332.0	63.1	1,511.9	61.0	1,748.1	62.8	2,219.4	69.8
Non Securitised debt	11.1	0.5	65.0	2.6	62.0	2.2	50.4	1.6
Overdraft at CBK	0.0	0.0	56.8	2.3	57.3	2.1	47.1	1.5
others	11.1	0.5	8.1	0.3	4.7	0.2	3.3	0.1
TOTAL DOMESTIC DEBT	2,112.3	100.0	2,478.8	100.0	2,785.5	100.0	3,177.5	100.0
(as a % of GDP)*	27.6		29.1		29.9		31.2	
(as a % of Total Debt)	47.9		49.2		48.0		47.5	
EXTERNAL DEBT**								
Bilateral	724.8	31.6	816.1	35.6	996.1	32.9	1,074.3	30.6
Multilateral	841.9	36.7	821.0	35.8	914.4	30.2	1,321.6	
Comm. Banks	712.1	31.0	906.4	39.5	1,095.8	36.2	1,102.3	31.4
Export Credit	15.9	0.7	16.7	0.7	16.9	0.6	17.6	0.5
TOTAL EXTERNAL DEBT	2,294.7	100.0	2,560.2	100.0	3,023.1	100.0	3,515.8	100.0
(as a % of GDP)*	30.0		30.0		32.5		34.5	
(as a % of Total Debt)	52.1		50.8		52.0		52.5	
TOTAL PUBLIC DEBT	4,407.0		5,039.0		5,808.6		6,693.3	
(as a % of GDP)*	57.5		59.1		62.4		65.6	
* Estimates								
** Provisional								
Source: The National Treasury and CBK								

Chart 3.4: Interest Payments (KSh Billion)



Source: The National Treasury

Chart 3.5: External Debt Service



Source: The National Treasury and CBK

4.0 REGIONAL INTEGRATION DEVELOPMENTS

4.0 REGIONAL INTEGRATION DEVELOPMENTS

Background

The CBK participates 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 integration initiatives are based on agreements aimed at building common institutions and fostering the adoption of common economic and financial policies among members states. The coordinated efforts are expected to improve macroeconomic management and stability within the region and integrate regional financial systems. This will stimulate intra-regional trade, raise economic growth rates and secure regional peace. The integration initiatives are evaluated against criteria that are specified in Monetary Cooperation Programmes.

The CBK works towards the achievement of policy convergence criteria relating to the monetary and financial system. The following are highlights of Kenya's progress in meeting these criteria.

The EAC Monetary Cooperation Programme

The EAC Central Banks, through the Monetary Affairs Committee (MAC), are mandated to steer aspects of monetary and financial cooperation with the goal of 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, macroeconomic convergence criteria comprising; 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 a floor on foreign exchange reserves cover of 4.5 months of imports.

In FY 2019/20, Kenya continued to fulfil the EAMU Convergence criteria on inflation and foreign exchange reserves. However, challenges remained with regard to attaining the criteria on fiscal deficit and gross national debt mainly due to demand for financing to offset increased spending on initiatives to mitigate the adverse impact of COVID-19 on businesses and households, and decline in tax revenue due to the pandemic.

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. Towards this end, partner states are expected to maintain a number of primary (preconditions for convergence) and secondary (reinforcement conditions) convergence criteria (**Table 4.1**). Kenya is on track to meeting the COMESA Convergence Criteria, having met the requirements on inflation and foreign exchange reserve adequacy.

Table 4.1: Convergence Criteria under the COMESA Monetary Programme

Primary Criteria	Secondary Criteria
<ul style="list-style-type: none"> Overall budget deficit to GDP ratio (including grants) not exceeding 5 percent. 	<ul style="list-style-type: none"> Variability of the nominal exchange rate against the US dollar not exceeding ± 10 percent, with a target of ± 5 percent.
<ul style="list-style-type: none"> Annual average inflation rate of 7 percent with a band of ± 1 percent. 	<ul style="list-style-type: none"> General Government debt to GDP ratio of less than 65 percent.
<ul style="list-style-type: none"> Central bank financing of the budget as a share of the previous year's tax revenue not exceeding 5 percent, with a target of 0 percent. 	<ul style="list-style-type: none"> Total tax revenue to GDP ratio of not less than 20 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, with a target of more than 6 months. 	<ul style="list-style-type: none"> Government capital investment to tax revenue ratio of not less than 20 percent.

Source: CBK

4.0 REGIONAL INTEGRATION DEVELOPMENTS

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

Table 4.2: The Convergence Criteria under the AMCP

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.

Source: CBK

5.0 CENTRAL BANK OPERATIONS

5.0 CENTRAL BANK OPERATIONS

5.1 Monetary Operations

Monetary Policy

In FY 2019/20, monetary policy formulation and implementation was 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 target range throughout the year, while non-food-non-fuel inflation remained below 5.0 percent, indicating muted demand pressures in the economy.

The Monetary Policy Committee (MPC) held bi-monthly meetings between July 2019 and March 2020. During its meetings in July and September 2019, the MPC retained the Central Bank Rate (CBR) at 9.00 percent as inflation expectations remained anchored and the monetary policy stance was deemed appropriate. The CBR was lowered to 8.50 percent and to 8.25 percent during the November 2019 and January 2020 meetings, respectively, as the MPC noted room for accommodative monetary policy to support economic activity.

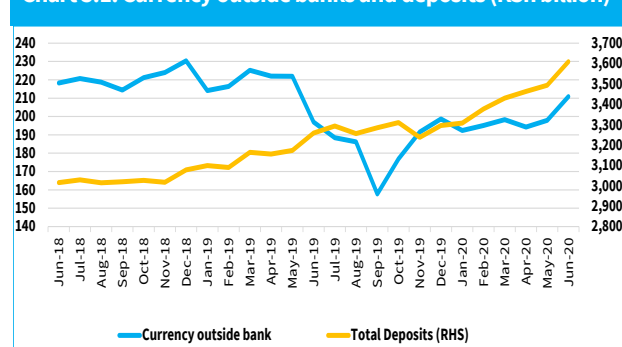
As a result of the COVID-19 shock in March, MPC decisions focused on mitigating the adverse effects of the pandemic on the economy. These decisions included lowering the CBR to 7.0 percent from 8.25 percent; reducing the Cash Reserve Ratio (CRR) from 5.25 percent to 4.25 percent which released KSh 35.2 billion in liquidity to banks for supporting customers who were distressed by COVID-19; and extending the maximum tenor of Repurchase Agreements (REPOs) from 28 days to 91 days to enhance access to liquidity by banks.

The MPC also decided to hold monthly meetings since March to facilitate close monitoring and assessment of the impact of the adopted policy measures, and the evolution of the COVID-19 pandemic. In its May and June 2020 meetings, the MPC retained the CBR at 7.00 percent, observing that the package of policy measures adopted since March were having the intended effect on the economy, and that these measures would be augmented by the announced fiscal measures for FY 2020/21.

Money Supply

The demonetisation of the old KSh 1,000 notes (equivalent to 80.3 percent of total currency in circulation) from June to September 2019 had a minimal impact on broad money supply, M3. At the end of the exercise KSh 7.4 billion (equivalent to 0.2 percent of M3 and 3.6 percent of total currency in circulation at the end of September 2019) were not exchanged due to the robust AML/CFT checks in place. However, the demonetisation resulted in a portfolio shift in the composition of M3 during the period towards deposits **(Chart 5.1)**. The exercise resulted in a contraction in currency outside banks, beyond the normal seasonal fluctuation observed during the end year festivities. Currency outside banks declined from KSh 222 billion at the end of May 2019 to KSh 158 billion at the end of September 2019, mainly due to reduced demand for physical cash by businesses and people as they exchanged the old 1,000 Shilling notes with new ones. The reduced demand for cash was partly mirrored in increased commercial banks deposits, which grew from KSh 3,174 billion to KSh 3,285 billion over the same period. In addition, increased usage of cashless payment platforms, such as mobile payments that remained high during the demonetisation period, partly reduced the demand for cash for transaction. Cash outside banks started to normalise immediately after the conclusion of the demonetisation exercise, rising from KSh 158 billion in September to KSh 199 billion in December. Currency outside banks increased further from April 2020, partly reflecting increased precautionary savings by the public during the COVID-19 pandemic.

Chart 5.1: Currency outside banks and deposits (KSh billion)



Source: CBK

5.0 CENTRAL BANK OPERATIONS

The 12-month growth in M3, declined from 9.2 percent in FY 2018/19 to 8.4 percent in FY 2019/20, reflecting slow growth of the net foreign assets (NFA) of the banking system. The decline in NFA was mainly due to relatively lower government external financing inflows. Growth in the net domestic assets (NDA) of the banking system

however increased reflecting increased lending to the private sector and the government (**Table 5.1**). On the liabilities side, the decline in growth of money supply was reflected in slower growth in deposits, primarily the other deposits at the Central Bank, partly attributed to the utilization of special projects deposits.

Table 5.1: Monetary Aggregates

		End Month Level (KSh Billion)			Annual Growth Rate			Annual Absolute Change (KSh Billion)		
		2017/18	2018/19	2019/20	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20
Components of M3										
1.	Money supply, M1 (1.1+1.2+1.3)	1,425.6	1,575.5	1,666.6	3.3	10.5	5.8	45.5	149.9	91.1
	1.1 Currency outside banks	218.3	196.9	210.9	5.4	-9.8	7.1	11.2	-21.3	13.9
	1.2 Demand deposits	1,126.8	1,212.8	1,350.0	3.1	7.6	11.3	34.4	86.0	137.2
	1.3 Other deposits at CBK 1/	81.2	165.8	105.8	0.0	104.2	-36.2	0.0	84.6	-60.0
2.	Money supply, M2 (1+2.1)	2,681.9	2,943.7	3,201.3	7.5	9.8	8.7	187.7	261.9	257.5
	2.1 Time and saving deposits	1,258.3	1,372.7	1,538.7	12.7	9.1	12.1	142.2	114.4	165.9
3.	Money supply, M3 (2+3.1)	3,262.6	3,564.2	3,863.6	10.4	9.2	8.4	306.7	301.6	299.4
	3.1 Foreign Currency Deposits	580.8	620.5	662.4	25.8	6.8	6.7	119.1	39.7	41.9
Sources of M3										
1.	Net foreign assets 2/	756.9	939.9	885.4	17.8	24.2	-5.8	114.3	183.0	-54.5
	Central Bank	783.6	941.0	918.1	6.1	20.1	-2.4	45.3	157.4	-22.9
	Banking Institutions	-26.7	-1.1	-32.7	-72.1	-95.9	2,906.6	69.1	25.6	-31.6
2.	Net domestic assets (2.1+2.2)	2,505.7	2,624.3	2,978.3	8.3	4.7	13.5	192.4	118.6	353.9
	2.1 Domestic credit	3,237.3	3,490.0	3,899.5	6.7	7.8	11.7	201.9	252.7	409.5
	2.1.1 Government (net)	745.1	890.5	1,117.9	15.3	19.5	25.5	98.8	145.5	227.4
	2.1.2 Private sector	2,380.4	2,503.0	2,693.2	4.3	5.2	7.6	98.0	122.6	190.2
	2.1.3 Other public sector	111.9	96.4	88.4	4.7	-13.8	-8.3	5.0	-15.4	-8.0
	2.2 Other assets net	-731.6	-865.6	-921.2	1.3	18.3	6.4	-9.5	-134.1	-55.6
Memorandum items										
4.	Overall liquidity, L (3+4.1)	4,434.2	4,896.0	5,420.4	12.1	10.4	10.7	479.4	461.8	524.5
	4.1 Non-bank holdings of government securities	1,171.6	1,331.7	1,556.8	17.3	13.7	16.9	172.7	160.2	225.1
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: CBK										

Domestic Credit

Annual growth in net domestic credit was 11.7 percent in FY 2019/20 compared with 7.8 percent in FY 2018/19, supported by private sector credit and net lending to the government (**Table 5.2**). Credit to the private sector was on a recovery path during the year, but was slowed by the effects of COVID-19 on the economy in the last quarter. Monetary policy actions and other policy measures to

improve liquidity conditions in the market, mitigated the adverse impact of the pandemic on lending. Growth in private sector credit therefore increased from 5.2 percent in FY 2018/19 to 7.6 percent in FY 2019/20. Strong lending was recorded to manufacturing, building and construction, real estate, trade and transport and communication (**Table 5.2**).

5.0 CENTRAL BANK OPERATIONS

Net lending to Government grew by 25.5 percent in FY 2019/20 from 19.5 percent in FY 2018/19, mainly reflecting increased drawdown of Government deposits at CBK due to accelerated Government payments

towards pending bills and COVID-19 pandemic related expenditures. However, net credit to Other Public Sector declined, due to repayments by parastatals.

Table 5.2: Banking Sector Net Domestic Credit

	End Month Level (KSh Billion)		Annual Growth Rate		Annual Absolute Change (KSh Billion)	
	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20
1. Credit to Government	890.5	1,117.9	19.5	25.5	145.5	227.4
Central Bank	-189.6	-89.2	-7.2	-53.0	14.8	100.5
Commercial Banks & NBFIs	1,080.2	1,207.1	13.8	11.7	130.7	126.9
2. Credit to other public sector	96.4	88.4	-13.8	-8.3	-15.4	-8.0
Local government	3.8	4.4	-13.7	16.8	-0.6	0.6
Parastatals	92.7	84.0	-13.8	-9.4	-14.8	-8.7
3. Credit to private sector	2,503.0	2,693.2	5.2	7.6	122.6	190.2
Agriculture	86.2	87.3	3.9	1.3	3.2	1.1
Manufacturing	357.6	401.7	11.4	12.3	36.5	44.1
Trade	447.1	497.0	5.5	11.2	23.2	49.9
Building and construction	109.2	114.2	-6.3	4.6	-7.4	5.1
Transport & communications	174.7	200.7	5.8	14.9	9.6	26.0
Finance & insurance	92.8	95.8	4.7	3.2	4.2	3.0
Real estate	377.4	395.8	1.0	4.9	3.8	18.3
Mining and quarrying	13.3	14.6	-4.3	10.0	-0.6	1.3
Private households	429.6	443.3	7.6	3.2	30.2	13.6
Consumer durables	220.1	253.5	21.3	15.2	38.7	33.4
Business services	146.6	142.9	-3.2	-2.6	-4.8	-3.8
Other activities	48.2	46.4	-22.6	-3.7	-14.1	-1.8
4. Total (1+2+3)	3,490.0	3,899.5	7.8	11.7	252.7	409.5

Source: CBK

Reserve Money

Reserve money declined by KSh 12.9 billion in FY 2019/20 compared to an increase of KSh 10.6 billion in the previous financial year, largely reflecting a reduction in bank reserves. The reduction in banks reserves followed the reduction in the CRR from 5.25 percent

to 4.25 percent in March 2020, and the enhanced open market operations to withdraw excess liquidity. The excess liquidity resulted from accelerated Government spending towards the end of the FY2019/20, including payments of pending bills and COVID-19 pandemic related expenditures (**Table 5.3**).

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Table 5.3: Reserve Money and its Components

	End Month Level		Annual Growth Rate		Annual Absolute Change (KSh Billion)	
	2018/19	2019/20	2018/19	2019/20	2018/19	2019/20
1. Net Foreign Assets	941.0	918.1	20.1	-2.4	157.4	-22.9
2. Net Domestic Assets	-501.2	-491.2	41.4	-2.0	-146.8	10.1
2.1 Government Borrowing (net)	-189.6	-89.2	-7.2	-53.0	14.8	100.5
2.2 Commercial banks (net)	-21.3	-131.0	-174.3	514.1	-50.1	-109.7
2.3 Other Domestic Assets (net)	-293.7	-274.3	61.3	-6.6	-111.6	19.3
3. Reserve Money	439.8	426.9	2.5	-2.9	10.6	-12.9
3.1 Currency outside banks	196.9	210.9	-9.8	7.1	-21.3	13.9
3.2 Bank reserves	242.8	216.0	15.1	-11.0	31.9	-26.8
3.2.1 Required Reserves	175.0	153.5	11.5	-12.2	18.0	-21.4
3.2.2 Cash in Till	52.6	46.9	18.9	-10.7	8.3	-5.6
3.2.3 Excess Reserves	15.3	15.5	56.7	1.6	5.5	0.2

Source: CBK

5.2 Interest Rates

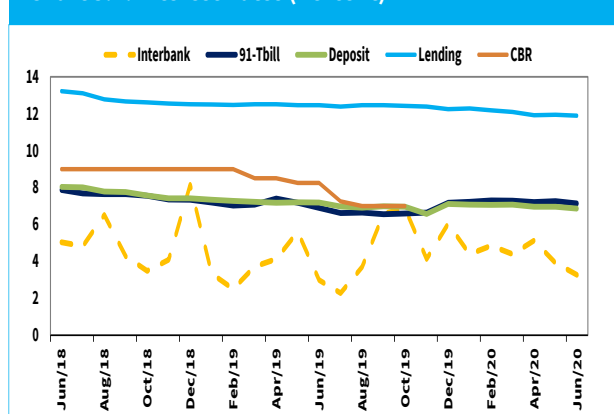
Short Term Rates

Short term interest rates declined during FY 2019/20 in line with the accommodative monetary policy stance adopted by the MPC, which resulted in improved market liquidity (**Chart 5.2**). The increase in market liquidity towards the end of the financial year was also attributable to Government spending. The average interbank interest rate was relatively stable at 4.64 percent in FY 2019/20 compared with an average of 4.47 percent in FY 2018/19. The average interbank rate remained below the CBR, partly reflecting improvements in the distribution of liquidity across bank tiers. The interest rates on government securities declined reflecting ample liquidity. The average 91-day Treasury bill rate declined from 7.33 percent to 6.94 percent, while the average 182-day Treasury bill rate decreased from 8.48 percent to 7.80 percent.

Commercial bank rates

The average commercial bank lending rate also declined from 12.47 percent in June 2019 to 11.89 percent in June 2020. Average commercial banks' deposit rate declined from 7.19 percent in June 2019 to 6.86 percent in June 2020.

Chart 5.2: Interest Rates (Percent)



Source: CBK

5.3 Foreign Exchange Operations and Reserves Management

Exchange Rate

The Kenya foreign exchange market remained stable supported by a narrowing current account deficit and balanced flows. The Kenya shilling strengthened against the US dollar from an average of 103.42 per US dollar in the first quarter of the FY 2019/20 to exchange at an average

5.0 CENTRAL BANK OPERATIONS

rate of 101.88 per US dollar in the third quarter (**Table 5.4**). However, with the onset of COVID-19, the US dollar strengthened leading to a weakening of currencies in emerging markets and developing economies. In tandem with this trend, the Kenya shilling gradually weakened before stabilizing by the end of the financial year.

Foreign Reserves

The official foreign exchange reserves remained significantly above the statutory requirement to endeavour to maintain at least 4.0 months of import cover and the EAC convergence criteria of 4.5 months of import cover. As at June 2020, official foreign exchange reserves stood at USD 9,740 million (5.9 months of import cover) compared to USD 9,656 million in June 2019 (**Table 5.5**).

5.4 Banking Sector Developments

During the financial year ended June 30, 2020, Kenya had 41 commercial banks, 1 mortgage finance company, 14 microfinance banks, 9 representative offices of foreign banks, 69 foreign exchange bureaus, 19 money remittance providers and 3 credit reference bureaus. In addition, CBK approved:

- 100 percent acquisition of National Bank of Kenya Ltd by KCB Group PLC on September 2, 2019;
- Merger of Commercial Bank of Africa Ltd and NIC Bank PLC to form NCBA Bank Kenya PLC on November 5, 2019;
- Acquisition of Transnational Bank Plc by Access Bank Plc of Nigeria on December 24, 2019; and
- Licensing of Muungano Microfinance Bank PLC on October 30, 2019.

Table 5.4: Kenya Shilling Exchange Rates

	2017/18	2018/19	2019/20				Annual Average
			Q1	Q2	Q3	Q4	2019/20
			Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	
US Dollar	102.37	101.16	103.42	102.52	101.88	106.50	103.58
Pound Sterling	137.86	130.94	127.51	131.83	130.51	132.19	130.51
Euro	122.14	115.44	115.05	113.44	112.30	117.19	114.49
100 Japanese Yen	92.84	91.09	93.05	94.50	93.47	99.08	95.03
South Africa Rand	7.99	7.14	7.06	6.96	6.68	5.94	6.66
Uganda Shilling*	35.74	36.94	35.67	35.99	36.40	35.41	35.87
Tanzania Shilling*	22.01	22.76	22.23	22.44	22.64	21.73	22.26
Rwanda Franc*	8.29	8.82	8.87	9.07	9.32	8.93	9.05
Burundi Franc*	17.15	17.76	17.83	18.12	18.51	17.82	18.07

* Units of currency per Kenya Shilling

Source: CBK

Table 5.5: Foreign Exchange Reserves and Residents' Foreign Currency Deposits

USD Million (End of Period)	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20
1. Gross Reserves	13,187	13,089	13,170	13,083	13,356	12,825	12,919	12,766	12,835	12,447	12,286	13,806	13,681
of which:													
Official	9,656	9,662	9,596	9,442	9,349	9,153	9,116	8,880	8,754	8,635	8,357	9,738	9,740
import cover*	6.0	6.0	5.9	5.8	5.7	5.6	5.5	5.3	5.3	5.2	5.0	5.9	5.9
Commercial Banks	3,531	3,427	3,574	3,642	4,007	3,672	3,803	3,886	4,081	3,812	3,929	4,067	3,941
2. Residents' foreign currency deposits	6,415	6,290	6,236	6,196	6,341	6,229	6,393	6,350	6,473	6,445	6,439	6,620	6,557

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

Source: CBK

5.0 CENTRAL BANK OPERATIONS

Performance of the Banking Industry

The industry balance sheet expanded by 10.3 percent in the year to June 2020, on increased loans and advances and government securities, which accounted for 81.1 percent of total assets. Customer deposits accounted for 75.0 percent of total liabilities (**Table 5.6**).

	Jun-19	Jun-20	Change Absolute	Change (%)
Cash	63.86	63.96	0.1	0.15
Balances at CBK	261.37	316.72	55.34	21.17
Placements	259.78	277.64	17.86	6.88
Government Securities	1,285.56	1,521.71	236.15	18.37
Other Investments	70.02	63.95	-6.07	-8.67
Loans & Advances (Net)	2,443.92	2,651.50	207.58	8.49
Other Assets	335.2	312.34	-22.86	-6.82
Total Assets	4719.71	5207.82	488.1	10.34
Customer Deposits	3,506.03	3,903.62	397.59	11.34
Other Liabilities	493.42	534.67	41.26	8.36
Capital & Reserves	720.27	769.52	49.25	6.84
Total Liabilities and Shareholder's Funds	4,719.71	5,207.82	488.1	10.34

Source: CBK

Gross Loans and Advances - increased by 9.61 percent in the year to June 2020 to KSh 2.9 trillion. Key sectors that drove this growth were; Mining and Quarrying, Tourism, Restaurant and Hotels, Transport and Communication, and Manufacturing (**Table 5.7**).

Capital Adequacy - In June 2020, core capital and total capital to total risk weighted assets ratios were 16.4 percent and 18.5 percent, respectively, above the statutory minimum ratios of 10.5 and 14.51 respectively. Similarly, core capital to total deposits ratio was 16.7 percent, above the statutory minimum of 8.0 percent.

In terms of **Asset Quality** gross NPLs to gross loans ratio increased from 12.7 percent in June 2019 to 13.1 percent in June 2020. Agriculture, Building and Construction, Energy and Water, and Financial Services sectors

Table 5.7: Kenyan Banking Sector Gross Loans, KSh Billion

Sectors	Jun-19	Jun-20	Absolute Change	Change (%)
Mining & Quarrying	10.7	24.47	13.78	128.79
Tourism, Restaurant & Hotels	79.84	94.71	14.87	18.63
Transport & Communication	179.21	211.39	32.18	17.96
Manufacturing	345.33	403.61	58.28	16.88
Personal/Household	712.4	796.98	84.58	11.87
Real Estate	393.98	429.6	35.62	9.04
Building & Construction	110.93	118.87	7.94	7.16
Agriculture	95.64	100.49	4.85	5.07
Trade	511.39	532.74	21.35	4.18
Energy & Water	111.63	103.46	-8.17	-7.32
Financial Services	102.74	92.37	-10.37	-10.1
Total	2,653.79	2,908.70	254.92	9.61

Source: CBK

recorded the highest increases in NPLs (**Table 5.8**). Increased NPLs could be attributed to:

- delayed payments by the public and private sectors;
- low demand of developed housing and commercial units in the real estate sector;
- delays in cash inflows attributed to low business turnover;
- extreme weather conditions (excess rainfall); and
- Poor business as a result of COVID-19 pandemic in the second quarter of 2020.

Profitability declined by 17.2 percent to KSh 134.1 billion in profit before tax in the year ended June 30, 2020, driven by 11.9 percent increase in expenses compared to 2.9 percent increase in income. Total income increased by 2.9 percent on earnings from placements and Government securities while total expenses increased by 11.9 percent to KSh 404.1 billion in June 2020 due to a 150.8 percent increase in bad debt charge.

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Table 5.8: Kenyan Banking Sector Gross Non-Performing Loans (KSh Billion)

Sectors	Jun-19	Jun-20	Absolute Change	Change (%)
Agriculture	7.83	13.9	6.07	77.56
Building & Construction	7.49	11.65	4.16	55.47
Energy and Water	52.26	69.6	17.34	33.17
Financial Services	15.14	19.09	3.94	26.05
Manufacturing	6.81	7.95	1.14	16.71
Mining & Quarrying	54.96	64.08	9.11	16.58
Personal/ Household	89.41	94.89	5.48	6.13
Real Estate	24.01	25.22	1.21	5.05
Tourism, Restaurant & Hotels	53.87	52.63	-1.24	-2.3
Trade	21.81	21.1	-0.71	-3.23
Transport & Communication	2.31	1.87	-0.44	-19.17
Total	335.92	381.98	46.06	13.71

Source: CBK

Liquidity remains strong with the overall liquidity ratio in June 2020 at 52.7 percent compared to 50.6 percent in June 2019, above the minimum statutory level of 20 percent.

Microfinance Banks (MFBs)

MFBs recorded a loss of KSh 1.0 billion in the year ended June 2020, compared to a loss of KSh 0.7 billion in the previous year ended June 2019. Customer deposits increased by 8.6 percent to KSh 46.8 billion in June 2020. The MFBs' core capital to risk weighted assets ratio decreased from 15 percent in June 2019 to 14 percent in June 2020, but the total capital to total risk weighted assets increased from 15.9 percent as at June 2019 to 16.3 percent in June 2020, above the minimum requirements of 10 percent and 12 percent respectively.

Agency Banking

As at June 2020, 20 commercial banks and 3 MFBs had contracted 65,939 and 2,222 active agents compared to 18 commercial banks and 3 microfinance banks with

61,226 and 1,974 active agents as at June 2019. The number of transactions via agents increased from 717.3 million in the year ended June 2019 to 815.3 million transactions in the year ended June 2020. The value transacted increased from KSh 4.8 trillion in the year ended June 2019 to KSh 5.7 trillion in the year to June 2020.

Legal and Regulatory Developments

The CBK continued implementation of the Banking sector Charter launched in February 2019. Other developments were:

- **Repeal of interest rate caps** in November 2019 after it was enacted in September 2016.
- **The Central Bank of Kenya (Mortgage Refinance Companies) Regulations, 2019** were gazetted on August 2, 2019 to allow licensing and regulation of mortgage refinancing companies by CBK. The Kenya Mortgage Refinance Company (KMRC), launched in May 2019, submitted its licence application in August 2019 for processing.
- **Issuance of revised Credit Reference Bureaus (CRB) Regulations** in April 2020 to strengthen Kenya's Credit Information Sharing System (CIS) by enhancing consumer protection for borrowers, expanding the sources of information and ensuring the sustainability of the CIS as a key tool to bridge the information gap about the borrower's creditworthiness.
- Withdrew the approvals granted to unregulated digital (mobile-based) and credit-only lenders as third party credit information providers to CRBs due to public complaints over misuse of the CIS mechanism by these entities.
- Suspended the listing of negative credit information for six months for borrowers whose loans were performing previously but became non-performing from April 1, 2020.

5.0 CENTRAL BANK OPERATIONS

5.5 Currency Operations

Demonetisation

The CBK successfully launched a new series of currency banknotes on May 31, 2019. The change in currency banknotes was done in compliance with Article 231 (4) of the Constitution of Kenya. In addition to the new currency, CBK announced the demonetisation of old generation KSh 1,000 banknotes with effect from the October 1, 2019. This gave a four-month window for exchange of the demonetised banknotes. The objective of the demonetisation was to deal conclusively with the emerging concerns about Illicit Financial Flows and proliferation of counterfeits.

To facilitate a seamless demonetisation process, CBK actively engaged stakeholders and various media to ensure that the correct message reached the public. There were ground campaigns where the Governor personally led the conversations in various parts of the country including Nairobi, Kwale, Garissa, Wajir, Kisumu and Narok. Radio, television and newspapers greatly supplemented the campaign and positive feedback received on the effectiveness of the message of demonetisation. In addition, suitable catch phrases such as uko tayari! went a long way in reinforcing the message of the demonetisation and the associated timelines. CBK ensured that an elaborate exchange mechanism was rolled out to facilitate a smooth transition from the old currency to new and that there was no shortage of cash to complete the exchange process in all corners of the country.

From a total of 217,047,000 pieces of old generation KSh 1,000 banknotes in circulation as at June 1, 2020, 97 percent or 209,661,000 pieces were withdrawn at the end of the exercise on September 30, 2020. The remaining 3 percent (7,387,674 pieces) worth KSh 7.388 billion, were rendered worthless. This balance comprised cash held by individuals who were unable or unwilling to deposit or subject themselves to the robust checks in place.

Infrastructure Development for Improved Currency Operations

As part of the improvement of currency services, the CBK advanced towards opening the Kisii Centre. The project, undertaken jointly with the Kenya Bankers Association, was at the final stages of completion and was expected to be formally opened later in 2020. Key staff to run the Centre were appointed to take over operations of the Centre.

In addition, CBK improved its currency processing capacity by upgrading the Banknote Processing Systems and Currency Destruction Systems at the head office, Branches and Centres. The upgraded systems played a crucial role in the successful introduction and subsequent processing of both old and new generation currency in 2019.

Currency in Circulation

Currency in circulation increased by KSh 8.2 billion in the FY 2019/20, an increase of 3.3 percent compared to a decline of 4.9 percent in the previous financial year (**Table 5.9**).

Table 5.9: Currency in Circulation

	Jun-19	Jun-20	Growth
	Ksh Billion	Ksh Billion	(%)
Banknotes	240.3	248.4	3.4
Coins	9.3	9.4	1.9
Total Currency in Circulation	249.5	257.8	3.3

Source: CBK

5.6 Banking Services and National Payments

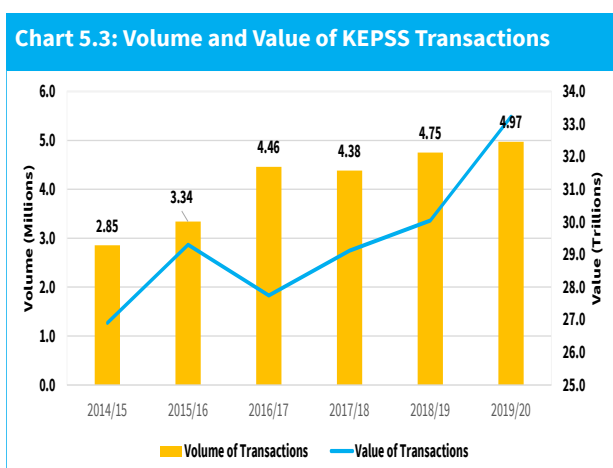
The year 2019/2020 witnessed major achievements in CBK's banking and payment services. A number of authorizations for payment service providers were completed, key regulatory guidelines were issued and security enhancements for SWIFT operations among commercial banks were implemented. Most notably, CBK completed a major upgrade of the Kenya

5.0 CENTRAL BANK OPERATIONS

Electronic Payment and Settlement System platform to give it unparalleled capabilities. This upgrade greatly improved efficiency and effectiveness of Kenya's payment, clearing and settlement systems.

Migration to new KEPSS platform

The Kenya Electronic Payment and Settlement System (KEPSS) is Kenya's Real Time Gross Settlement System (RTGS). It was set up in 2005 as part of CBK's efforts to modernize payments in Kenya. KEPSS settles Kenya's high-value and time-critical payments. In 2019/20, KEPSS processed 4.97 million transaction messages valued at KSh 33.23 trillion compared to 4.75 million transaction messages worth KSh 30.04 trillion in 2018/19 (Chart 5.3).



Source: CBK

On June 5, 2020, the CBK went live with a new platform for the Kenya Electronic Payment and Settlement System (KEPSS). The previous KEPSS platform, implemented in 2005 had a number of capacity limitations. It could do up to 50,000 transactions per day compared to the new system's capacity of more than one million transactions per day. The new system has other advantages including elimination of manual paper-based instructions; efficient liquidity optimization; ability to configure customized alerts for exceptional transactions; unique transaction reference numbers for ease of tracking; compliance with ISO20022 SWIFT standards for messaging; Anti Money

Laundering/Combating the Financing of Terrorism (AML/CFT) capabilities. The new KEPSS platform is functionally ready for a 24/7 economy.

Authorization of Payment Service Providers (PSPs)

In the year, CBK granted approval to Airtel Network Kenya Limited to carve off the mobile money business from the data and voice business to enhance governance. Further authorizations were also granted to Kenswitch Kenya Limited, Interswitch East Africa Kenya Limited and Integrated Payment Services Limited (IPSL). Other previously authorized PSPs include Safaricom Plc, Airtel Network Kenya Ltd, Telkom Kenya Ltd and Mobile Pay Ltd. This brings the total number of authorized PSPs to seven, deepening growth and payment service delivery in Kenya.

Guidelines and Circulars

To ensure a robust legal and regulatory framework, CBK issued a Cybersecurity Guideline for PSPs to set minimum standards that PSPs should adopt for effective cybersecurity governance. The CBK also issued two circulars in March and June 2020, announcing a range of measures to encourage the use of mobile and digital payments in response to the COVID-19 pandemic. This was part of CBK's wider effort to cushion and support businesses and Kenyans against the impact of COVID-19.

Regional Payment and Settlement Systems

The KEPSS interfaces with two regional payment systems, the East Africa Payment System (EAPS) and the COMESA Regional Electronic Payment and Settlement System. The EAPS is used by traders and banks to make payments in the EAC region. Settlement for EAPS transactions takes place in the EAC Partner States currencies i.e. KSh, UGX, TZS and RWF. In 2019/2020, banks sent 3,020 transactions worth about USD 496.1 million over the EAPS network. The leading currency utilized for EAPS payments in value terms was the Kenya shilling with a total value of USD 342.7 million which represented 69.1 percent of the total payments.

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SWIFT Customer Security Program

The CBK coordinated implementation of SWIFT Customer Security Program 2019. This is a global program that involves all commercial banks putting in place security controls against cyber-attacks. The Kenyan financial industry achieved a 91 percent compliance level. In addition, banks that connect to SWIFT received training on ISO 20022 message standards to enable migration to the standard by 2022.

5.7 Domestic Debt Operations and Developments

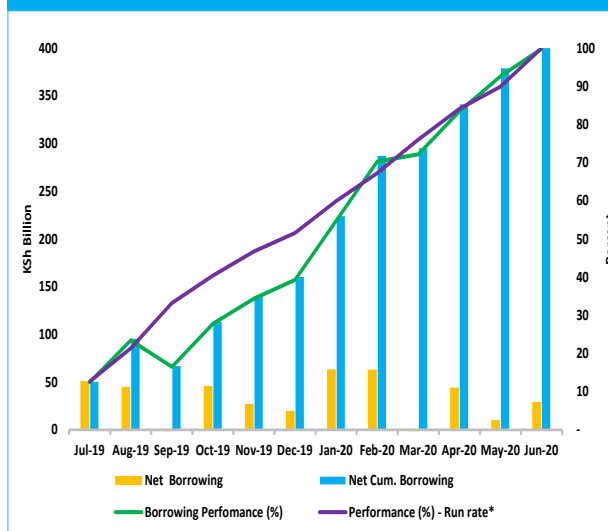
The domestic debt market performed well during the year with sustained yield curve stability, lengthening of the maturity profile of domestic debt and increased bond market liquidity.

As a result, the CBK successfully met the Government's net domestic borrowing target in FY 2019/20. Securities amounting to KSh 408.9 billion were issued which was 99.8 percent of the revised target of KSh 409.7 billion (**Chart 5.4**).

To support the benchmark bonds program, ten T-bonds were reopened while seven new T-bonds and three infrastructure bonds were issued mainly in the medium-long term maturity spectrum.

In line with the Medium-Term Debt Strategy (MTDS) the

Chart 5.4: Domestic Borrowing Programme Performance in FY 2019-2020



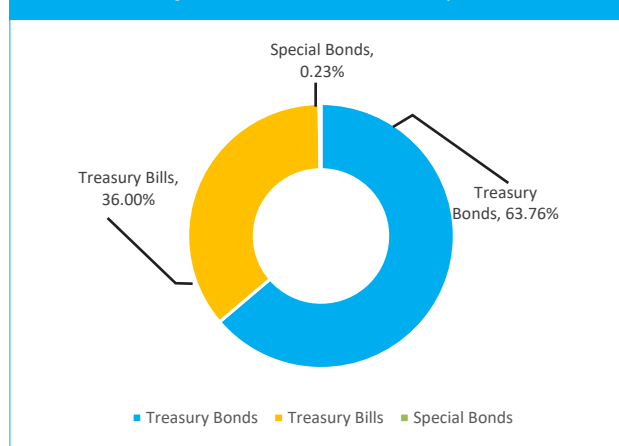
Source: CBK

Average Time to Maturity (ATM) for Treasury bonds rose to 7.9 years as at 30 June 2020 from 7.6 years in June 2019, an increase of 4 percent. T-bills to bonds ratio stood at 29:71 as at June 30, 2020 compared to 36: 64 in June 2019 (**Chart 5.5 & Chart 5.6**).

Successful Inaugural T-bill to T-bond Switch

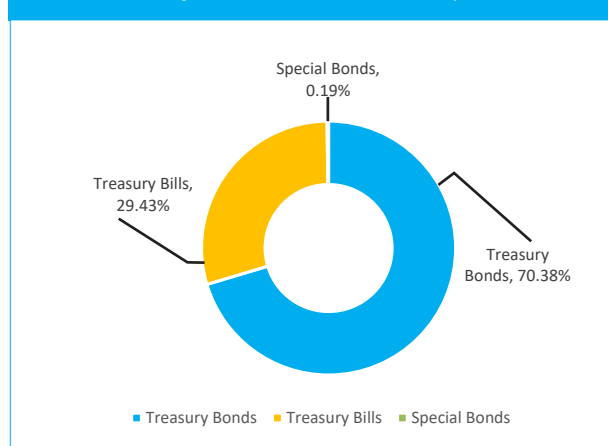
CBK conducted the inaugural switch on June 1, 2020 with the objective of lengthening the maturity profile of existing debt and to rebalance the T-bill portfolio which had concentration in the 364-day T-bills, accounting

Chart 5.5: Composition of GoK Securities, June 2019



Source: CBK

Chart 5.6: Composition of GoK Securities, June 2020



Source: CBK

5.0 CENTRAL BANK OPERATIONS

for 86.5 percent. Investors in the source instrument (364-day T-bill Issue No.2236/364, KSh 25.6 billion due on June 1, 2020) were offered the destination bond, a new 6-year (effective 4.5 years) 10.2 percent coupon amortized Infrastructure Bond, Issue No. IFB1/2020/6 on a voluntary basis. Total bids received at the IFB auction were KSh 21.2 billion against the source T-bill maturity of KSh 25.6 billion, representing an 83 percent subscription rate. KSh 20.2 billion was accepted at an average yield of 11.6 percent same as the overall weighed market yield.

The switch was successfully undertaken against the backdrop of the ongoing COVID-19 pandemic further strengthening confidence and credibility in the market.

Green Bond Issuance

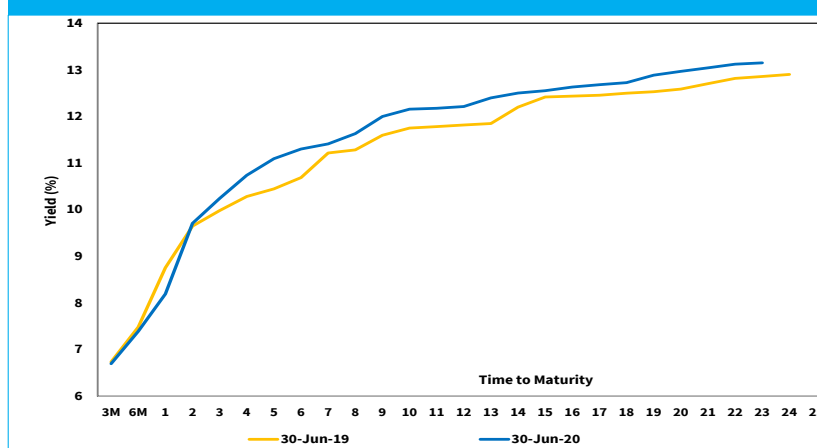
In the FY 2019/20, Kenya witnessed its first Green bond issuance with a dual listing by Accorn Group at the Nairobi Securities Exchange and London Stock Exchange in January 2020. The Governor, who is the patron of the Green Bond Programme, committed to provide support towards further issuances in the medium term.

Outlook

Government Securities Switch

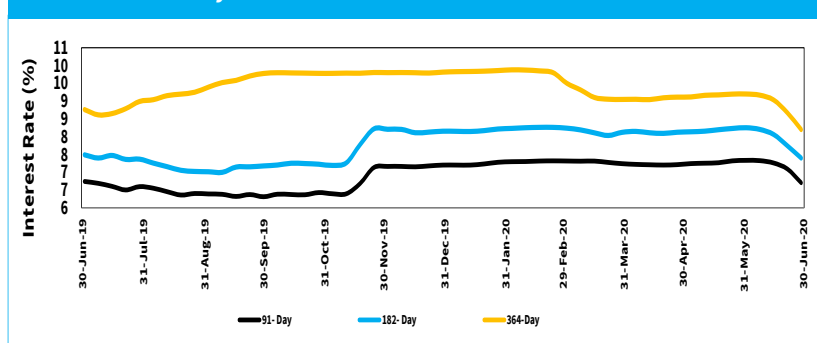
- Building on the proof of concept and success of the inaugural switch, CBK continues to review the regular issuance programme to strengthen and support the development of the financial market through further innovation.

Chart 5.7: Kenya Government Securities Yield Curve



Source: CBK

Chart 5.8: Treasury Bills Interest Rates



Source: CBK

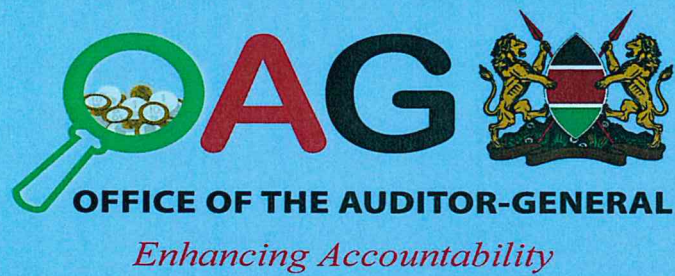
Central Securities Depository (CSD) System - This modern market infrastructure expected to improve the Government debt market operations, interbank market liquidity distribution and capital market development was progressing towards completion in the new financial year.

Treasury Mobile Direct (TMD) - CBK successfully rolled out TMD in February 2020, a digital channel for retail investors to access government securities through their mobile phones. The second phase of TMD would be undertaken in FY 2020/21 to enhance the service range and user convenience.

Internet Banking (IB) - IB is an electronic platform for access to the government securities market by institutional investors. 27 commercial banks have so far executed the IB Agreement, with 18 banks and 3 micro finance banks connected to the platform.

6.0 FINANCIAL PERFORMANCE FOR THE YEAR ENDED JUNE 2020

REPUBLIC OF KENYA



REPORT

OF

THE AUDITOR-GENERAL

ON

CENTRAL BANK OF KENYA

FOR THE YEAR ENDED
30 JUNE, 2020

BANK INFORMATION FOR THE YEAR ENDED 30 JUNE 2020

BOARD OF DIRECTORS

Mr. Mohammed Nyaoga	Chairman
Dr. Patrick Njoroge	Governor
Mr. Samson Cherutich	Member
Mrs. Rachel Dzombo	Member
Mrs. Nelius W. Kariuki	Member
Mr. Ravi J. Ruparel	Member
Dr. Julius Muia	Principal Secretary, The National Treasury

SENIOR MANAGEMENT

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

HEADS OF DEPARTMENT

Mr. Kennedy Abuga	Director – Governor's Office (Board Secretary)
Ms. Rose Detho	Director - Strategic Management Department - Retired on 1 June 2020
Mr. William Nyagaka	Director - Financial Markets Department - Until 31 March 2020
	Director - Kenya School of Monetary Studies - Appointed on 2 June 2020
Mr. David Luusa	Director - Financial Markets Department - Appointed on 1 April 2020
Mr. Gerald Nyaoma	Director - Bank Supervision Department
Mr. Antony Gacanja	Director - Information Technology Department
Mr. Stephen Muriu	Director - General Services Department - Appointed on 25 November 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. Moses Ngotho	Acting Director - Finance Department
Mr. Raphael Otieno	Acting Director - Research Department
Mrs. Matilda Onyango	Acting Director - Internal Audit Department and Risk Management
Mr. Joshua Kimoro	Acting Director - Kenya School of Monetary Studies - Until 1 June 2020
Mr. Patrice Odude	Acting Director- Strategic Management Department - Appointed on - 2 June 2020

REGISTERED OFFICE AND PRINCIPAL PLACE OF BUSINESS

Central Bank of Kenya Building
Haile Selassie Avenue
P.O. Box 60000
00200 Nairobi, Kenya
Tel. (+254) (020) 2860000

BRANCHES

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

BANK INFORMATION (continued) FOR THE YEAR ENDED 30 JUNE 2020

CURRENCY CENTRES

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

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

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

SUBSIDIARY

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

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

STATEMENT OF CORPORATE GOVERNANCE FOR THE YEAR ENDED 30 JUNE 2020

1.0 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 for a term of four (4) years 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 the responsibility of approving 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.	Mr. Samson Cherutich	Member	Accountant	Appointed on 5 December 2020	4 December 2020
7.	Mrs. Rachel Dzombo	Member	Management Expert	Appointed on 5 December 2020	4 December 2020

STATEMENT OF CORPORATE GOVERNANCE (continued) FOR THE YEAR ENDED 30 JUNE 2020

The Members of the Board (all Kenyans) in the year ended 30 June 2020 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	12
2.	Dr. Patrick Njoroge	Governor	Economist	12
3.	Principal Secretary/ The National Treasury	Executive Officer	Economist	8
4.	Mrs. Nelius Kariuki	Member	Economist	12
5.	Mr. Ravi Ruparel	Member	Financial Sector Expert	12
6.	Mr. Samson Cherutich	Member	Accountant	12
7.	Mrs. Rachel Dzombo	Member	Management Expert	12

The remuneration paid to the Directors for services rendered during the financial year 2019/2020 is disclosed in Note 29 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 2020 were Mr. Samson K. Cherutich (Chairman), Mr. Ravi J. Ruparel, Mrs. Nelius W. Kariuki and Mrs. Rachel Dzombo. The members are all Non-Executive Directors with experience in Accounting, Auditing, Financial and

Management. The Committee meets once every two (2) months and as necessary. The Terms of Reference of the Audit Committee cover five (5) major areas, namely; Internal Control System, Risk Management, Financial Reporting and Related Reporting Practices, External and Internal Audits.

The Audit Committee's mandate, under Internal Control, includes ensuring that internal control and risk management is planned, structured and implemented at the Bank. The Committee also ensures that internal and external audit recommendations are implemented.

The mandate relating to Financial Reporting and Related Reporting Practices requires the Audit Committee to review the annual financial statements of the Bank, the external auditor's opinion and their comments on internal controls and other observations. The Committee also reviews significant accounting and reporting issues and their impact on financial reports and legal matters that could significantly impact on the financial statements, among other financial reporting responsibilities.

With regard to External Audit, the Audit Committee reviews the external auditor's proposed audit scope, approach and audit deliverables, and reviews the financial statements before submission to the Board for consideration and approval.

STATEMENT OF CORPORATE GOVERNANCE (continued)

FOR THE YEAR ENDED 30 JUNE 2020

The Committee's mandate on Internal Audit covers review of the activities and resources of the internal audit activity, including the effectiveness, standing and independence of the internal audit function within the Bank. It also covers review of the internal audit plan and follow up of the implementation of internal auditor findings and recommendations. The Audit Committee reports to the Board of Directors on the standing and independence of the internal audit function within the Bank. The Audit Committee also reports to the Board of Directors on internal audit scope, approach and deliverables.

The Committee Members' positions, disciplines and number of meetings attended for the year ended 30 June 2020 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.	Mrs. Nelius Kariuki	Member	Economist	8
4.	Mrs. Rachel Dzombo	Member	Management Expert	8

1.4. Human Resources Committee (HRC)

The members of the HRC in the year ended 30 June 2020 were Mrs. Nelius Kariuki (Chairman), Mr. Samson Cherutich, 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:

- Monitor the formulation and implementation of Human Resource Policies in the Bank;
- In relation to staff matters, they ensure 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.
- Monitor the implementation of Board resolutions relating to the HRC of the Board.

The goal of the committee is to drive the HR function at the Bank to attain best in class global standards.

The members of the Human Resources Committee in the year ended 30 June 2020 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.	Mrs. Rachel Dzombo	Member	Management Expert	6
4.	Mr. Ravi Ruparel	Member	Financial Sector Expert	6

STATEMENT OF CORPORATE GOVERNANCE (continued) FOR THE YEAR ENDED 30 JUNE 2020

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 financial year 2019/20, the MPC formulated monetary policy aimed at maintaining overall inflation within the target of 5 percent with a flexible margin of 2.5 percent on either side. The MPC adopted an accommodative monetary policy stance to support economic activity, by lowering the Central Bank Rate (CBR) from 9.00 percent in June 2019 to 8.50 percent in November 2019 and to 8.25 percent in January 2020. The economy witnessed a severe shock in the second half of the period, attributed to the adverse impact of the global COVID-19 (coronavirus) pandemic. Global financial markets witnessed significant volatility due to heightened uncertainties with regard to the pandemic.

The MPC moved quickly to implement policy measures aimed at preventing the pandemic from becoming a severe economic crisis. In March 2020, the Committee augmented its accommodative policy stance by lowering the CBR to 7.25 percent. The Committee also reduced the Cash Reserve Ratio (CRR) to 4.25 percent from 5.25 percent

during its March meeting, releasing KSh.35.2 billion as additional liquidity availed to banks to directly support borrowers that were distressed as a result of the pandemic. Additionally, the MPC extended the maximum tenor of Repurchase Agreements (REPOs) from 28 to 91 days in order to provide flexibility on liquidity management facilities provided to banks by CBK, and to enable banks access longer term liquidity secured on their holdings of government securities without having to discount them. The MPC shifted to monthly meetings in order to closely monitor market developments and the impact of its previous policy decisions on the economy. In view of a worsening global economic outlook, the MPC augmented its accommodative policy stance by lowering the CBR further to 7 percent in April 2020.

Overall inflation remained within the target range during the year, supported by declines in food prices due to favourable weather conditions, lower international oil prices, a reduction in the Value Added Tax (VAT) rate to 14 percent from 16 percent, and muted demand pressures. The inflation rate stood at 4.6 percent in June 2020 compared to 4.3 percent in June 2019. Non-food-non-fuel (NFFNF) inflation remained stable below 5 percent over the period, indicating that demand pressures were muted. The stability of the foreign exchange market in the period minimized the threat of imported inflation. The CBK foreign exchange reserves, which stood at USD9,503.5 million (5.71 months of import cover) (2019: USD 9,108.6 million (equivalent to 5.8 months of import cover)) at the end of June 2020, continued to provide adequate cover and a buffer against short-term shocks in the foreign exchange market.

The repeal of the interest rate caps on commercial bank loans in November 2019, restored the clarity of monetary policy decisions and was expected to strengthen the transmission of monetary policy.

STATEMENT OF CORPORATE GOVERNANCE (continued)

FOR THE YEAR ENDED 30 JUNE 2020

The caps had led to a significant rationing of credit, particularly to the most vulnerable. The adoption by banks of the Banking Sector Charter during the period is a commitment to entrench a responsible and disciplined banking sector which is cognisant of, and responsive to, the needs of their customers.

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.

The MPC held eight (8) meetings in the year ended 30 June 2020, and attendance was as follows:

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

*Mr. David Luusa replaced Mr. William Nyagaka as a member of the MPC in April 2020 following the appointment of Mr. Luusa as the Director of Financial Markets Department.

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 1, to review the overall performance of the Bank.

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

1.7. 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.

STATEMENT OF CORPORATE GOVERNANCE (continued) FOR THE YEAR ENDED 30 JUNE 2020

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.

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 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 changes in exchange rate. The Bank's financial performance is presented on page 13 of these financial statements.

During financial year ended 30 June 2020, the Bank recorded a net surplus of KShs 41,530 million compared to KShs 26,138 million in financial year ended 30 June 2019. The surplus is included as part of the General Reserve Fund.

During the financial year ended 30 June 2020, the Bank's operating surplus before unrealized gains was KShs 17,055 million (2019: KShs 21,016 million). Interest income of KShs 22,308 million (2019: KShs 23,347 million) declined due to lower rates offered on foreign deposit placements and a decline in fixed income yields respectively as a result of global monetary policy easing cycles. An unrealised foreign exchange gain of KShs 24,475 million was recorded during the year ended 30 June 2020 (2019: KShs 5,122 million) due to the impact of USD strength. The Bank also recorded a fair value gain on fixed income securities of KShs 8,452 million (2019: KShs 7,005 million). The gain recorded during the year has been presented in other comprehensive income.

In addition, an actuarial gain of KShs 1,949 million (2019: loss of KShs 2,928 million) was also earned. 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 1,350,434 million (2019: KShs 1,239,158 million) mainly attributed to net inflows from development partners and changes in the value of securities maintained for monetary policy implementation.

Liabilities increased to KShs 1,154,419 million (2019: KShs 1,080,683 million) as a result of an increase in deposits from banks and government largely attributed to proceeds to mitigate the impact of the COVID-19 pandemic.

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 30 JUNE 2020

The Directors submit their report together with the audited financial statements for the year ended 30 June 2020, 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 surplus for the year was KShs 41,530 million (2019: KShs 26,138 million) made up of KShs 17,055 million (2019: KShs 21,016 million) realized surplus and KShs 24,475 million unrealized surplus (2019: KShs 5,122 million). The surplus has been included as part of the General Reserve Fund. On 20 March 2020, the Directors approved a transfer of KShs 7,388 million to the Consolidated Fund from the General Reserve Fund. This transfer represented a one-off surplus arising from the demonetization exercise carried out by the CBK in the year. The transfer of this surplus to the Government of Kenya revenues was done to support their efforts in the COVID-19 pandemic crisis. The directors recommend a transfer of operational surplus in the year to 30 June 2020 of KShs 2,500 million (2019: KShs 4,000 million).

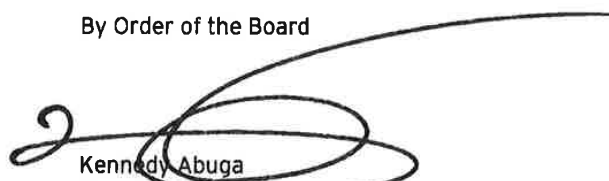
4. BOARD OF DIRECTORS

The members of the Board of Directors who served during the year and up to the date of this report are listed on page 31.

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 2020 and report to the Auditor - General.

By Order of the Board



Kennedy Abuga
Board Secretary
21/9/2020

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE YEAR ENDED 30 JUNE 2020

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 2020 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 are prepared on a going concern basis, taking into account the legal mandate and responsibilities of the Bank, in particular is monetary policy, financial stability and payment system leadership.

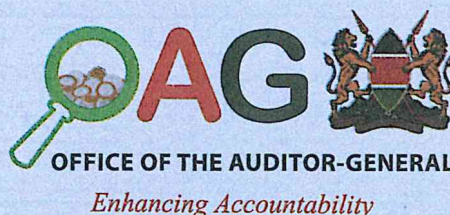
Approved by the Board of Directors and signed on its behalf by:


Chairman, Board of Directors
Mr. Mohammed Nyaoga
2/9/2020


Governor
Dr. Patrick Njoroge
2/9/2020

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, 2020

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying consolidated financial statements of Central Bank of Kenya set out on pages 46 to 121, which comprise the consolidated statement of financial position as at 30 June, 2020, 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, 2020, 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 Management 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 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, risk management and overall governance 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 Management is aware of the intention to liquidate the Bank or to cease operations.

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.

In addition to the responsibility for the preparation and presentation of the financial statements described above, 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.

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

Report of the Auditor-General on Central Bank of Kenya for the year ended 30 June, 2020

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

22 September, 2020

Report of the Auditor-General on Central Bank of Kenya for the year ended 30 June, 2020


CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2020


	Notes	2020 KShs' million	2019 KShs' million
Interest income	4	22,308	23,347
Interest expense	5	(4,618)	(1,492)
Net interest income		17,690	21,855
Fees and commission income	6(a)	3,000	3,000
Net trading income	6(b)	11,753	10,099
Other income	7(a)	982	1,371
Demonetization of old currency	7(b)	7,388	-
Operating income		40,813	36,325
Credit loss expense on financial assets	8	(8,627)	(2,365)
Operating expenses	9(a)	(15,131)	(12,944)
Operating surplus before unrealized gains		17,055	21,016
Unrealised gains:			
Foreign exchange gain		24,475	5,122
Surplus for the year		41,530	26,138
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(a)	8,452	7,005
Reclassification to income statement	10(b)	(3,020)	-
Changes in allowance for expected credit losses	8	17	2
Net gains on debt instruments at fair value through other comprehensive income		5,449	7,007
Total items that will be reclassified to profit or loss		5,449	7,007
Other comprehensive income that will not be reclassified to profit or loss:			
Actuarial gain/(loss) in retirement benefit asset	20	1,949	(2,928)
Total items that will not be reclassified to profit or loss		1,949	(2,928)
Other comprehensive income for the year		7,398	4,079
Total comprehensive income for the year		48,928	30,217

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2020

	Notes	2020 KShs' million	2019 KShs' million
ASSETS			
Balances due from banking institutions	11	369,505	542,849
Funds held with International Monetary Fund (IMF)	12(a)	3,255	1,008
Securities and advances to banks	13	55,561	66,909
Loans and advances	14	3,274	3,363
Debt instruments at fair value through other comprehensive income	15	724,892	504,533
Equity instruments at fair value through other comprehensive income	16	10	9
Other assets	17(a)	5,595	5,684
Gold holdings	17(b)	106	81
Right-of-use assets	18(a)	222	-
Property and equipment	18(b)	31,618	30,001
Intangible assets	19	1,224	837
Retirement benefit asset	20	6,537	4,328
IMF On-Lent to GOK	21(a)	79,702	-
Due from Government of Kenya	21(b)	68,933	79,556
TOTAL ASSETS		1,350,434	1,239,158
LIABILITIES			
Currency in circulation	22	257,792	249,509
Investment by banks	23	6,997	-
Deposits from Banks and Government	24	732,187	741,000
Due to IMF	12(b)	151,841	83,653
Other liabilities	25	5,602	6,521
TOTAL LIABILITIES		1,154,419	1,080,683
EQUITY			
Share capital	26(a)	35,000	20,000
General reserve fund	26(b)	128,199	109,608
Fair value reserve	26(c)	12,515	7,066
Revaluation reserve	26(d)	17,801	17,801
Consolidated fund	26(e)	2,500	4,000
TOTAL EQUITY		196,015	158,475
TOTAL LIABILITIES AND EQUITY		1,350,434	1,239,158

The financial statements were authorised for issue by the Board of Directors on21/..... 2020
and signed on its behalf by:


Chairman of the Board
Mr. Mohammed Nyaoga


Governor
Dr. Patrick Njoroge

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2020

	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 2020							
At 1 July 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>
Surplus for the year		-	41,530	-	-	-	41,530
Net change in fair value of debt instrument at FVOCI		-	-	-	8,452	-	8,452
Net amount reclassified to the income statement on sale and maturity of debt instruments at FVOCI					(3,020)		(3,020)
Net change in allowance for expected credit losses on debt instruments at FVOCI		-	-	-	17	-	17
Actuarial gain on retirement benefit asset	20	<u>-</u>	<u>1,949</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,949</u>
Total comprehensive income for the year		-	43,479	-	5,449	-	48,928
Additional share capital	26(a)	15,000	(15,000)	-	-	-	-
Transactions with owners							
-Transfer to consolidated fund	26(e)	-	(9,888)	-	-	9,888	-
-Payments out of consolidated fund	26(e)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(11,388)</u>	<u>(11,388)</u>
At 30 June 2020		<u>35,000</u>	<u>128,199</u>	<u>17,801</u>	<u>12,515</u>	<u>2,500</u>	<u>196,015</u>

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued) FOR THE YEAR ENDED 30 JUNE 2020

Year ended 30 June 2018	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
At 1 July 2018							
- As previously stated		5,000	106,162	17,801	-	800	129,763
- Impact of adopting IFRS 9		-	(764)	-	59	-	(705)
Restated opening balance under IFRS 9		5,000	105,398	17,801	59	800	129,058
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	26(a)	15,000	(15,000)	-	-	-	-
Transactions with owners							
-Transfer to consolidated fund	26(e)	-	(4,000)	-	-	4,000	-
-Payments out of consolidated fund	26(e)	-	-	-	-	(800)	(800)
At 30 June 2019		20,000	109,608	17,801	7,066	4,000	158,475

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2020

	Notes	2020 KShs' million	2019 KShs' million
OPERATING ACTIVITIES			
Cash (used in)/ generated from operating activities	27	(43,555)	146,941
Interest received		22,308	23,347
Interest paid		(4,618)	(1,492)
Interest paid on lease liabilities	18(a)	(7)	-
Cash (used in)/ generated from operating activities		<u>(25,872)</u>	<u>168,796</u>
INVESTING ACTIVITIES			
Purchase of property and equipment	18(b)	(3,394)	(4,098)
Purchase of intangible assets	19	(546)	(806)
Proceeds from disposal of property and equipment		64	14
Net change in debt instruments at fair value through other comprehensive income		(181,615)	(93,786)
Net change in securities and advances to Banks		(31,979)	(2,263)
Net change in funds held with International Monetary Fund (IMF)		<u>(2,247)</u>	<u>1,004</u>
Net cash used in investing activities		<u>(219,717)</u>	<u>(99,935)</u>
FINANCING ACTIVITIES			
Payment of principal portion of lease liabilities	18(a)	(158)	-
Receipts during the year	28(b)	79,702	-
Repayments to the International Monetary Fund (IMF)	28(b)	<u>(11,634)</u>	<u>(16,615)</u>
Net cash generated from/(used in) financing activities		<u>67,910</u>	<u>(16,615)</u>
Net (decrease)/ increase in cash and cash equivalents		<u>(177,679)</u>	<u>52,246</u>
Cash and cash equivalents at the beginning of the year		628,833	577,327
Effect of IFRS 9 on cash and cash equivalents balances		-	(740)
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	28(a)	<u>451,154</u>	<u>628,833</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2020

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

The following new standards and amendments became effective as of 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
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
- 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

Several other amendments and interpretations apply for the first time in 2019, 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.

IFRS 16 Leases

The Bank applied IFRS 16 Leases for the first time. The nature and effect of the changes as a result of adoption of this new accounting standard is described below.

IFRS 16 supersedes 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. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to recognise most leases on the balance sheet.

Lessor accounting under IFRS 16 is substantially unchanged from IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 does not have an impact for leases where the Bank is the lessor.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

New and amended standards and interpretations (continued)

IFRS 16 Leases (continued)

The Bank adopted IFRS 16 using the modified retrospective method of adoption with the date of initial application of 1 July 2019. Under this method, the right-of-use asset was measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application. The Bank reassessed whether a contract is or contains a lease on the date of initial application as defined under IFRS 16.

The Bank has lease contracts for various items of buildings and equipment. Before the adoption of IFRS 16, the Bank classified each of its leases (as lessee) at the inception date as operating leases. Refer to Note 2 (q) Leases for the accounting policy prior to 1 July 2019.

Upon adoption of IFRS 16, the Bank applied a single recognition and measurement approach for all leases except for short-term leases and leases of low-value assets. Refer to Note 2 (q) Leases for the accounting policy beginning 1 July 2019. The standard provides specific transition requirements and practical expedients, which have been applied by the Bank.

Leases previously accounted for as operating leases

The Bank recognised right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and leases of low-value assets. The right-of-use assets for all leases were recognised based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognised. Lease liabilities were recognised based on the present value of the remaining lease payments, discounted using the incremental borrowing rate at the date of initial application.

The Bank also applied the available practical expedients wherein it:

- Measured the right-of-use asset at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application
- Used a single discount rate to a portfolio of leases with reasonably similar characteristics
- Applied the short-term leases exemptions to leases with lease term that ends within 12 months of the date of initial application
- Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application
- Used hindsight in determining the lease term where the contract contained options to extend or terminate the lease

Based on the above, as at 1 July 2019:

- Right-of-use assets of KShs 352 million were recognised and presented separately in the statement of financial position.
- Additional lease liabilities of KShs 350 million (included in Other liabilities) were recognised.
- Prepayments of KShs 2 million related to previous operating leases were derecognised.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

New and amended standards and interpretations (continued)

IFRS 16 Leases (continued)

The lease liabilities as at 1 July 2019 can be reconciled to the operating lease commitments as of 30 June 2019, as follows:

	KShs' Million
Assets	
Operating lease commitments as at 30 June 2019	186
Weighted average incremental borrowing rate as at 1 July 2019	<u>9%</u>
Discounted operating lease commitments as at 1 July 2019	154
Less:	
Contracts reassessed as non-lease contracts	(59)
Add:	
Contract reassessed as lease contracts (adjustment as result of newly identified leases)	<u>255</u>
Lease liabilities as at 1 July 2019	<u>350</u>

Standards issued but not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are listed below.

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
- Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7

Effective for annual periods beginning on or after 1 Jun 2020

- COVID-19-Related Rent Concessions – Amendment to IFRS 16

Effective for annual periods beginning on or after 1 January 2022

- Classification of Liabilities as Current or Non-current - Amendments to IAS 1
- Reference to the Conceptual Framework – Amendments to IFRS 3
- Property, Plant and Equipment: Proceeds before Intended Use – Amendments to IAS 16
- Onerous Contracts – Costs of Fulfilling a Contract – Amendments to IAS 37
- AIP IFRS 1 First-time Adoption of International Financial Reporting Standards – Subsidiary as a first-time adopter

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- AIP IFRS 9 Financial Instruments – Fees in the '10 per cent' test for derecognition of financial liabilities
- AIP IAS 41 Agriculture – Taxation in fair value measurements

Effective for annual periods beginning on or after 1 January 2023

- IFRS 17 Insurance Contracts

Effective date postponed indefinitely

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

None of the standards and interpretations listed above are expected to have a significant impact on the Bank's financial statements when they become effective.

(c) 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 2020. Kenya School of Monetary Studies is a subsidiary of the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The 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.

(d) 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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)'.

(e) 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.

(f) 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.

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 debt instruments at 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)

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- 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), IMF On-Lent to GOK and due from Government of Kenya.

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. Fixed income securities comprise Government debt securities issued by sovereign governments, Municipal bonds and bonds issued by international financial institutions.

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 as it intends to hold these investments for the foreseeable future.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Classes of financial instruments

Category (as defined by IFRS 9)		Class (as determined by the Bank)		2020	2019
				KShs' million	KShs' million
Financial assets	Financial assets at amortised cost	Securities and advances to banks		55,561	66,909
		Funds held with IMF		3,255	1,008
		Net advances to staff and banks under liquidation		3,274	3,363
		Other assets (classified as financial assets)		500	330
		Due from Government	Government term loan	21,783	22,229
			IMF On-Lent to GOK	79,702	-
			GOK Overdraft facility	47,150	57,327
		Balances due from banking institutions	Foreign currency denominated term deposits and current account balances	369,505	542,849
	Financial assets at Fair value through other comprehensive income	Fixed income securities	World Bank managed and internally managed fixed income portfolios	724,892	504,533
		Equity	Investment securities		
				10	9
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Cash reserve ratio and current account deposits	450,764	403,551
		Due to IMF		151,841	83,653
		Investments by banks		6,997	-
		Other liabilities		5,343	6,324
		Deposits from Government institutions		281,423	337,449

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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:

- Fixed income 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’. Financial instruments are considered credit – impaired are referred to as ‘Stage 3 financial instruments’. The Bank records an allowance for the lifetime ECL.

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 reorganization; and,
- the disappearance of an active market for a security because of financial difficulties.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 with a corresponding charge to profit or loss.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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 investment by banks, 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, investment by banks 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.

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 offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(g) 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.

(h) 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.

(i) 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

(j) 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:

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

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

(k) 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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. An impairment loss recognised for goodwill is not reversed in a subsequent period.

(l) 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) 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.

(n) Provisions

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

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

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

(o) 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.

(p) Share capital

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

(q) Leases

Policy before 1 July 2019

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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The operating leases generate rental income which is recorded in profit or loss on a straight-line basis over the period of the lease.

Policy after 1 July 2019

The Bank assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Bank as a lessee

The Bank applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Bank recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

Right-of-use assets

The Bank recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the lease term as follows:

Buildings	1 to 5 years
Equipment	1 to 5 years

The right-of-use assets are also subject to impairment. Refer to the accounting policies in Note 2(k) Impairment of non-financial assets.

Lease liabilities

At the commencement date of the lease, the Bank recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments.

In calculating the present value of lease payments, the Bank uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term or a change in the lease payments.

The Bank's lease liabilities are included in Other liabilities (see Note 25).

Short-term leases and leases of low-value assets

The Bank applies the short-term lease recognition exemption to its short-term leases of buildings and equipment (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of equipments that are considered to be low value. Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Bank as a lessor

Leases in which the Bank does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. Rental income arising is accounted for on a straight-line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature.

(r) 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.

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.

(s) 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(t) 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.

(u) 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. The Bank demonetises currency denominations that it considers no longer suitable for circulation through a Gazette Notice.

(v) Loan due from the Government of Kenya

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

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the government agreed to repay the loan at 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.

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

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

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

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand promissory notes 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.

(x) Fair value measurement

The Bank measures financial instruments such as debt instruments at fair value through other comprehensive income, and non-financial assets such as land and buildings and gold holdings, at fair value at each balance sheet date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- In the principal market for the asset or liability

Or

- In the absence of a principal market, in the most advantageous market for the asset or liability
- The principal or the most advantageous market must be accessible by the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

External valuers are involved for valuation of land and buildings. Involvement of external valuers is determined after every three years. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Valuers are normally rotated every three years.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy, as explained above.

Fair-value related disclosures for financial instruments and non-financial assets that are measured at fair value or where fair values are disclosed, are summarised in the following notes:

- Disclosures for valuation methods, significant estimates and assumptions Notes 3, 15, 17(b), 18(b) and 31

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- Quantitative disclosures of fair value measurement hierarchy Note 31
- Debt instruments at fair value through other comprehensive income Note 15
- Gold holdings Note 17(b)
- Land and buildings Note 18(b)

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

The measurement of impairment losses under IFRS 9 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

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

- 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 30(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 8, 11, 13, 14, 17 and 30(i).

Post-retirement benefits

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 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 31 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(b) and 31 for additional disclosures.

Policy applicable after 1 July 2019

Leases - Estimating the incremental borrowing rate

The Bank cannot readily determine the interest rate implicit in the lease, therefore, it uses its incremental borrowing rate (IBR) to measure lease liabilities. The IBR is the rate of interest that the Bank would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Bank 'would have to pay'.

The Bank estimates the IBR using observable inputs i.e. market interest rates.

Determining the lease term of contracts with renewal and termination options – Group as lessee

The Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

4. INTEREST INCOME

	2020 KShs' million	2019 KShs' million
Interest income calculated using the effective interest method		
Financial assets – debt instruments at amortised cost	11,587	15,768
Financial assets at fair value through other comprehensive income	<u>10,721</u>	<u>7,579</u>
	<u>22,308</u>	<u>23,347</u>
Interest income from debt instruments at amortised cost		
Interest on term deposits	4,856	8,048
Interest on Government of Kenya loan	666	695
Interest on Government of Kenya overdraft	3,245	2,523
Interest on staff loans and advances	104	104
Interest on advances to banks	2,142	3,373
Other interest income*	<u>574</u>	<u>1,025</u>
	<u>11,587</u>	<u>15,768</u>
Interest income from debt instruments at fair value through other comprehensive income comprises:		
Internally managed portfolio	10,093	6,938
Externally managed portfolio – RAMP	<u>628</u>	<u>641</u>
	<u>10,721</u>	<u>7,579</u>

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

Interest from debt instruments at fair value through other comprehensive income went up by KShs 3,142 million and interest on term deposit went down by KShs 3,192 million due to an alignment of securities given market operating conditions.

Overall, total interest income declined by KShs 1,039 million due to drop in interest rates offered on term deposits, lower volume of term deposits and lower rates of interest on fixed income securities as a consequence of COVID-19 global disruptions.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

5. INTEREST EXPENSE

	2020 KShs' million	2019 KShs' million
Interest expense calculated using the effective interest method		
Interest on monetary policy issues – investments by banks	4,355	1,089
Interest expense – IMF	<u>263</u>	<u>403</u>
	<u>4,618</u>	<u>1,492</u>

6. (a) FEES AND COMMISSION INCOME

Fees and commission relate to income the Bank earns from the Government of Kenya through its agency role in the issuance of Treasury bills and bonds.

	2020 KShs' million	2019 KShs' million
(b) NET TRADING INCOME		
Net gain on sale of foreign exchange currencies	7,437	8,933
Net gain on disposal of financial assets at fair value through other comprehensive income	<u>4,316</u>	<u>1,166</u>
	<u>11,753</u>	<u>10,099</u>

Net trading income increased by KShs 1,654 million to KShs 11,753 million (2019: Increased by KShs 5,854 million to KShs 10,099 million) following sale and maturity of debt instruments at fair value through other comprehensive income.

7. (a) OTHER INCOME

	2020 KShs' million	2019 KShs' million
Licence fees from commercial banks and foreign exchange bureaus	291	281
Penalties from commercial banks and foreign exchange bureaus	36	420
Rental income	57	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	271	371
Gain on disposal of property and equipment	-	10
KEPSS Billing revenue	301	280
Miscellaneous income	<u>26</u>	<u>7</u>
	<u>982</u>	<u>1,371</u>
(b) DEMONETIZATION OF OLD CURRENCY	<u>7,388</u>	<u>-</u>

This amount relates to 7,388,000 pieces of older series of KShs 1,000 note that were not returned on conclusion of demonetisation exercise on 30 September 2019.

8. CREDIT LOSS EXPENSE

The table below shows the ECL charges on financial instruments:

Impairment losses on staff loans (Note 14)	3	12
Impairment losses on balances due from banking institutions (Note 11)	87	(49)
Impairment losses on securities and advances to banks (Note 13)	(8,700)	(2,326)
Impairment losses on debt instruments at fair value through other comprehensive income	<u>(17)</u>	<u>(2)</u>
	<u>(8,627)</u>	<u>(2,365)</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

9. (a) OPERATING EXPENSES

	2020 KShs' million	2019 KShs' million
Employee benefits (Note 9(b))	5,121	4,570
Currency production expenses	3,047	2,214
Property maintenance and utility expenses	1,910	1,602
Depreciation of property and equipment (Note 18(b))	1,695	1,246
Amortisation of intangible assets (Note 19)	159	134
Amortization of right -of -use asset (Note 18(a))	133	-
Interest on leases liabilities	21	-
Provision for impairment loss on other assets (Note 17(a))	17	16
Auditor's remuneration	11	11
Transport and travelling	197	229
Office expenses	216	303
Postal service expense	208	214
Legal and professional fees	500	517
Loss on disposal of property and equipment	18	-
Other administrative expenses	<u>1,878</u>	<u>1,888</u>
	<u>15,131</u>	<u>12,944</u>

(b) EMPLOYEE BENEFITS

Wages and salaries	4,181	4,036
Pension costs – Defined contribution plan	421	388
Medical expenses	342	330
Other staff costs	291	313
Directors' emoluments (Note 29(ii))	60	79
Net income relating to the retirement benefit asset (Note 20)	<u>(174)</u>	<u>(576)</u>
	<u>5,121</u>	<u>4,570</u>

10. (a) CHANGES IN FAIR VALUE OF INVESTMENTS

Fair value changes on debt instruments at fair value through other comprehensive income:

Internally managed portfolio	8,183	6,468
Externally managed portfolio – RAMP	<u>269</u>	<u>537</u>
	<u>8,452</u>	<u>7,005</u>

(b) RECLASSIFICATION TO THE INCOME STATEMENT

Net amount reclassified to the income statement on sale and maturity of debt instruments at FVOCI:

Internally managed portfolio	2,680	-
Externally managed portfolio – RAMP	<u>340</u>	<u>-</u>
	<u>3,020</u>	<u>-</u>

This amount relates to reclassification on sale or maturity of debt instruments.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

11. BALANCES DUE FROM BANKING INSTITUTIONS

	2020	2019
	KShs' million	KShs' million
Current accounts	39,341	67,162
Foreign currency denominated term deposits	243,473	354,329
Accrued interest on term deposits	60	743
Special project accounts	57,520	95,282
Domestic foreign currency cheque clearing	28,426	25,107
Repss clearing and regional central banks	<u>713</u>	<u>341</u>
	369,533	542,964
Allowance for impairment losses	<u>(28)</u>	<u>(115)</u>
	<u>369,505</u>	<u>542,849</u>

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

	2020	2019
	KShs' million	KShs' million
At the beginning of the year	115	-
IFRS 9 adjustment on 1 July 2018	-	66
Charge to the profit or loss (Note 8)	<u>(87)</u>	<u>49</u>
At 30 June	<u>28</u>	<u>115</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 30 (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 24).

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

	2020	2020	2019	2019
	SDR million	KShs' million	SDR million	KShs' million
(a) Assets				
IMF balances (SDR asset account)	<u>22</u>	<u>3,255</u>	<u>8</u>	<u>1,008</u>
(b) Liabilities				
International Monetary Fund Account No. 1	20	2,886	20	2,766
International Monetary Fund Account No. 2	-	4	-	12
International Monetary Fund – PRGF Account	<u>212</u>	<u>31,124</u>	<u>310</u>	<u>43,990</u>
Rapid Credit Facility	543	79,702	-	-
IMF - SDR Allocation account	<u>260</u>	<u>38,125</u>	<u>260</u>	<u>36,885</u>
	<u>1,035</u>	<u>151,841</u>	<u>590</u>	<u>83,653</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

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

The Bank received SDR 542.8 Million from the Fund for direct budget support of the Government of Kenya initiatives towards COVID-19 pandemic. These funds were released to the Bank under Rapid Credit facility (RCF) and represent a debt due from the Government of Kenya to the IMF. This debt is recognised in the books of the CBK, but on-lent to the government through the National Treasury.

Kenya's quota in IMF of SDR 542.8 million (2019: 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 (2019: 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. The Rapid Credit Facility will be paid within a period of ten years from November 2025 to May 2030.

13. SECURITIES AND ADVANCES TO BANKS

	2020 KShs' million	2019 KShs' million
Treasury bonds discounted	7,513	8,454
Treasury bills discounted	116	2,524
Accrued interest bonds discounted	241	257
Repo treasury bills (Injection)	21,041	20,100
Accrued interest repo	214	46
Liquidity support framework	36,949	37,110
Due from commercial banks	<u>1,187</u>	<u>1,418</u>
	67,261	69,909
Allowance for impairment losses	<u>(11,700)</u>	<u>(3,000)</u>
	<u>55,561</u>	<u>66,909</u>

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

	2020 KShs' million	2019 KShs' million
At 1 July	3,000	-
IFRS 9 adjustment on 1 July 2018	-	674
Charge to profit or loss (Note 8)	<u>8,700</u>	<u>2,326</u>
At 30 June	<u>11,700</u>	<u>3,000</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 30 (i).

The carrying amount of securities and advances to banks has reduced by KShs 11,348 million due to liquidity needs in the market.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

13. SECURITIES AND ADVANCES TO BANKS (continued)

Year ended 30 June 2020

	Maturity period			Total
	0-3 months	4-12 months	Over 1 year	
	KShs' million	KShs' million	KShs' million	KShs' million
Treasury bills discounted	46	70	-	116
Treasury bonds discounted	-	281	7,232	7,513
Accrued interest bonds discounted	39	202	-	241
Repo treasury bills & bonds (Injection)	21,041	-	-	21,041
Accrued interest repo	214	-	-	214
Due from commercial banks	1,187	-	-	1,187
Liquidity support framework	-	-	25,249	25,249
	<u>22,527</u>	<u>553</u>	<u>32,481</u>	<u>55,561</u>

Year ended 30 June 2019

	Maturity period			Total
	0-3 months	4-12 months	Over 1 year	
	KShs' million	KShs' million	KShs' million	KShs' million
Treasury bills discounted	569	1,955	-	2,524
Treasury bonds discounted	911	100	7,433	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>34,110</u>
	<u>57,154</u>	<u>2,312</u>	<u>7,443</u>	<u>66,909</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

14. LOANS AND ADVANCES

	2020 KShs' million	2019 KShs' million
Due from banks under liquidation	3,400	3,400
Advances to employees	<u>3,327</u>	<u>3,419</u>
	6,727	6,819
Allowance for impairment losses	<u>(3,453)</u>	<u>(3,456)</u>
Net advances	<u>3,274</u>	<u>3,363</u>
The movement in the allowance for impairment losses is as follows:		
At 1 July	3,456	3,503
Reversal of impairment losses on adoption of IFRS 9 on 1 July 2018	-	(35)
Reversal of impairment allowance (Note 8)	<u>(3)</u>	<u>(12)</u>
At 30 June	<u>3,453</u>	<u>3,456</u>

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

	2020 KShs' million	2019 KShs' million
Fixed income securities – Internally managed portfolio	690,431	471,929
Fixed income securities under World Bank RAMP	<u>34,461</u>	<u>32,604</u>
	<u>724,892</u>	<u>504,533</u>

Maturity analysis

	Maturity period			Total
Year ended 30 June 2020	0-3 months KShs' million	4-12 months KShs' million	Over 1 year KShs' million	KShs' million
Fixed income securities – Internally managed Portfolio	57,638	375,418	257,375	690,431
Fixed income securities under World Bank RAMP	<u>1,484</u>	<u>10,104</u>	<u>22,873</u>	<u>34,461</u>
	<u>59,122</u>	<u>385,522</u>	<u>280,248</u>	<u>724,892</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

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

Maturity analysis

At 30 June 2019	Maturity period			Total KShs' million
	0-3 months KShs' million	4-12 months KShs' million	Over 1 year KShs' million	
Fixed income securities – Internally managed Portfolio	27,453	130,798	313,678	471,929
Fixed income securities under World Bank RAMP	<u>1,377</u>	<u>8,982</u>	<u>22,245</u>	<u>32,604</u>
	<u>28,830</u>	<u>139,780</u>	<u>335,923</u>	<u>504,533</u>

Fixed income securities increased by KShs 220,359 million to KShs 724,892 million (2019: KShs 504,533 million) mainly due to a shift in investment strategy from money markets to fixed income securities during the year under review.

16. UNLISTED EQUITY INVESTMENTS

	2020 KShs' million	2019 KShs' million
Unquoted equity securities at fair value through other comprehensive income	<u>10</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 (2019: 24) SWIFT shares at 30 June 2020.

17. (a) OTHER ASSETS

	2020 KShs' million	2019 KShs' million
Prepayments	1,930	2,686
Deferred currency expenses	2,933	2,165
Sundry debtors	5,462	5,275
Items in the course of collection	211	467
Uncleared effects	<u>21</u>	<u>36</u>

	10,557	10,629
Allowance for impairment losses	<u>(4,962)</u>	<u>(4,945)</u>

	<u>5,595</u>	<u>5,684</u>
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All other assets balances are recoverable within one year.

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

At 1 July	4,945	4,929
Increase in impairment allowance (Note 9(a))	<u>17</u>	<u>16</u>
At 30 June	<u>4,962</u>	<u>4,945</u>

(b) GOLD HOLDINGS

Gold holdings	<u>106</u>	<u>81</u>
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Movements in gold holdings are due to mark to market movements.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

18. (a.) RIGHT OF USE ASSETS

Year ended 30 June 2020	Leases relating to buildings KShs' million	Leases relating to equipment KShs' million	Total KShs' million
COST			
Effect of adoption of IFRS 16 on 1 July 2019 (Note 2(b))	148	204	352
Additions	<u>3</u>	<u>-</u>	<u>3</u>
At 30 June 2020	<u>151</u>	<u>204</u>	<u>355</u>
ACCUMULATED DEPRECIATION			
At 1 July 2019	-	-	-
Charge for the year	<u>62</u>	<u>71</u>	<u>133</u>
At 30 June 2020	<u>62</u>	<u>71</u>	<u>133</u>
NET CARRYING AMOUNT			
At 30 June 2020	<u>89</u>	<u>133</u>	<u>222</u>

Set out below are the carrying amounts of lease liabilities (included under 'Other liabilities' in Note 25) and the movements during the period:

	KShs' million
At 1 July 2019 – effect of adoption of IFRS 16 (Note 2(b))	350
Additions	3
Accretion of interest	21
Payment of principal	(158)
Payment of interest	<u>(7)</u>
At 30 June 2020	<u>209</u>

The maturity analysis of lease liabilities is disclosed in Note 30. The following are the amounts recognised in profit or loss:

	2020 KShs 'million
Depreciation expense for right-of-use assets	133
Interest expense on lease liabilities	21
Expense relating to short-term leases (included in Other administrative expenses)	<u>5</u>
Total amount recognised in profit or loss	<u>159</u>

The Bank had total cash outflows for leases of KShs 165 million during the year. No impairment loss or reversals of impairment loss has been recognized in profit or loss during the period.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

18. (b) PROPERTY AND EQUIPMENT

Year ended 30 June 2020	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
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AT COST OR VALUATION

At 1 July 2019	12,820	4,913	8,579	459	8,381	35,152
Additions	-	497	846	5	2,046	3,394
Capitalization of work in progress	6,462	-	(6,462)	-	-	-
Disposal	-	-	-	(33)	(1,287)	(1,320)
At 30 June 2020	<u>19,282</u>	<u>5,410</u>	<u>2,963</u>	<u>431</u>	<u>9,140</u>	<u>37,226</u>

DEPRECIATION

At 1 July 2019	451	114	-	390	4,196	5,151
Charge for the year	477	113	-	28	1,077	1,695
Disposals	-	-	-	(33)	(1,205)	(1,238)
At 30 June 2020	<u>928</u>	<u>227</u>	<u>-</u>	<u>385</u>	<u>4,068</u>	<u>5,608</u>

NET CARRYING AMOUNT

At 30 June 2020	<u>18,354</u>	<u>5,183</u>	<u>2,963</u>	<u>46</u>	<u>5,072</u>	<u>31,618</u>
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Work in progress relates to integrated security management system and office modernisation Phase III at Head Office.

Land and building were revalued in 31 May 2018 by Lloyd Masika Limited, registered valuers, who has experience in valuing similar properties. Land was revalued on the basis of open market value, while building was valued on the basis of depreciated replacement cost.

The directors believe the carrying values reflect the fair value as at 30 June 2020, after considering the actual market state and circumstances as of the reporting date.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

18. (b) PROPERTY AND EQUIPMENT (continued)

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
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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>
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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.

Land and building were revalued in 31 May 2018 by Lloyd Masika Limited, registered valuers, who has experience in valuing similar properties. Land was revalued on the basis of open market value, while building was valued on the basis of depreciated replacement cost.

The directors believe the carrying values reflect the fair value as at 30 June 2019, after considering the actual market state and circumstances as of the reporting date.

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)).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

18. (b) PROPERTY AND EQUIPMENT (continued)

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

- The Bank's residential properties are all owner-occupied. 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 2020			
COST			
At 1 July 2019	2,415	208	2,623
Additions	<u>13</u>	<u>533</u>	<u>546</u>
At 30 June 2020	<u>2,428</u>	<u>741</u>	<u>3,169</u>
ACCUMULATED AMORTISATION			
At 1 July 2019	1,786	-	1,786
Charge for the year	<u>159</u>	<u>-</u>	<u>159</u>
At 30 June 2020	<u>1,945</u>	<u>-</u>	<u>1,945</u>
NET CARRYING AMOUNT			
At 30 June 2020	<u>483</u>	<u>741</u>	<u>1,224</u>
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>

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

20. RETIREMENT BENEFIT ASSET

	2020 KShs' million	2019 KShs' million
Present value of funded obligations	17,910	16,423
Fair value of plan assets	<u>(30,270)</u>	<u>(30,640)</u>
Net overfunding in funded plan	(12,360)	(14,217)
Limit on defined benefit asset	<u>5,823</u>	<u>9,889</u>
Asset in the statement of financial position	<u>(6,537)</u>	<u>(4,328)</u>
Movements in the net defined benefit asset recognised are as follows:		
At 1 July	4,328	6,584
Net income recognised in profit or loss (Note 9(b))	174	576
Net expense recognized in other comprehensive income (OCI)	1,949	(2,928)
Employer contributions	<u>86</u>	<u>96</u>
At 30 June	<u>6,537</u>	<u>4,328</u>
Movements in the plan assets are as follows:		
At 1 July	30,640	30,279
Interest income on plan assets	3,847	3,950
Employer contributions	86	96
Employee contributions	<u>43</u>	<u>48</u>
Benefits expenses paid	(1,601)	(1,299)
Return on plan assets excluding amount in interest income	(2,659)	(2,434)
Prior year adjustments	<u>(86)</u>	<u>-</u>
At 30 June	<u>30,270</u>	<u>30,640</u>
Movements in the plan benefit obligation are as follows:		
At 1 July	16,423	14,551
Current service cost net of employees' contributions	275	274
Interest cost	2,036	1,884
Employee contributions	43	48
Actuarial loss due to demographic assumptions	11	-
Actuarial (gain)/loss due to participants' movement	(1,004)	381
Actuarial loss due to change in financial assumptions	1,727	584
Benefits paid	<u>(1,601)</u>	<u>(1,299)</u>
At 30 June	<u>17,910</u>	<u>16,423</u>
The principal actuarial assumptions at the reporting date were:		
Discount rate (p.a.)	11.50%	12.90%
Salary increase (p.a.)	7.00%	7.00%
Future pension increases	<u>3.00%</u>	<u>3.00%</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

20. RETIREMENT BENEFIT ASSET (continued)	2020	2019	2018	2017	2016
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
Five-year summary					
Fair value of plan assets	30,270	30,640	30,279	28,464	27,161
Present value of funded obligations	(17,910)	(16,423)	(14,551)	(13,440)	(17,623)
Adjustment to retirement benefit asset	<u>(5,823)</u>	<u>(9,889)</u>	<u>(9,144)</u>	<u>(6,827)</u>	<u>(1,762)</u>
Net retirement benefit asset	<u>6,537</u>	<u>4,328</u>	<u>6,584</u>	<u>8,197</u>	<u>7,776</u>

Plan assets are distributed as follows:

	2020		2019	
	KShs' million	%	KShs' million	%
Quoted shares	5,684	18.8%	6,992	22.8%
Investment properties	8,358	27.6%	7,573	24.7%
Government of Kenya treasury bills and bonds	14,667	48.5%	13,670	44.6%
Commercial paper and corporate bonds	219	0.7%	874	2.9%
Offshore investments	133	0.4%	109	0.4%
Fixed and term deposits	1,114	3.7%	1,107	3.6%
Fixed assets	1	-	1	-
Net current assets	<u>94</u>	<u>0.3%</u>	<u>314</u>	<u>1.0%</u>
	<u>30,270</u>	<u>100%</u>	<u>30,640</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 19,361 million (increase by KShs 1,451 million). This sensitivity analysis has been determined based on reasonably possible changes of the assumption occurring at the end of 30 June 2020, 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 on 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 7.0 years (2019: 9.9 years). The Bank expects to pay KShs 133 million to its defined benefit plan in financial year ended 30 June 2021.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

21. (a) IMF On-Lent to GOK

	2020	2019
	KShs' million	KShs' million
	<u>79,702</u>	<u>-</u>

The balance as at 30 June 2020 relates to IMF on-lent funds disbursed to the Government of Kenya by the International Monetary Fund (IMF) amounting SDR 542.8 million under Rapid Credit Facility to mitigate the impact of COVID-19 pandemic. The On-Lent to GOK will be paid half-yearly within a period of ten years from November 2025 to May 2030.

21. (b) DUE FROM GOVERNMENT OF KENYA

	2020	2019
	KShs' million	KShs' million
Overdraft	47,150	57,327
Government loan	<u>21,783</u>	<u>22,229</u>
	<u>68,933</u>	<u>79,556</u>

Movement in the government loan is as follows:

At 1 July	22,229	23,339
Principal repayment	(555)	(1,110)
Interest charged	666	665
Interest paid	<u>(557)</u>	<u>(665)</u>
At 30 June	<u>21,783</u>	<u>22,229</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 2020 is KShs 68,495 million (2019: KShs 65,716 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 7%.

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 are paid half yearly while interests accruing are paid monthly.

	2020	2019
	KShs' million	KShs' million
Kenya bank notes	248,373	240,264
Kenya coins	<u>9,419</u>	<u>9,245</u>
	<u>257,792</u>	<u>249,509</u>
Movement in the account was as follows:		
At 1 July	249,509	262,439
Deposits by commercial banks	(571,022)	(548,258)
Withdrawals by commercial banks	586,732	535,349
(Deposits)/withdrawals by CBK	(39)	(21)
Demonetization of old currency	<u>(7,388)</u>	<u>-</u>
At 30 June	<u>257,792</u>	<u>249,509</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

23. INVESTMENT BY BANKS

	2020 KShs' million	2019 KShs' million
REPO securities sold to banks	<u>6,997</u>	<u>-</u>

The balance on 30 June 2020 relates to repurchase agreements contracted by the Bank to address excess liquidity and matures within a short period of between 7 to 14 days.

	2020 KShs' million	2019 KShs' million
24. DEPOSITS FROM BANKS AND GOVERNMENT		
Local commercial banks clearing accounts and cash ratio reserve	352,490	270,262
Local banks foreign exchange settlement accounts	25,824	24,511
External banks foreign exchange settlement accounts	2,620	183
Other public entities and project accounts	69,830	108,595
Government of Kenya	<u>281,423</u>	<u>337,449</u>
	<u>732,187</u>	<u>741,000</u>

25. OTHER LIABILITIES

Impersonal accounts	1,412	2,587
Sundry creditors	3,489	3,513
Lease liability (Note 18(a))	209	-
Refundable deposits	233	224
Leave accrual	235	177
Gratuity to staff members	<u>24</u>	<u>20</u>
	<u>5,602</u>	<u>6,521</u>

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

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

26	(a) SHARE CAPITAL	2020 KShs' million	2019 KShs' million
	Authorised share capital:		
	At 1 July	50,000	5,000
	Additional share capital	<u>-</u>	<u>45,000</u>
	At 30 June	<u>50,000</u>	<u>50,000</u>
	Paid up share capital:		
	At 1 July	20,000	5,000
	Additional share capital	<u>15,000</u>	<u>15,000</u>
	At 30 June	<u>35,000</u>	<u>20,000</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 paid up share capital from KShs 20 billion to KShs 35 billion. The increase was paid up from the general reserve fund.

(b) GENERAL RESERVE FUND

The general reserve fund represents accumulated surpluses arising from normal operations of the Bank and unrealized gains on exchange rate fluctuations.

(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.

Movement in the consolidated fund is as follows:

	2020 KShs' million	2019 KShs' million
At 1 July	4,000	800
Transfer from General reserve	9,888	4,000
Payments out of consolidated fund	<u>(11,388)</u>	<u>(800)</u>
At 30 June	<u>2,500</u>	<u>4,000</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

27. CASH (USED IN)/ GENERATED FROM OPERATIONS

	2020 KShs' million	2019 KShs' million
Surplus for the year	41,530	26,138
Adjustments for:		
Depreciation of property and equipment (Note 18(b))	1,695	1,246
Amortisation of intangible assets (Note 19)	159	134
Amortisation of right-of-use assets (Note 18(a))	133	-
Gain on disposal of property and equipment (Note 7)	-	(10)
Loss on disposal of property and equipment (Note 9(a))	18	
Credit loss expense on financial assets	8,714	2,082
Net interest income	(17,690)	(21,855)
Interest on lease liability (Note 9(a))	21	-
Provision for impairment loss on other assets (Note 9(a))	17	16
Net credit relating to the retirement benefit asset (Note 20)	(174)	(576)
Employer contributions on defined benefit asset (Note 20)	(86)	(96)
Demonetization of old currency (Note 7(b))	(7,388)	-
Reclassification from fair value reserve (Note 10(b))	(3,020)	-
Unrealised foreign exchange loss/(gain) on due to IMF	<u>120</u>	<u>(16)</u>
Operating surplus before working capital changes	24,049	7,063
Changes in working capital:		
Loans and advances	92	(731)
Other assets	70	(2,398)
Due from Government of Kenya	10,623	632
Currency in circulation	15,671	(12,930)
Deposits	(8,813)	156,713
Investment by banks	6,997	-
IMF on lend	(79,702)	-
Gold holdings	(25)	(10)
Consolidated fund (Note 26(e))	(11,388)	(800)
Other liabilities	<u>(1,129)</u>	<u>(598)</u>
Net cash (used in)/generated from operations	<u>(43,555)</u>	<u>146,941</u>

28. CASH AND CASH EQUIVALENTS

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

	2020 KShs' million	2019 KShs' million
Balances due from banking institutions (Note 11)	369,505	542,849
Financial assets – FVOCI (Note 15)	59,122	28,830
Securities discounted by banks and other advances (Note 13)	<u>22,527</u>	<u>57,154</u>
	<u>451,154</u>	<u>628,833</u>
(b) Changes in liabilities arising from financing activities		
At 1 July	83,653	100,284
Cash flow items:		
Repayments to IMF	(11,634)	(16,615)
Receipts during the year	79,702	-
Foreign exchange changes	<u>120</u>	<u>(16)</u>
At 30 June	<u>151,841</u>	<u>83,653</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

29. RELATED PARTY TRANSACTIONS

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya (the ultimate owner of the Bank).

The main transactions are ordinary banking facilities to government ministries included in Note 24 and lending to the Government of Kenya included in Note 21.

(i) Loans

The Bank extends loan facilities to the key management staff. 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 2020 are disclosed in Note 14. Collateral information is disclosed in Note 30. The repayment terms of the loans are between 2 years and 20 years.

	2020	2019
Loans to key management staff	KShs' million	KShs' million
At 1 July	50	75
Loans advanced during the year	23	12
Loan repayments	<u>(21)</u>	<u>(37)</u>
At 30 June	<u>52</u>	<u>50</u>
(ii) Directors' emoluments:		
Fees to non-executive directors	18	22
Directors' travelling expenses	8	24
Other remuneration to executive directors	<u>34</u>	<u>33</u>
	<u>60</u>	<u>79</u>
(iii) Remuneration to senior management	<u>240</u>	<u>185</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(b))	68,933	79,556
Government of Kenya Deposits (Note 24)	281,423	337,449
IMF On-lent to GOK (Note 21(a))	79,702	-
Interest earned from Government of Kenya – Loan (Note 4)	666	695
Interest earned from Government of Kenya - Overdraft (Note 4)	3,245	2,523
Fees and commission income (Note 6(a))	3,000	3,000
Loan principal repayment (Note 21(b))	<u>555</u>	<u>1,110</u>

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

29. RELATED PARTY TRANSACTIONS (continued)

(vi) Kenya School of Monetary Studies (KSMS)

The Kenya School of Monetary Studies (the “School”) is a subsidiary of the Bank. It 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 transactions and balances		
Grants from CBK	468	471
Buildings	8,780	2,317
Land	4,250	4,250
Receivable from KSMS	59	59
Accumulated deficit	<u>62</u>	<u>62</u>

(vii) 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.

30. 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 Internal Audit and Risk Management 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.

(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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

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

(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 balances due from banking institutions, funds held with IMF, securities and advances to banks, IMF On-Lent to GOK, loans and advances, debt instruments at fair value through other comprehensive income, other assets (sundry debtors) and due from Government of Kenya.

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 2020 and 30 June 2019.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

	2020 KShs' million	2019 KShs' million
Balances due from banking institutions	369,505	542,849
Funds held with International Monetary Fund (IMF)	3,255	1,008
Securities and advances to banks	55,561	66,909
IMF On-Lent to GOK	79,702	-
Loans and advances	3,274	3,363
Debt instruments at fair value through other comprehensive income	724,892	504,533
Other assets – sundry debtors	500	330
Due from Government of Kenya	<u>68,933</u>	<u>79,556</u>
	<u>1,305,622</u>	<u>1,198,548</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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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 debt instruments at FVOCI. 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(f). The credit ratings show the best-two rating amongst Standard & Poor's, Moody's and Fitch.

	Stage 1 KShs' million	Stage 2 KShs' million	Stage 3 KShs' million	Total KShs' million
Balance due from banking institutions				
Rated AAA	36,248	-	-	36,248
Rated AA- to AA+	146,509	-	-	146,509
Rated A- to A+	109,007	-	-	109,007
Rated BBB – BB	807	-	-	807
Unrated	<u>76,962</u>	-	-	<u>76,962</u>
Gross carrying amount	369,533	-	-	369,533
Impairment allowance	<u>(28)</u>	-	-	<u>(28)</u>
Net carrying amount	<u>369,505</u>	-	-	<u>369,505</u>
Debt instruments at fair value through OCI				
Rated AAA	715,417	-	-	715,417
Rated AA- to AA+	<u>9,475</u>	-	-	<u>9,475</u>
Carrying amount	<u>724,892</u>	-	-	<u>724,892</u>
Due from Government of Kenya				
Unrated	<u>68,933</u>	-	-	<u>68,933</u>
Funds with IMF				
Unrated	<u>3,255</u>	-	-	<u>3,255</u>
IMF On-Lent to GOK				
Unrated	<u>79,702</u>	-	-	<u>79,702</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)
Year ended 30 June 2020

	Stage 1 KShs' million	Stage 2 KShs' million	Stage 3 KShs' million	Total KShs' million
Securities and advances to banks				
Unrated	<u>65,114</u>	<u>-</u>	<u>2,147</u>	<u>67,261</u>
Gross carrying amount	65,114		2,147	67,261
Impairment allowance	<u>(9,553)</u>	<u>-</u>	<u>(2,147)</u>	<u>(11,700)</u>
Net carrying amount	<u>55,561</u>	<u>-</u>	<u>-</u>	<u>55,561</u>
Loans and advances				
Unrated	<u>3,166</u>	<u>11</u>	<u>3,550</u>	<u>6,727</u>
Gross carrying amount	3,166	11	3,550	6,727
Impairment allowance	<u>(3)</u>	<u>-</u>	<u>(3,450)</u>	<u>(3,453)</u>
Net carrying amount	<u>3,163</u>	<u>11</u>	<u>100</u>	<u>3,274</u>
Other assets				
Unrated	<u>-</u>	<u>-</u>	<u>5,462</u>	<u>5,462</u>
Gross carrying amount	-	-	5,462	5,462
Impairment allowance	<u>-</u>	<u>-</u>	<u>(4,962)</u>	<u>(4,962)</u>
Net carrying amount	<u>-</u>	<u>-</u>	<u>500</u>	<u>500</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Year ended 30 June 2019

	Stage 1 KShs' million	Stage 2 KShs' million	Stage 3 KShs' million	Total KShs' million
Balance due from financial institutions				
Rated AAA	2	-	-	2
Rated AA- to AA+	248,830	-	-	248,830
Rated A- to A+	175,335	-	-	175,335
No Rating	<u>118,797</u>	<u>-</u>	<u>-</u>	<u>118,797</u>
Gross carrying amount	542,964	-	-	542,964
Impairment allowance	<u>(115)</u>	<u>-</u>	<u>-</u>	<u>(115)</u>
Net carrying amount	<u>542,849</u>	<u>=</u>	<u>=</u>	<u>542,849</u>
Debt instruments at fair value through OCI				
Rated AAA	496,925	-	-	496,925
Rated AA- to AA+	7,608	-	-	7,608
Carrying amount	504,533	-	-	504,533
Due from Government of Kenya				
Unrated	79,556	-	-	79,556
Funds with IMF				
Unrated	1,008	-	-	1,008
Securities and advances to banks				
Unrated	68,698	-	1,211	69,909
Gross carrying amount	<u>68,698</u>	<u>=</u>	<u>1,211</u>	<u>69,909</u>
Impairment allowance	<u>(2,092)</u>	<u>=</u>	<u>(908)</u>	<u>(3,000)</u>
Net carrying amount	<u>66,606</u>	<u>=</u>	<u>303</u>	<u>66,909</u>
Loans and advances				
Unrated	<u>3,237</u>	<u>25</u>	<u>3,557</u>	<u>6,819</u>
Gross carrying amount	<u>3,237</u>	<u>25</u>	<u>3,557</u>	<u>6,819</u>
Impairment allowance	<u>(7)</u>	<u>=</u>	<u>(3,449)</u>	<u>(3,456)</u>
Net carrying amount	<u>3,230</u>	<u>25</u>	<u>108</u>	<u>3,363</u>
Other assets				
Unrated	<u>=</u>	<u>=</u>	<u>5,275</u>	<u>5,275</u>
Gross carrying amount	<u>=</u>	<u>=</u>	<u>5,275</u>	<u>5,275</u>
Impairment allowance	<u>=</u>	<u>=</u>	<u>(4,945)</u>	<u>(4,945)</u>
Net carrying amount	<u>=</u>	<u>=</u>	<u>330</u>	<u>330</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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 2020	30 June 2019	
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 2020, the Bank held advances to banks of KShs 22,228 million (2019: KShs 21,518 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 26,137 million (2019: KShs 26,268 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).

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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

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.

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. The Bloomberg PD includes the estimates of forward-looking parameters such as GDP, forex rates, and interest rates. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

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
- 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 decreases 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

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 realizing 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.

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

Incorporation of forward-looking information

In its ECL models, the Bank relies on Bloomberg credit risk model for provision of probabilities of default values for the both the investment counterparties and the sovereigns. The bank also relies on credit rating agencies (Standard & Poor's (S&P), Moody's, Fitch Group) for credit rating information. Credit ratings are a tool, among others, that investors can use when making decisions about purchasing bonds and other fixed income investments. They express independent opinions on creditworthiness, using a common terminology that may help investors make more informed investment decisions.

As part of their ratings analysis, the external credit agencies as well as the Bloomberg credit risk model evaluate current and historical information and assess the potential impact of a broad range of forward-looking information, such as:

- Industry specific risk and broad economic factors that may affect the business cycle. The market data category includes two inputs: share price/ market cap and price volatility.
- Key performance indicators such as effective short-term debt, long-term debt, T12M interest expense and for financial firms, interest coverage fields are replaced with factors that are meaningful for that type of firm, for instance, non-performing loans and loan loss reserves for banks.
- Economic, regulatory and geopolitical influences, management and corporate governance attributes as well as income and economic structure.

Additionally, for Sovereign or national government, the analysis may take into consideration:

- Deficit levels, foreign currency reserves, non-performing bank loans, GDP growth and a political risk indicator. Country financials are obtained from the World Bank, Eurostat and the IMF.
- Fiscal and Economic performance such as GDP growth, Revenue as a percentage of GDP,
- Monetary Stability which reflects the price behaviour in the business cycles.
- EIU Political risk score which addresses the sovereign's willingness to repay debt. Willingness to pay is a qualitative issue that distinguishes sovereigns from most other types of issuers.

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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

Measurement of ECL (continued)

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.

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	369,533	Bloomberg PD rating model	Basel II recovery studies
Debt instruments at fair value through other comprehensive income	724,892	Bloomberg PD rating model	Basel II recovery studies

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

Year ended 30 June 2020

Debt instruments at fair value through other comprehensive income	Stage 1 Gross carrying amount KShs' million	ECL KShs' million	Stage 2 Gross carrying amount KShs' million	ECL KShs' million	Stage 3 Gross carrying amount KShs' million	ECL KShs' million	Total Gross carrying amount KShs' million	ECL KShs' million
At 1 July 2019	504,533	61	-	-	-	-	504,533	61
New assets originated or purchased	556,932	45	-	-	-	-	556,932	45
Asset derecognized or repaid	(365,842)	(17)	-	-	-	-	(365,842)	(17)
Accrued interest	775	-	-	-	-	-	775	-
Realised gains	1,296	-	-	-	-	-	1,296	-
Foreign exchange adjustments	18,746	-	-	-	-	-	18,746	-
Changes in risk parameters	-	(11)	-	-	-	-	-	(11)
Fair value changes	8,452	-	-	-	-	-	8,452	-
At 30 June 2020	<u>724,892</u>	<u>78</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>724,892</u>	<u>78</u>
Balances due from banking institutions								
At 1 July 2019	542,964	115	-	-	-	-	542,964	115
Net movement during the year	<u>(173,431)</u>	<u>(87)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(173,431)</u>	<u>(87)</u>
At 30 June 2020	<u>369,533</u>	<u>28</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>369,533</u>	<u>28</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Year ended 30 June 2020

	Stage 1 Gross carrying amount KShs' million	ECL KShs' million	Stage 2 Gross carrying amount KShs' million	ECL KShs' million	Stage 3 Gross carrying amount KShs' million	ECL KShs' million	Total Gross carry- ing amount KShs' million	ECL KShs' million
Securities and advances to banks								
At 1 July 2019	68,698	2,092	-	-	1,211	908	69,909	3,000
New assets originated or purchased	199,313	-	-	-	-	-	199,313	-
Asset derecognized or repaid	(202,113)	-	-	-	-	-	(202,113)	-
Accrued interest	152	-	-	-	-	-	152	-
Transfer to Stage 3	(936)	-	-	-	936	-	-	-
Change in risk parameters	-	7,461	-	-	-	1,239	-	8,700
At 30 June 2020	<u>65,114</u>	<u>9,553</u>	<u>-</u>	<u>-</u>	<u>2,147</u>	<u>2,147</u>	<u>67,261</u>	<u>11,700</u>
Other assets								
At 1 July 2019	322	-	-	-	4,953	4,945	5,275	4,945
New assets originated or purchased	427	-	-	-	-	-	427	-
Asset derecognized or repaid	(240)	-	-	-	-	-	(240)	-
Transfer to Stage 3	(17)	-	-	-	17	17	-	17
At 30 June 2020	<u>492</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,970</u>	<u>4,962</u>	<u>5,462</u>	<u>4,962</u>
Loans and advances								
At 1 July 2019	3,237	7	25	-	3,557	3,449	6,819	3,456
New assets originated or purchased	812	1	-	-	-	-	812	1
Asset derecognized or repaid	(858)	(2)	(8)	-	(38)	-	(904)	(2)
Transfer to Stages	(19)	-	(6)	-	25	-	-	-
Changes in risk parameters	-	(2)	-	-	-	-	-	(2)
At 30 June 2020	<u>3,172</u>	<u>4</u>	<u>11</u>	<u>-</u>	<u>3,544</u>	<u>3,449</u>	<u>6,727</u>	<u>3,453</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

Year ended 30 June 2019

Debt instruments at fair value through other comprehensive income	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount	ECL	Gross carrying amount	ECL	Gross carrying amount	ECL	Gross carrying amount	ECL
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
At 1 July 2018	400,333	59	-	-	-	-	400,333	59
New assets originated or purchased	418,501	45	-	-	-	-	418,501	45
Asset derecognized or repaid	(328,580)	(36)	-	-	-	-	(328,580)	(36)
Accrued interest	778	-	-	-	-	-	778	-
Realised gains	1,166	-	-	-	-	-	1,166	-
Foreign exchange adjustments	5,330	-	-	-	-	-	5,330	-
Changes in risk parameters	-	(7)	-	-	-	-	-	(7)
Fair value changes	<u>7,005</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,005</u>	<u>-</u>
At 30 June 2019	<u>504,533</u>	<u>61</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>504,533</u>	<u>61</u>
Balances due from banking institutions								
At 1 July 2018	522,987	66	-	-	-	-	522,987	66
Net movement during the year	<u>19,977</u>	<u>49</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,977</u>	<u>49</u>
At 30 June 2019	<u>542,964</u>	<u>115</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>542,964</u>	<u>115</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

Year ended 30 June 2019

	Stage 1 Gross carrying amount KShs' million	ECL KShs' million	Stage 2 Gross carrying amount KShs' million	ECL KShs' million	Stage 3 Gross carrying amount KShs' million	ECL KShs' million	Total Gross carrying amount KShs' million	ECL KShs' million
Securities and advances to banks								
At 1 July 2018	37,609	3	-	-	894	671	38,503	674
New assets originated or purchased	529,744	2,326	-	-	-	-	529,744	2,326
Asset derecognized or repaid	(497,961)	-	-	-	(360)	-	(498,321)	-
Accrued interest	(17)	-	-	-	-	-	(17)	-
Transfer to Stage 3	(677)	(237)	-	-	677	237	-	-
At 30 June 2019	<u>68,698</u>	<u>2,092</u>	<u>-</u>	<u>-</u>	<u>1,211</u>	<u>908</u>	<u>69,909</u>	<u>3,000</u>
Other assets								
At 1 July 2018	960	-	-	-	4,937	4,929	5,897	4,929
New assets originated or purchased	46	-	-	-	-	-	46	-
Asset derecognized or repaid	(668)	-	-	-	-	-	(668)	-
Transfer to Stage 3	(16)	-	-	-	16	16	-	16
At 30 June 2019	<u>322</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,953</u>	<u>4,945</u>	<u>5,275</u>	<u>4,945</u>
Loans and advances								
At 1 July 2018	2,490	6	11	-	3,587	3,462	6,088	3,468
New assets originated or purchased	1,219	7	-	-	-	-	1,219	7
Asset derecognized or repaid	(455)	(6)	(3)	-	(30)	(13)	(488)	(19)
Transfer to Stages	(17)	-	17	-	-	-	-	-
At 30 June 2019	<u>3,237</u>	<u>7</u>	<u>25</u>	<u>-</u>	<u>3,557</u>	<u>3,449</u>	<u>6,819</u>	<u>3,456</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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	49,793	54,072	55,934	28,616	14,274	17,227	149,617	369,533
Funds held with IMF	3,255	-	-	-	-	-	-	3,255
IMF On-Lent to GOK	-	-	-	-	-	79,702	-	79,702
Securities and advances to banks	-	-	-	-	-	67,261	-	67,261
Loans and advances	-	-	-	-	-	6,727	-	6,727
Debt instruments at fair value through OCI	604,561	21,573	-	-	3,320	-	95,438	724,892
Other assets - Sundry debtors	-	-	-	-	-	5,462	-	5,462
Due from Government of Kenya	-	-	-	-	-	68,933	-	68,933
Total financial assets	657,609	75,645	55,934	28,616	17,594	245,312	245,055	1,325,765

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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 2019

	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	163,493	59,155	14,206	74,180	29,914	6,137	195,879	542,964
Funds held with IMF	1,008	-	-	-	-	-	-	1,008
Securities and advances to banks	-	-	-	-	-	69,909	-	69,909
Loans and advances	-	-	-	-	-	6,819	-	6,819
Financial assets at fair value through profit or loss	352,824	53,335	-	-	2,665	-	95,709	504,533
Other assets - Sundry debtors	-	-	-	-	-	5,275	-	5,275
Due from Government of Kenya	-	-	-	-	-	79,556	-	79,556
Total financial assets	517,325	112,490	14,206	74,180	32,579	167,696	291,588	1,210,064

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

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

Year ended 30 June 2020

	Balances due from financial institutions KShs' million	Securities and advances KShs' million	Fund held with IMF KShs' million	IMF-On Lent to GoK 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	37,054	-	-	-	-	-	-	-	37,054
Foreign Governments	-	-	-	-	-	614,959	-	-	614,959
Supranational Institutions	54,484	-	3,255	-	-	79,352	-	-	137,091
Commercial Banks	277,995	59,392	-	-	3,400	-	-	-	340,787
Foreign Agencies	-	-	-	-	-	30,581	-	-	30,581
Government of Kenya	-	7,869	-	79,702	-	-	68,933	-	156,504
Others	-	-	-	-	3,327	-	-	5,462	8,789
	<u>369,533</u>	<u>67,261</u>	<u>3,255</u>	<u>79,702</u>	<u>6,727</u>	<u>724,892</u>	<u>68,933</u>	<u>5,462</u>	<u>1,325,765</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

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

Year ended 30 June 2019

	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	425,049	58,674	-	3,400	-	-	-	487,123
Foreign Agencies	-	-	-	-	60,456	-	-	60,456
Government of Kenya	-	11,235	-	-	-	79,556	-	90,791
Others	-	-	-	3,419	-	-	5,275	8,694
	<u>542,964</u>	<u>69,909</u>	<u>1,008</u>	<u>6,819</u>	<u>504,533</u>	<u>79,556</u>	<u>5,275</u>	<u>1,210,064</u>

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. 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

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Bank's interest rate risk arises from balances due from banking institutions, securities and advances to banks, debt instruments at FVOCI, loans and advances, due from the Government of Kenya and deposits from bank and Government. 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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 2020	1 – 3 months KShs' million	4-12 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	369,533	-	-	-	-	369,533
Securities and advances to banks	59,477	552	2,471	4,761	-	67,261
Debt instruments at FVOCI	59,122	385,521	280,249	-	-	724,892
Funds held with International Monetary Fund (IMF)	-	-	-	-	3,255	3,255
Loans and advances	163	428	1,741	995	3,400	6,727
Other assets	-	-	-	-	5,462	5,462
IMF On-lent to GOK	-	-	-	-	79,702	79,702
Due from Government of Kenya	47,259	1,110	4,440	16,124	-	68,933
Total financial assets	535,554	387,611	288,901	21,880	91,819	1,325,765
Liabilities						
Deposits from banks and government	176,494	-	-	-	555,693	732,187
Other liabilities	-	-	-	-	5,343	5,343
Investment by banks	6,997	-	-	-	-	6,997
Due to International Monetary Fund (IMF)	-	-	-	-	151,841	151,841
Total financial liabilities	183,491	-	-	-	712,877	896,368
Interest sensitivity gap	352,063	387,611	288,901	21,880	(621,058)	429,397

As at 30 June 2020, increase of 10 basis points would have resulted in a decrease/increase in profit of KShs 429 million (2019: KShs 379 million).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk continued

Interest rate risk (continued)

At 30 June 2019	1 – 3 months KShs' million	4-12 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
Debt instruments at FVOCI	28,830	139,780	335,923	-	-	504,533
Funds held with International Monetary Fund (IMF)	-	-	-	-	1,008	1,008
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	104,965	1,210,064
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	(726,012)	379,087

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).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. 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 2020. Included in the table are the Bank's financial instruments categorised by currency.

At 30 June 2020	USD KShs' million	GBP KShs' million	EUR KShs' million	SDR KShs' million	Others KShs' million	Total KShs' million
Assets						
Balances due from banking institutions	150,714	24,093	33,791	-	160,935	369,533
Debt instruments at FVOCI	724,892	-	-	-	-	724,892
Funds held with International Monetary Fund (IMF)	-	-	-	3,255	-	3,255
Total financial assets	875,606	24,093	33,791	3,255	160,935	1,097,680
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	151,841	-	151,841
Deposits from banks and government	43,431	2,354	10,641	-	319	56,745
Total financial liabilities	43,431	2,354	10,641	151,841	319	208,586
Net position	832,175	21,739	23,150	(148,586)	160,616	889,094

NOTES TO THE FINANCIAL STATEMENTS (continued) FOR THE YEAR ENDED 30 JUNE 2020

30. 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 2019						
Assets						
Balances due from banking institutions	332,164	25,362	13,560	-	171,878	542,964
Financial assets at fair value	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

As at 30 June 2020, 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 41,609 million (2019: KShs 41,040 million)
- British Pound KShs 1,087 million (2019: KShs 1,153 million)
- Euro KShs 1,158 million (2019: KShs 363 million)
- SDR KShs 7,429million (2019: KShs 4,132million).

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(iii) Liquidity risk

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

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash 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	0 – 3 months	4-12 months	1 - 5 years	Over 5 years	Total
	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million	KShs' million
At 30 June 2020						
Investment by banks	-	6,997	-	-	-	6,997
Deposits from banks and govern- ment	555,693	176,494	-	-	-	732,187
Due to International Monetary Fund (IMF)	-	963	15,661	16,879	118,338	151,841
Lease liability	-	25	162	32	-	219
Other liabilities	-	-	5,343	-	-	5,343
Total financial liabilities	555,693	184,479	21,166	16,911	118,338	896,587
At 30 June 2019						
Deposits from banks and govern- ment	632,405	-	108,595	-	-	741,000
Due to International Monetary Fund (IMF)	-	1,542	15,158	66,953	-	83,653
Other liabilities	-	-	6,324	-	-	6,324
Total financial liabilities	632,405	1,542	130,077	66,953	-	830,977

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

31. 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:

	2020		2019	
	Carrying amount	Fair value	Carrying amount	Fair Value
	KShs' million	KShs' million	KShs' million	KShs' million
Financial assets				
Securities and advances to banks (rediscounted treasury bonds)	7,513	8,137	8,454	9,158
Loans and advances	3,274	2,218	3,363	2,377
Due from Government of Kenya	<u>68,933</u>	<u>62,992</u>	<u>79,556</u>	<u>71,419</u>
Financial liabilities				
Due to International Monetary Fund	<u>151,841</u>	<u>45,338</u>	<u>83,653</u>	<u>65,996</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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

31. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

b) Fair value hierarchy (continued)

Year ended 30 June 2020	Level 1 KShs' million	Level 2 KShs' million	Level 3 KShs' million
Assets measured at fair value:			
Property and equipment			
-Land and buildings	-	-	23,537
Debt instruments at fair value through other comprehensive income	724,892	-	-
Equity instruments at fair value through other comprehensive income	-	-	10
Gold holdings	<u>106</u>	<u>-</u>	<u>-</u>
Assets for which fair values are disclosed:			
Securities and advances to banks (rediscounted treasury bonds)	8,137	-	-
Loans and advances	-	2,218	-
Due from Government of Kenya	<u>-</u>	<u>62,992</u>	<u>-</u>
Liabilities for which fair values are disclosed:			
Due to International Monetary Fund	<u>-</u>	<u>45,338</u>	<u>-</u>
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>
There were no transfers between levels 1, 2 and 3 in the year.			

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

31. 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 Due from Government of Kenya	DCF	Interest rate	12%
Due to IMF	DCF	Interest rate	7%
	DCF	Interest rate	0.14%
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	12,369	6,462	(477)	18,354
Leasehold land and buildings	<u>4,799</u>	<u>497</u>	<u>(113)</u>	<u>5,183</u>
	<u>17,168</u>	<u>6,959</u>	<u>(590)</u>	<u>23,537</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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

32. 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.

At 30 June 2020, the Bank had capital commitments of KShs 5,610 million (2019: KShs 7,833 million) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

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

Operating leases – Bank as a lessor

The Bank has entered into operating leases on its land and buildings consisting of certain office buildings. These leases have terms of between one and 30 years. All leases include a clause to enable upward revision of the rental charge on an annual basis according to prevailing market conditions. The lessee is also required to provide a residual value guarantee on the properties. Rental income recognised by the Bank during the year is KShs 41 million (2019: KShs 2 million).

Future minimum rentals receivable under non-cancellable operating leases as at 30 June are as follows:

	2020 KShs' million	2019 KShs' million
Not later than 1 year	68	2
Later than 1 year and not later than 5 years	35	3
	<u>—</u>	<u>—</u>
	<u>103</u>	<u>5</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

33. 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 2020	Within 12 months KShs' million	After 12 months KShs' million	Total KShs' million
ASSETS			
Balances due from banking institutions	369,505	-	369,505
Funds held with International Monetary Fund (IMF)	3,255	-	3,255
IMF Funds on – lent to GOK	-	79,702	79,702
Securities and advances to banks	23,080	32,481	55,561
Loans and advances	591	2,683	3,274
Debt instruments at fair value through other comprehensive income	444,643	280,249	724,892
Equity instruments at fair value through other comprehensive income	-	10	10
Other assets	5,595	-	5,595
Gold holdings	-	106	106
Right-of-use asset – leases	-	222	222
Property and equipment	-	31,618	31,618
Intangible assets	-	1,224	1,224
Retirement benefit assets	-	6,537	6,537
Due from Government of Kenya	<u>48,369</u>	<u>20,564</u>	<u>68,933</u>
TOTAL ASSETS	<u>895,038</u>	<u>455,396</u>	<u>1,350,434</u>
LIABILITIES			
Currency in circulation	-	257,792	257,792
Investments by banks	6,997	-	6,997
Deposits from Banks and Government	732,187	-	732,187
Due to IMF	16,624	135,217	151,841
Other liabilities	<u>5,570</u>	<u>32</u>	<u>5,602</u>
TOTAL LIABILITIES	<u>761,378</u>	<u>393,041</u>	<u>1,154,419</u>
NET ASSETS	<u>133,660</u>	<u>62,355</u>	<u>196,015</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

FOR THE YEAR ENDED 30 JUNE 2020

33. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

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>



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