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CENTRAL BANK OF KENYA

FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010

DIRECTORS

Prof. Njuguna Ndung'u	-	Governor and Chairman
Dr. Hezron Nyangito	-	Deputy Governor and Deputy Chairman
Mr. Joseph K. Kinyua	-	Permanent Secretary - Treasury, Member
Mr. Joseph K. Waiguru	-	Member
Dr. William O. Ogara	-	Member
Mr. Nicholas A. Nesbitt	-	Member
Ms. Agnes Wanjiru	-	Member
Ms. Wanza Kioko	-	Member (Resigned 8 December 2009)

SENIOR MANAGEMENT

Prof. Njuguna Ndung'u	-	Governor
Dr. Hezron Nyangito	-	Deputy Governor
Mr. Kennedy K. Abuga	-	Director –Governor's Office & Board Secretary
Mr. Aggrey J.K. Bett	-	Director – Finance and IMS Department
Mr. Fredrick Pere	-	Director – Banking Supervision Department (Appointed 26 August 2009)
Ms Rose Detho	-	Director – Banking Supervision Department (Transferred on 26 August 2009)
Prof. Kinandu Muragu	-	Executive Director – Kenya School of Monetary Studies
Mr. William Nyagaka	-	Director – Internal Audit & Risk Management Department
Mr. Charles Koori	-	Director-Research Department
Mr. Casssian J. Nyanjwa	-	Director – Department of Estates, Supplies and Transport (Appointed 26 August 2009)
Mr. NicholasN.B.T. Korir	-	Director – Department of Estates, Supplies and Transport (Transferred on 26 August 2009)
Mr. James T. Lopoyetum	-	Director – Currency Operations and Branch Administration Department
Mr. Gerald Nyaoma	-	Director – Banking Department
Mr. Jackson M. Kitili	-	Director – Monetary Operations & Debt Management Department
Mr. Peter K. Rotich	-	Director - Human Resources and Administration Department

REGISTERED OFFICE

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

BRANCHES

Mombasa	**Kisumu**	**Nyeri**
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80100 Mombasa, Kenya	40100 Kisumu, Kenya	P.O. Box 840–10100, Nyeri

Eldoret

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Kenya School of Monetary Studies

Thika Road
P.O. Box 65041–00200 Nairobi, Kenya

AUDITORS

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00100 Nairobi GPO, Kenya

MAIN LAWYERS

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

DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE, 2010

The directors submit their report together with the audited financial statements for the year ended 30 June, 2010, which shows the state of affairs of the Bank.

1. Incorporation

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

2. Principal activities

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

3. Results

3.1 Financial results

The results for the year as set out on page 9 show that the Bank recorded a loss of KShs 1,639 million (inclusive of foreign currency translation losses amounting to KShs 1,247 million occasioned by appreciation of the Kenya Shilling against hard currencies during part of the financial year). This is in comparison to a profit of KShs 23,229 million in 2009(inclusive of foreign currency translation gain of KShs 13,462 million). This subdued performance over the previous year is mainly due to interest rates for all term deposits that fell from an average of more than 2% in 2009 to an average of under 0.5% in 2010 for USA Dollar, Sterling Pounds and Euros owing to the ongoing World economic turbulence. This drop in interest rates contributed substantially to the 65% fall in interest income from KShs 8,852 million in 2009 to KShs 3,089 million in the year under review. Another main factor that contributed to the fall in net surplus in 2010 is the fact that the income for 2009 included an amount of Kshs 3,141 million that related to the sale of the former Grand Regency Hotel. Furthermore, some operating expenses such as staff costs (15% more), depreciation (35% more) and currency printing costs (18% more) registered higher costs all totaling KShs 1,019million over previous year's due to a one off staff remuneration package effected in the year; acquisition of equipment and change in policy on treatment of intangible assets and the need to meet increased demand for cash in the economy. However, the above adverse cost effects were moderated by reduction in expenses associated with conduct of monetary policy that were KShs 332 million lower than the previous year's owing to less need for mop-ups due to tight liquidity prevailing in the economy for most part of the year under review.

3.2 Financial position

The financial position of the Bank is set out in the statement of financial position on page 10. During the year under review, the assets of the Bank increased by KShs 59,865 million (20%). The increase is mainly due to foreign currency reserves that increased by KShs 37,948 million or 10% owing to earnings from the reserves and net purchases to build up reserves. Increasing the assets also are the Special Drawing Rights amounting to SDR 224 million and equivalent to KShs 25,828 million allocated to the Bank by IMF during the year. The other factor that added to the assets is Government borrowing from the Bank that went up by KShs 12,357 million during the year in line with the new borrowing limit that has been raised to KShs 22 billion. Borrowings by commercial banks from the Bank fell significantly by KShs 15 billion owing to relative stability of liquidity in the economy leading to less need by commercial banks to rely on the Bank for day to day liquidity needs for the better part of the financial year.

The rise in the assets of the Bank during the year under review was also countered and boosted by minor decreases and increases in balances of other assets.

Correspondingly, liabilities and equity also increased by KShs 59,865million (20%) mainly due to recognition of the above SDRs equivalent to KShs 25,828 million as liabilities owing to IMF. Other significant increases were reported in deposits from commercial banks and currency in circulation by KShs 17,591million or 14% and KShs 16,982 million or 16% respectively. The increase in currency in circulation mirror demand for cash in the economy. Other liabilities also went up significantly by KShs 5,646 million or 381% due to increase in un-cleared (impersonal accounts) effects by KShs 4,421 million and bonds pending payment that increased by KShs 1,026 million (100%). The above increases were moderated by a reduction in Equity by KShs 8,839 million due to payment of dividends to the government amounting to KShs 7,200 million and the net deficit of KShs 1,639 million incurred during the year under review.

4. Dividend

Having regard to the financial results described above where the Bank registered an unrealized loss of KShs 1,639 million and the needs of the shareholder, the Board of Directors recommend payment of KShs 2.0 billion dividend for the year ended 30 June 2010 (2009: KShs 7.2 billion).

5. Directors

The directors who served during the year and up to the date of this report are listed on page 3539.

6. Auditors

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

By Order of the Board
K. K. ABUGA,
Board Secretary.
Date: 20 September 2010

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for the preparation and presentation of the financial statements of Central Bank of Kenya set out on pages 9 to 59 which comprise the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Directors responsibility includes: determining that the basis of accounting described in Note 2 is an acceptable basis for preparing and presenting the financial statements in the circumstances; designing, implementing and maintaining internal controls relevant to the preparation and presentation of these financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The Directors accept responsibility for the financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Central Bank of Kenya Act. The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Bank and of its operating results.

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

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

Approval of the financial statements

The financial statements, as indicated above, were approved by the Board of Directors on 20 September, 2010 and were signed on its behalf by:

NJUGUNA NDUNG'U	**WILLIAM O. OGARA**
Governor	**Director**

STATEMENT OF CORPORATE GOVERNANCE

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

Board of Directors

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

Currently there are four Non-Executive Directors namely Messrs Joseph K. Waiguru, Nicholas A. Nesbitt, William O. Ogara and Ms Agnes Wanjiru who are all serving their first term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

Board meetings

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

Audit Committee

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

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

Monetary Policy Committee (MPC)

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

The Committee is currently made up of the following:

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

Human Resources Committee

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

Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on page 3539 The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

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

Directors' Emoluments and Loans

The remuneration paid to the Directors for services rendered during the financial year 2009/2010 is disclosed in note 29 (iv) of the financial statements. The Non Executive Directors are paid a monthly retainer fee and a sitting allowance for every meeting attended. There were no loans to Non-Executive Directors during the year while Executive Directors are paid a monthly salary and are eligible for the staff loans.

Code of Ethics

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

Internal Controls

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

Authorizations

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

Internal Audit and Risk Management

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

Transparency

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

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

We have audited the Bank financial statements of Central Bank of Kenya set out on pages 3543 to 3568 which comprise the statements of financial position of the Bank at 30 June, 2010, and the Bank's statement of comprehensive income, statement of changes in equity of the Bank and cash flow statement of the Bank for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

As stated on page 3541, the directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank at 30 June 2010, and the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Central Bank of Kenya Act.

Dated the 20th September, 2010.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 KShs'million	2009 KShs'million
Interest income	4	3,089	8,852
Interest expense	5	(91)	(432)
Net interest income		**2,998**	**8,420**
Fee and commission income	6	3,005	3,005
Foreign exchange (loss)/gain	7	(1,247)	13,462
Other operating income	8	984	4,849
Operating income		**5,740**	**29,736**
Operating expenses	9	(7,379)	(6,507)
(Loss)/profit for the year		**(1,639)**	**23,229**
Other comprehensive income		-	-
Total comprehensive income		**(1,639)**	**23,229**

The notes set out on pages 3545 to 3568 form an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE, 2010

ASSETS	**Note**	**2010 KShs million**	**2009 KShs million**
Balances due from banking institutions and gold holdings	10	284,682	246,734
International Monetary Fund	11	26,272	914
Items in the course of collection	12	316	1,430
Advances to banks	13	31	15,011
Loans and advances	14	20,674	8,317
Other assets	15	2,462	2,870
Retirement benefit asset	16	1,894	1,425
Property and equipment	17	1,024	1,034
Prepaid operating lease rentals	18	272	275
Intangible assets	19	853	378
Due from Government of Kenya	20	33,102	33,329
TOTAL ASSETS		**371,582**	**311,717**

LIABILITIES			
Currency in circulation	21	125,024	108,042
Deposits	22	143,228	125,637
International Monetary Fund	11	63,276	37,448
Other liabilities	23	7,134	1,488
Dividends payable	24	2,641	-
Provisions	25	113	97
TOTAL LIABILITIES		**341,416**	**272,712**
EQUITY AND RESERVES			
Share capital	26	5,000	5,000
General reserve fund	27	23,166	26,805
Proposed dividend	28	2,000	7,200
TOTAL EQUITY AND RESERVES		**30,166**	**39,005**
TOTAL LIABILITIES AND EQUITY		**371,582**	**311,717**

The financial statements were approved by the Board of Directors for issue on 20 September 2010 and signed on its behalf by:

NJUGUNA NDUNG'U
Governor

WILLIAM O. OGARA
Director

The notes set out on pages 13 to 59 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2010

	Share capital KShs million	General reserve fund KShs million	Proposed Dividend KShs million	Total KShs million
At 1 July 2008				
Opening balance as previously stated	1,500	12,754	4,000	18,254
Prior year adjustment*	-	1,522	-	1,522
Restated opening balance	**1,500**	**14,276**	**4,000**	**19,776**
Comprehensive income for the year				
Profit for the year	-	23,229	-	23,229
Total comprehensive income for the year	**-**	**23,229**	**-**	**23,229**
Transactions with owners directly recorded in equity				
Additional capital paid during the year	3,500	(3,500)	-	-
2008 dividends paid	-	-	(4,000)	(4,000)
Proposed dividend	-	(7,200)	7,200	-
Total contributions by and distribution to the owners	**3,500**	**(10,700)**	**3,200**	**(4,000)**
As at 30 June 2009	**5,000**	**26,805**	**7,200**	**39,005**
At 1 July 2009	5,000	26,805	7,200	39,005
Comprehensive income for the year				
Loss for the year	-	(1,639)	-	(1,639)
Total comprehensive income for the year	**-**	**(1,639)**	**-**	**(1,639)**
Transactions with owners directly recorded in equity				
2009 dividends paid	-	-	(4,559)	(4,559)
Transfer to dividends payable (Earmarked)	-	-	(2,641)	(2,641)
Proposed dividends	-	(2,000)	2,000	-
Total contributions by and distribution to the owners	**-**	(2,000)	**(5,200)**	**(7,200)**
As at 30 June 2010	**5,000**	**23,166**	**2,000**	**30,166**

The notes set out on pages 3545 to 3568 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2010

	Note	2010 KShs'million	2009 KShs'million
Operating activities			
Net cash (absorbed)/generated by operating activities	29(a)	**35,756**	**14,161**
Investing activities			
Receipts of government loan		227	1,110
Purchase of property and equipment		(650)	(697)
Purchase of intangible assets		(379)	(388)
Proceeds from disposal of property and equipment		-	10
Proceeds from International Monetary Fund - SDR accounts		(25,358)	(708)
Net cash used in investing activities		**(26,160)**	**(673)**
Financing activities			
Dividends paid		(4,559)	(4,000)
Currency in circulation		16,982	8,292
Net cash from financing activities		**12,423**	**4,292**
Net increase in cash and cash equivalents		22,019	17,780
Cash and cash equivalents at start of year		256,542	225,300
Exchange rate effects		(1,247)	13,462
Cash and cash equivalents at end of year	29(b)	**277,314**	**256,542**

The notes set out on pages 3545 to 3568 form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010

1. REPORTING ENTITY

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

(i) Basis of preparation

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

(ii) Statement of compliance

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS) and interpretations of those Standards.

(iii) Form of presentation

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

(iv) Significant accounting judgement and estimates

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

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

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

(v) Functional and presentation currency

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

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

(vi) New standards adopted during the year

On 1 January 2009, the Bank retrospectively adopted IAS 1; *Presentation of Financial Statements (revised in 2007)*. As a result in the financial statements, certain disclosures and note terminologies have changed. In addition changes in owners' equity are presented in the statement of changes in equity while all non owner changes in equity are presented in other comprehensive income.

(b) Revenue recognition

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

(i) Interest income and expenses

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

(ii) Fees and commission income

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

(c) Translation of foreign currencies

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

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

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

(d) Currency printing and minting expenses

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

(e) Employee benefits

(i) Retirement benefits

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

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

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

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

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

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

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

(ii) Other employee benefits

The Bank provides free medical treatment to staff, spouse and up to a maximum of four children below the age of 23 years. The related expenses are recognised once incurred.

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

(f) Property and equipment

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

Building improvements	Ten years
Motor vehicles, furniture and equipment	Two years

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

Subsequent expenditures are capitalized only when they increase the current economic benefits and meet the recognition criteria. Expenditure incurred to replace a component of item of property and equipment is accounted for separately and capitalized while the major replaced component is derecognised.

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

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

The assets residual values, useful lives and methods of depreciation are reviewed and adjusted if appropriate at the each financial year end. An asset's carrying amount is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value (less costs to sell) and value in use.

(g) Intangible assets

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

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

The useful lives of intangible assets are assessed to be finite and are amortised over the useful economic life. The amortisation period with a finite useful life are reviewed at least at each financial year end. The amortisation expense on intangible assets with finite lives is recognised in the profit or loss.

Amortisation is calculated using the straight line method to write down the cost of intangible assets to the residual values over the estimated useful life as follows:

Computer software - two years

(h) Impairment of non-financial assets

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

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

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

(i) Financial instruments

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

(i) Date of recognition

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

(ii) Recognition and initial measurement

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

(iii) Classification and measurement

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

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

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

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

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

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

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

(iv) Derecognition

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

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

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

(v) ***Gains and losses on subsequent measurement***

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

(vi) ***Offsetting***

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

(vii) ***Impairment of financial assets***

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

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

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

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

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

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

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

(j) Amounts repayable under Repurchase Agreements (REPOs)

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

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

When the Bank mops money from commercial banks, it creates a liability in its books and secures this borrowing (liability) by assigning part of the securitized debt owing from Government to the Bank to the commercial banks it has mopped from. The Bank freezes the money mopped and pays interest at market rates on the money. The money mopped stays until maturity (7 to 91 days).

Similarly the Bank also lends money to commercial banks (reverse repo). In this process, the Bank creates an asset in its books and takes a security from the borrowing bank usually in form of Treasury Bills or Bonds. The Bank earns interest from the borrowing commercial bank on this lending. The injected money stays with the borrowing bank until maturity (1 to 7 days).

(i) The Bank treats reverse REPOs as collateralized loans for accounting purposes. In this case, a reverse REPO is recorded as a secured advance and is shown separately as Advance to Banks while repurchase agreements are shown as a liability in the books of bank.

(ii) REPOs continue to be recognised in the statement of financial position and are measured in accordance with policies for non-trading investment.

(iii) The difference between sales and repurchase price is treated as interest expenditure and is recognised in the profit or loss.

The Bank also accepts deposits from commercial banks on a voluntary basis at market terms for an agreed period. This is a relatively new monetary instrument that the Bank uses in addition to REPO and is similar to REPO only that it is not secured.

(k) Currency in circulation

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

(l) Deposits

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

Cash Ratio Deposits are taken from commercial banks for liquidity management (monetary policy purposes) of the Bank in accordance with the Banking Act and are interest free. Cash Ratio Reserves is a monetary policy instrument used to manage liquidity. The deposits earn no interest to commercial banks and the Bank does not trade on these deposits in any way. The deposits are currently computed at 4.5% of each commercial bank's deposits it has taken from the public. Each commercial bank is required to deposit the applicable amount at the Bank and the computation is done on monthly basis.

(m) Provisions

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

(n) Leasing

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

(i) Bank as a lessee

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

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

(ii) Bank as a lessor

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

(o) Dividends

The Board of directors in the year 2007 passed a policy on dividends payments to the Government of Kenya stating all dividends should be net of unrealised revaluations gains and after taking into the 10% retained earnings as required by the Central Bank of Kenya Act Cap 491.

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

(p) Other liabilities

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

(q) Cash and cash equivalents

Cash and cash equivalents comprises of cash balances, bank deposits, current accounts, gold holding, government securities with maturity of up to 3 months from the date of issue.

(r) Commitments on behalf of Treasury

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

(s) Comparatives

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

(t) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 30 June 2010, and have not been applied in preparing these financial statements as follows:

- Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments which become mandatory for the Bank's 2011 financial statements, with retrospective application required, is not expected to have a significant impact on the financial statements.

- IAS 24 *Related Party Disclosures* amends the definition of a related party and modifies certain related party disclosure requirements for government related entities. The amendment to IAS 24 will become mandatory for the Bank's 2011 financial statements and are expected to have an impact on the presentation of related party information in the Bank's financial statements.

- IFRS 9 *Financial Instruments*, published on 12 November 2009 as part of phase 1 of the IASB's comprehensive project to replace IAS 39, deals with classification and measurement of financial assets. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets; amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value.

  The standard eliminates the existing IAS 39 categories of *held-to-maturity, available-for-sale* and *loans and receivables*. For an investment in an equity instrument which is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share-by-share basis, to present all fair value changes from the investment in other comprehensive income. No amount recognised in other comprehensive income would ever be reclassified to the statement of comprehensive income at a later date. However, dividends on such investments are recognised in the statement of comprehensive income, rather than other comprehensive income unless they clearly represent a partial recovery of the cost of the investment.

  Investments in equity instruments in respect of which an entity does not elect to present fair value changes in other comprehensive income would be measured at fair value with changes in fair value recognised in the statement of comprehensive income.

  The standard requires that derivatives embedded in contracts with a host that is a financial asset within the scope of the standard are not separated; instead the hybrid financial instrument is assessed in its entirety as to whether it should be measured at amortised cost or fair value.

  The standard is effective for annual periods beginning on or after 1 January 2013. Management is in the process of assessing the impact of the revised standard to the Bank.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

(a) Impairment losses on loans and advances

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

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

(b) Pensions

The actuarial valuation cost of the defined benefit pension plan is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long nature of these plans, such estimates are subject to significant uncertainty. See Note 16 for assumptions used.

(c) Property, equipment and intangible assets

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

(d) Useful life of currency

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

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

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

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

		2010 KShs million	2009 KShs million
4	**INTEREST INCOME**		
	Cash and cash equivalents (Note 4a)	57	21
	Held to maturity investments (Note 4b)	1,015	6,889
	Loans and advances (Note 4c)	1,726	916
	Held for trading investments (Note 4d)	291	121
		3,089	**8,852**
(a)	**Interest income from cash and cash equivalents**		
	Interest on Sterling Pound deposits	-	3
	Interest on US Dollar deposits	-	5
	Interest on Euro deposits	-	9
	Income from IMF	57	4
		57	21
(b)	**Interest income from held to maturity investments**		
	Interest on Sterling Pound term deposits	372	3,436
	Interest on US Dollar term deposits	328	2,060
	Interest on Euro term deposits	315	1,393
		1,015	**6,889**
	The weighted average interest rates for term deposits were:		
	US Dollar	0.36%	1.72%
	UK Sterling Pounds	0.48%	2.48%
	Euro	0.54%	2.58%
(c)	**Interest income from loans and advances**		
	Interest on loan due from Government	993	1,025
	Interest on Government overdraft	314	466
	Interest on staff loans	80	75
	Interest on reverse REPOs	245	70
	Interest on local commercial banks overnight loans	11	45
	Interest on foreign commercial banks overnight loans	3	26
	Other interest income	80	114
		1,726	**1,821**
(d)	Interest income from held for trading investments		
	Interest income – World Bank RAMP	**291**	**121**

During the year, the Bank engaged the services of Reserve Asset Management Programme (RAMP) which is the investment arm of the World Bank to assist in building capacity in foreign reserves management. The Bank has availed US $ 300 million (2009- US $ 400 million) for the Programme.

		2010 KShs million	2009 KShs million
(e)	**Additional disclosure on income by source**		
	Foreign investments earnings	1,366	7,058
	Local investments earnings	1,643	1,719
	Other interest earnings	80	75
		3,089	**8,852**
5	**INTEREST EXPENSE**		
	Interest on monetary policy issues/ REPOs	2	334
	Interest paid to IMF	89	98
		91	**432**
6	**FEE AND COMMISSION INCOME**		
	Commission on sale of Government securities	3,000	3,000
	Poverty Reduction and Growth Facility (PRGF) (IMF-GoK) Commission	5	5
		3,005	**3,005**

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

7 FOREIGN EXCHANGE (LOSS) /GAIN

Foreign exchange dealing profit (Note 7a)	786	1,470
Foreign Bonds Pending Receivables	13	-
Foreign exchange translation (loss)/gain (Note 7b)	(2,046)	11,992
	(1,247)	**13,462**

(a) Foreign exchange dealing profit

Gains on sale of foreign exchange to Government	784	1,227
Foreign exchange dealing profit on commercial banks	2	243
	786	**1,470**

(b) Foreign exchange translation loss

Revaluation (loss)/gain on current accounts	(378)	(1,242)
Revaluation loss on foreign deposits	(3,545)	15,546
Revaluation loss on IMF accounts	(363)	(2,318)
Revaluation of RAMP securities	2,240	-
Others	-	6
	(2,046)	**11,992**

Exchange rates	**2010 KShs million**	**2009 KShs million**
US Dollar	81.80	77.05
GBP	123.01	128.83
Euro	99.88	108.90

	2010	**2009**
Foreign currency investment mix		
US Dollar	40%+ /-5%	42%
GBP Sterling Pound	30%+/-5%	35%
Euro	20%+/-5%	23%
	100.00%%	**100.00%%**

8 OTHER OPERATING INCOME	**2010 KShs million**	**2009 KShs million**
Recovery on impaired loan (Note 8a)	-	3,141
Actuarial gain on retirement benefit obligations	468	1,370
Miscellaneous income	36	90
Licence fees from Commercial Banks and bureaus	159	-
Rent received	3	16
KSMS other operating income-hospitality services and tuition fee	318	222
Proceeds from disposal of property and equipment	-	10
	984	**4,849**

(a) Recovery on impaired loan	**US$ Million**	**KShs Million**
10% on sale of Grand Regency Hotel	4.5	277
90% on sale of Grand Regency Hotel	40.5	2,671
Receipt from the Receiver Manager	-	297
Retirement benefits for employees of the Hotel	-	(104)
	45	**3,141**

The recovery on impaired loan in 2009 relates to write back of provisions for Exchange Bank Limited loan. In 1992, during a period of severe shortage of foreign currency in Kenya, Exchange Bank sold foreign currency amounting to US$ 210 million to the Bank. Exchange Bank was credited with KShs 13.5 billion being the Kenya shilling equivalent but did not deliver the foreign currency in the Bank's overseas correspondent accounts as required to. The amount of KShs 13.5 billion owing from Exchange Bank was eventually off set by repayments and against deposits held at the Bank and the outstanding balance of about KShs 4.5 billion was secured by way of a legal charge on L.R. No. 209/9514 (belonging to Uhuru Highway Development Limited and trading as Grand Regency Hotel) valued at KShs 2.5 billion. The Hotel was sold in 2008 for US $ 45 million (KShs 3.1 billion) leaving an irrecoverable balance of KShs 1.5 billion that was already fully provided for and with the sale of the hotel, extinguished from the books of the Bank.

9 OPERATING EXPENSES

	2010 KShs million	2009 KShs million
Staff costs (Note 9(a))	3,736	3,260
Currency expenses (Note 9(b))	1,491	1,260
Property maintenance expenses (Note 9(c))	566	2,533
Depreciation on property and equipment (Note 17)	544	231
Amortisation on intangible assets (Note 19)	19	28
Other expenses (Note 9(d))	1,011	1,057
Auditors' remuneration	5	4
Banking expenses	4	4
Operating lease rentals (Note 18)	3	3
	7,379	6,507

(a) Staff costs

	2010	2009
Personnel emoluments	3,357	2,925
Medical benefit	143	135
Staff training and development costs	218	188
Directors' expenses	18	12
	3,736	3,350

(b) Currency expenses

	2010	2009
Notes production	1,047	1,108
Coins production	429	140
Notes issue	8	7
Coin Issue	5	5
Agency Centres	2	-
	1,491	1,260

(c) Property maintenance expenses

	2010	2009
Upkeep of property	197	234
Security of premises	204	193
Property renovation	56	121
Electricity	57	71
Others	52	41
	566	660

(d) Other expenses

	2010	2009
Transport and travelling	136	125
Office expenses	108	126
Postal service expense	99	88
Legal and professional fees	100	105
Other administrative expenses	568	613
	1,011	1,057

10 BALANCES DUE FROM BANKING INSTITUTIONS AND GOLD HOLDINGS

	2010 KShs million	2009 KShs million
Cash and cash equivalents (Note 10(a))	15,651	8,975
Held for trading investments (Note 10(b))	33,515	15,449
Held to maturity investments (Note 10(c))	235,459	222,276
Gold holdings	57	34
	284,682	246,734

(a) Cash and cash equivalents

	2010	2009
Special project accounts	7,051	4,695
Current account	4,350	2,598
Domestic forex currency cheque clearing	4,244	1,676
Forex travellers cheques	6	6
	15,651	8,975

		2010	2009
(b)	**Held for trading**		
	US Dollar deposits	16	925
	Fixed income securities	33,346	14,469
	Accrued interest	153	55
		33,515	**15,449**
(c)	**Held to maturity investments**		
	Term deposits (Note 10 (c)(i))	235,264	221,824
	Accrued interest on term deposits	195	452
		235,459	**222,276**
	(i) Term deposits		
	Dollar deposits	75,773	90,534
	Sterling Pound deposits	94,070	80,649
	Euro deposits	65,421	50,641
		235,264	**221,824**

11. INTERNATIONAL MONETARY FUND

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.

	2010		2009	
	SDR Million	**KShs Million**	**SDR' Million**	**KShs Million**
Assets				
IMF balances (SDR asset account)	218	26,272	8	914
Liabilities				
International Monetary Fund Account No. 1	20	2,430	20	3,128
International Monetary Fund Account No. 2	-	4	-	3
International Monetary Fund – PRGF Account	279	33,734	281	33,599
IMF-SDR Allocation account	218	26,867	-	-
International Monetary Fund loans to Government of Kenya	2	241	6	718
	519	63,276	307	37,448
Security at 30 June	238	28,079	238	28,079

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

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository

Kenya's Quota in IMF and SDRs allocations amounting to SDR 271.4 million and SDR 259.6 million respectively. The Quota (SDR 271.4 million) is accounted for in the books of the Government of Kenya.

12 ITEMS IN THE COURSE OF COLLECTION	**2010 KShs million**	**2009 KShs million**
Items in the course of collection	**316**	**1,430**

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

13 ADVANCES TO BANKS	**2010 Kshs Million**	**2009 Kshs million**
REPO Treasury Bills	-	9,552
REPO Treasury Bonds	-	5,437
Treasury Bonds Discounted	17	10
Treasury Bills Discounted	13	9
Accrued interest	1	3
	31	**15,011**

The Bank lends money to commercial banks through reverse Repo for a short duration of up to 7 days only. These advances are secured against government securities of any maturity. The discounted government securities held are of varying maturities.

14 LOANS AND ADVANCES	**2010 KShs million**	**2009**
Irrecoverable amount from banks under liquidation	3,767	3,767
Government overdraft account (see below and Note 30)	17,649	5,124
Loan from IMF to the Government of Kenya (Note 30)	241	718
Advances to employees		
Salary advance	186	178
Car loans	419	379
Housing scheme	1,916	1,746
Development loan	280	189

	24,458	12,101
Provision for loan impairment (banks & staff)	(3,784)	(3,784)
Net advances as at 30 June	**20,674**	**8,317**

Movement in the loan impairment allowance is as follows:

At start of the year	(3,784)	(8,352)
Additional impairment allowance made during the year	(1)	(63)
Irrecoverable amount on sale of the Hotel	-	1,490
Recoveries on sale of the Hotel in the year (Note 8a)	-	3,141
Other recoveries	1	-
At end of the year	**(3,784)**	**(3,784)**

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit stands at KShs 22,926,066 based on the Government financial statements for 2007/2008, which are the latest audited financial statements at the date of approval of these financial statements. The limit for the previous year was KShs 16,882,643,732 based on the Government financial statements for 2006/2007.

15. OTHER ASSETS

	2010 KShs million	2009 KShs million
Prepayments and sundry debtors	678	972
Deferred currency expenses	1,570	1,580
Advances	214	318
	2,462	**2,870**

The policy of the Bank is to recognise currency notes expenses upon issuing out of currency notes for circulation.

16 RETIREMENT BENEFIT ASSET

The Bank's employees are eligible for retirement benefits under a defined benefit plan provided through a separate fund. The defined benefit plan is funded by the Bank and the employees of the Bank. The retirement benefit asset is wholly recognised in the financial statements of the Bank. All employees of Deposit Protection Fund Board (DPF) are staff of the Bank and DPF only reimburses the bank their emoluments.

The amounts recognised in the statement of financial position are determined on the basis of an actuarial review carried out by Actuarial Services (EA) Limited as at 30 June.

	2010 *KShs million*	**2009** **KShs million**
Present value of funded obligations	11,550	9,582
Fair value of plan assets	(14,868)	(11,678)
Present value of net asset	(3,318)	(2,096)
Unrecognised actuarial gain	1,424	671
Balance at 30 June	**(1,894)**	**(1,425)**

The amounts recognised in the profit or loss are as follows:

Current service costs	507	453
Interest costs	844	921
Expected return on plan assets	(1,087)	(1,085)
Net gains recognised in the year	-	(67)
Adjustment for previous year values	(399)	(135)
Past service cost	-	(1,138)
Total expenses included in operating expenses	(135)	(1,051)

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

Net liability at start of period	(1,425)	(55)
Net expense recognised in the profit or loss	(135)	(1,051)
Employer contributions	(334)	(319)
Net liability at end of period	(1,894)	(1,425)
Actual return on plan assets	**2,852**	**(380)**

The principal actuarial assumptions at the reporting date were:

	2009	2008
Discount rate (p.a.)	9%	9%
Salary increase (p.a.)	7%	7%
Expected return on plan assets (p.a.)	9%	9%
Future pension increases	0%	0%

Historical information	2010 KShs million	2009 KShs million	2008 KShs million	2007 KShs million	2006 KShs million
Fair value of plan assets	14,868	11,678	12,136	10,774	9,260
Present value of funded obligations	(11,550)	(9,582)	(10,496)	(9,416)	(8,126)
Retirement benefit obligations	**3,318**	**2,096**	**1,640**	**1,358**	**1,134**

17 PROPERTY AND EQUIPMENT

30 June 2010 Cost	Land and buildings KShs million	Motor vehicles KShs million	Furniture and Equipment KShs million	Total KShs million
At start of year	988	196	3,813	4,997
Reclassification to intangible asset (Note 19)	-	-	(115)	(115)
At 30 June 2009 as restated	988	196	3,698	4,882
Additions	98	30	522	650
Disposals	-	(9)	-	(9)
At end of the year	1,086	217	4,220	5,523
Accumulated depreciation				
At start of the year	954	175	2,834	3,963
Charge for the year	10	21	514	545
On disposal	-	(9)	-	(9)
At end of the year	964	187	3,348	4,499
Net book value at 30 June 2010	**122**	**30**	**872**	**1,024**
30 June 2009				
Cost				
At start of year	987	215	3,130	4,332
Additions	1	13	683	697
Disposals	-	(32)	-	(32)
At end of the year	988	196	3,813	4,997
Depreciation				
At start of the year	945	169	2,651	3,765
Charge for the year	9	39	183	231
Eliminated on disposal	-	(32)	-	(32)
At end of the year	954	176	2,834	3,964
Net book value at 30 June 2009	**34**	**20**	**979**	**1,033**

18 PREPAID OPERATING LEASE RENTALS

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

		2010 KShs million	2009 KShs million
Cost			
At 30 June	300		300
Amortisation			
At 1 July		25	22
Amortisation for the year		3	3
At end of the year		28	25
Net carrying value at end of the year		**272**	**275**

The prepaid operating lease rentals relate to L.R. No. IR 53398 which has a lease term of 99 years. The leasehold land was acquired by the Bank in 2002 at a cost of KShs 300,000,000. The cost is amortised on the basis of the remaining life of the lease.

19 INTANGIBLE ASSETS

	Software KShs million	Work-in-Progress KShs million	2010 Total KShs million	2009 Total KShs million
Cost				
At 1 July	217	351	568	180
Reclassification from property and equipment(Note 17)	-	115	115	-
At 1 July 2009 restated	217	466	683	180
	Software KShs million	**Work-in-Progress KShs million**	**2010 Total KShs million**	**2009 Total KShs million**
Additions	3	376	379	388
At end of the year	220	842	1,062	568

Amortisation				
At 1 July	190	-	190	162
Amortisation for the year	19	-	19	28
At end of the year	209	-	209	190
Net carrying value at end of the year	**11**	**842**	**853**	**378**

The work-in-progress relates to software acquired for the System of Integrated Management Banking and Accounting (SIMBA) project.

20 DUE FROM GOVERNMENT OF KENYA

	2010 KShs million	2009 KShs million
At start of the year	33,329	34,439
Accrued interest receivable	328	-
Receipts during the year	(555)	(1,110)
At end of the year	**33,102**	**33,329**

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 lending to GoK to 5% of GoK 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 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 held-to-maturity investment and is carried at amortized cost. The Directors have assessed the loan for impairment and the amount of the impairment is measured as the difference between the loan's carrying amount and the present value of estimated future cash flows discounted at the loan's original effective interest rate of 3% per annum. The assessment has indicated that the loan is not impaired.

21 CURRENCY IN CIRCULATION

	2010 KShs million	2009 KShs million
Kenya notes	120,574	104,002
Kenya coins	4,444	4,034
Commemorative coins	6	6
	125,024	**108,042**
Balance at the beginning of the year	108,042	99,750
Deposits by banks	(271,430)	(283,489)
Withdrawals by banks	288,412	291,781
Balance at the end of the year	**125,024**	**108,042**

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

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

22 DEPOSITS

	2010 KShs million	2009 KShs million
Local commercial banks (Note 22 a)	85,236	51,901
Local banks forex settlement accounts (Note 22 b)	3,669	1,297
External banks forex settlement accounts	94	89
Other public entities and project accounts	10,672	8,181
Government of Kenya(Note 22 c)	43,557	64,169
	143,228	**125,637**

(a) Local commercial banks

Clearing accounts	34,681	7,974
Cash reserve ratio	50,555	43,927
	85,236	**51,901**

The cash reserve ratio is a statutory ratio for monetary policy. Commercial Banks and Non-Bank Financial Institutions (NBFI's) are required to hold at the Central Bank of Kenya a prescribed percentage of their total deposits. The ratio was revised to 5% in December 2008. Prior to that, the ratio was 6% and it is currently at 4.5%. The statutory deposits are determined from commercial banks monthly returns submitted to Central Bank of Kenya on or before the tenth day of every month. Currently there are 43 licensed commercial banks and 2 mortgage finance companies.

(b)	Local banks forex settlement accounts	2010 KShs million	2009 KShs million
	Euro	441	228
	Dollar	2,900	952
	Sterling Pound	328	117
		3,669	1,297

(c)	Government of Kenya		
	Paymaster General	22,504	23,785
	Treasury Funding Account	17,151	15,747
	The Exchequer Account	1,601	18,417
	Others	2,301	6,220
		43,557	64,169

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

23 OTHER LIABILITIES

	2010 KShs million	2009 KShs million
Impersonal accounts	4,707	325
Sundry creditors	733	663
Bonds Pending payables	1,026	-
Refundable deposits	668	421
Development deposits	-	79
	7,134	1,488

24 DIVIDENDS PAYABLE

Dividends payable	2,641	-

The movement in dividends payable is as follows:

Balance at 1 July	-	-
Dividends approved in the year	7,200	-
Paid during the year	(4,559)	-
Funds earmarked for an on-going project	2,641	-

25 PROVISIONS

Leave accrual	60	66
Gratuity to staff members	53	31
	113	97

26 SHARE CAPITAL

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

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

27 GENERAL RESERVE FUND

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

28 DIVIDENDS

The directors have recommended payment of a dividend of KShs 2.0 billion for the year ended 30 June 2010 (2009: KShs 7.2 billion).

29. (a) NOTES TO THE CASH FLOW STATEMENT

Cash flows from operating activities	2010 KShs million	2009 KShs million
Net (loss)/profit for the year	(1,639)	23,229
Adjustments for:		
Depreciation of property and equipment	545	231
Amortization of prepaid operating leases	3	3
Amortization of intangible assets	19	28

	2010 KShs million	2009 KShs million
Revaluation of currency production costs	-	1,522
Exchange rate loss/(profit) effects	1,247	(13,462)
Gain on disposal of property and equipment	-	(10)
Surplus in defined benefit scheme	(469)	(1,370)
Operating profit before working capital changes	**(294)**	**10,171**
Net increase in loans and advances	(12,357)	(4,857)
Decrease in amounts repayable under repurchase agreements	-	(1,807)
Increase in balance with International Monetary Fund	25,828	17,751
Increase in project accounts	-	(244)
(Increase)/decrease in accrued interest on balances due from banking institutions	(2,196)	1,767
Decrease in items in the course of collection	1,114	1,455
Increase/(decrease) in deposits	17,591	(5,504)
Decrease/(increase) in other assets	408	(1,626)
Increase/(decrease) in other liabilities	5,662	(2,945)
Net cash generated by operations	**35,756**	**14,161**

(b) Cash and cash equivalents

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

	2010 KShs million	2009 KShs million
Term deposits	235,264	221,824
Current accounts	4,350	2,598
Domestic forex cheques clearing	4,244	1,676
Travellers Cheques	6	6
Gold holdings	57	34
	243,921	226,138
Advances to Banks	31	15,010
Investments with RAMP	33,362	15,394
	277,314	**256,542**

30 RELATED PARTY TRANSACTIONS

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

(i) Loans

The Bank extends loan facilities to its members of staff, the Governor and the Deputy Governor. Loans and advances (Note 14) include advances to employees that as at 30 June 2010 amounted to KShs 2,801 million (2009: KShs 2,492 million). The advances are at preferential rates of interest determined by the Bank.

	2010 KShs million	2009 KShs million
(ii) **Loans to executive directors**		
At start of the year	9	1
Loans advanced during the year	-	10
Loan repayments	(3)	(2)
At end of the year	**6**	**9**
(iii) **Loans to key management personnel**		
At start of the year	39	18
Loans advanced during the year	57	41
Loan repayments	(34)	(20)
At end of the year	**62**	**39**
(iv) **Directors' emoluments:**		
Fees to non executive directors	15	25
Other remuneration to executive directors	50	50
	2010 KShs million	**2009 KShs million**
	65	**75**
(v) **Remuneration to senior management**	**182**	**148**
(vi) **Post –employment pension**	**2**	**2**

(vii) Government of Kenya

Transactions entered into with the Government include:

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

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

Due from Government of Kenya (Note 20)	33,102	33,329
Overdraft account (Note 14)	17,649	5,124
Loan from IMF to the Government of Kenya (Note 11)	241	718
Government of Kenya deposits (Note 22)	43,557	64,169

(viii) Deposit Protection Fund Board

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

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was KShs 26 million (2009: KShs 13million).

(ix) Kenya School of Monetary Studies

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

31 RISK MANAGEMENT

(a) Structure and Reporting

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

(i) Audit Committee of the Board

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

(ii) Bank Risk Management Committee

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

(iii) Internal Audit and Risk Management Department (IARM)

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

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

(b) Strategy in Using Financial Instruments

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

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

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

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

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

(c) Risks facing the Bank

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

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

(i) Financial risks

Credit risk

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

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

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

(i) Financial risks - continued

Credit risk - continued

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

	2010 KShs million	**2009 KShs million**
Individually impaired:		
Staff loans 49	30	
Banks in liquidation	3,766	3,767
	3,815	3,797
Allowance for impairment	(3,784)	(3,784)
	31	**13**
Loans past due but not impaired:		
Past due upto 30 days	33,102	33,329
Past due 31 – 60 days	-	-
Past due 61 – 90 days	-	-
Past due 91 – 150 days	-	-
	33,102	**33,329**

Loans neither past due nor impaired:		
Staff loans and advances	2,752	2,463
IMF on let to the Goverment	241	717
Goverment Overdraft	17,649	5,124
	20,642	**8,304**

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

	2010 KShs Millions	**2009 KShs Millions**
Assets		
Republic of Kenya	63,408	65,736
United Kingdom	189,088	194,138
Rest of Europe	2,310	31,341
United states of America	116,243	20,481
Rest of the World	533	21
	371,582	**311,717**
Liabilities		
Republic of Kenya	**371,582**	**311,717**

(i) Financial risks - continued

Interest risk

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

As at 30 June 2010	**Interest rate**	**3 months or less KShs million**	**Between 3-12 months KShs million**	**Over 1 year KShs million**	**Non-interest bearing KShs million**	**Total KShs million**
Assets						
Balances due from banking institutions and gold holdings	0.36-0.54%	277,283	348	-	7,051	284,682
International Monetary Fund (SDR Account)	0-0.5%	-	-	26,272	-	26,272
Items in the course of collection	-	-	-	-	316	316
Advances to Banks	-	31	-	-	-	31
Loans and advances	3%	74	241	20,359	-	20,674
Other assets	-	-	-	-	2,462	2,462
Property, plant and equipment	-	-	-	-	1,024	1,024
Prepaid leasehold land	-	-	-	-	272	272
Intangible assets	-	-	-	-	853	853
Retirement benefit asset	-	-	-	-	1,894	1,894
Due from Government of Kenya	3%	883	1,110	31,109	-	33,102
Total assets		**278,271**	**1,699**	**77,740**	**13,872**	**371,582**
Liabilities and equity						
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	-	-	-	-	143,228	143,228
International Monetary Fund	-	-	-	-	63,276	63,276
Other liabilities	-	-	-	-	7,134	7,134
Provisions	-	-	-	-	113	113
Dividends payable	-	-	-	-	2,641	2,641
	-					
Equity and reserves		-	-	-	30,166	30,166
Total liabilities and equity		**-**	**-**	**-**	**371,582**	**371,582**
Interest sensitivity gap 2010		**278,271**	**1,699**	**77,740**	**(357,710)**	**-**
Assets						
Balances due from banking institutions and gold holdings	1.72-2.58%	242,039	-	-	4,695	246,734
International Monetary Fund (SDR Account)	0-0.5%	914	-	-	-	914
Items in the course of collection	-	-	-	-	1,430	1,430
Advances to Banks	-	15,011	-	-	-	15,011
Loans and advances	3%	74	934	7,309	-	8,317
Other assets	-	-	-	-	2,870	2,870
Property, plant and equipment	-	-	-	-	1,034	1,034
Prepaid leasehold land	-	-	-	-	275	275
Intangible assets	-	-	-	-	378	378
Retirement benefit asset	-	-	-	-	1,425	1,425
Due from Government of Kenya	3%	-	1,110	32,219	-	33,329
Total assets		**258,038**	**2,044**	**39,528**	**12,107**	**311,717**

	Interest rate	3 months or less KShs million	Between 3-12 months KShs million	Over 1 year KShs million	Non-interest bearing KShs million	Total KShs million
Liabilities and equity	-					
Currency in circulation	-	-	-	-	108,042	108,042
Deposits	-	-	-	-	125,637	125,637
International Monetary Fund	-	-	-	-	37,448	37,448
Other liabilities	-	-	-	-	1,488	1,488
Provisions	-	-	-	-	97	97
Equity and reserves	-	-	-	-	39,005	39,005
Total liabilities and equity		-	-	-	311,717	311,717
Interest sensitivity gap 2009		**258,038**	**2,044**	**39,528**	**(299,610)**	**-**

Sensitivity analysis on interest rate risk

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

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shape of yield curves. The Bank bases its analysis on the interest sensitivity gap (Note 31(b). The sensitivity computations assume that financial assets maintain a constant rate of return from one year to the next. The effect on profit due to reasonable possible changes in interest rates, with all other variables held constant, is as follows:

	2010 KShs million	2009 KShs million
Effect on profit before tax of a +13% change in interest rates	101	440
Effect on profit before tax of a -13% change in interest rates	(101)	(440)

Foreign currency exchange rate risk

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

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

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

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

The net foreign currency position of the Bank as of 30 June 2010 and 2009 is summarized below. The table presented below provides the Bank's assets, and liabilities, at carrying amounts, categorized by currency.

The various currencies to which the Bank is exposed at 30 June 2010 are summarised below (all expressed in KShs million):-

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	137,412	76,279	70,388	-	-	542	284,621
Special Drawing Rights	-	-	-	26,272	-	-	26,272
Gold holdings	-	-	-	-	57	-	57
Total assets	137,412	76,279	70,388	26,272	57	542	310,950
Liabilities							
Balances due to IMF	-	-	-	63,276	-	-	63,276
Commissions for EEC Development Fund	-	-	-	-	-	-	-
Local Banks forex settlements	2,900	441	328	-	-	-	3,669
Local bank guarantees	488	-	-	-	-	-	488
Forex bureaux deposits	180	-	-	-	-	-	180
Total liabilities	3,568	441	328	63,276	-	-	67,613
Net statement of financial position at June 2010	**133,844**	**75,838**	**70,060**	**(37,004)**	**57**	**542**	**243,337**

The various currencies to which the Bank is exposed at 30 June 2009 are summarised below (all expressed in KShs million):

	USD	GBP	EURO	SDR	GOLD	OTHER	TOTAL
Assets							
Balances due from banking institutions	112,263	82,955	51,425	-	-	57	246,700
Special Drawing Rights	-	-	-	914	-	-	914
Gold holdings	-	-	-	-	34	-	34
Total assets	112,263	82,955	51,425	914	34	57	247,648
Liabilities							
Balances due to IMF	-	-	-	37,448	-	-	37,448
Commissions for EEC Development Fund	-	-	79	-	-	-	79
Local Banks forex settlements	952	118	229	-	-	-	1,299
Local bank guarantees	272	-	-	-	-	-	272
Forex bureaux deposits	148	-	-	-	-	-	148
Total liabilities	1,372	118	308	37,448	-	-	39,246
Net statement of financial position 2009	**110,891**	**82,837**	**51,117**	**(36,534)**	**34**	**57**	**208,402**

Sensitivity analysis on currency risk

Currency risk is the risk of loss resulting from changes in exchange rates. The Bank bases its analysis on the interest sensitivity gap (Note 30). The Bank has assets and liabilities in various currencies; however, the most significant exposure arises from assets denominated in the US dollar, GBP and Euro currencies. The following table demonstrates the sensitivity to reasonably possible change in the KShs/ US dollar exchange rate, with all other variables held constant, of the Bank's profit earned.

	2010 KShs million	2009 KShs million
Effect on profit before tax of a +7% change in exchange rates	21,766	16,093
Effect on profit before tax of a -7% change in exchange rates	(21,766)	(16,093)

Liquidity risk

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

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

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2010 to the contractual maturity date.

LIABILITIES	On demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	125,024	125,024
Deposits	92,673	-	50,555	-	-	143,228
International Monetary Fund	-	-	241	1,535	61,500	63,276
Other liabilities	-	-	7,134	-	-	7,134
Provisions		-	113			113
Dividends payable	-	-	2,641	-	-	2,641
TOTAL LIABILITIES	92,673	-	60,684	1,535	186,524	341,416
Liquidity gap 2010	(92,673)	-	(60,684)	(1,535)	(186,524)	(341,416)

The table below analyses liabilities into relevant maturity groupings based on the remaining period at 30 June 2009 to the contractual maturity date.

LIABILITIES	On Demand KShs million	Due within 3 months KShs million	Due between 3-12 months KShs million	Due between 1-5yrs KShs million	Due after 5 years KShs million	Total KShs million
Currency in circulation	-	-	-	-	108,042	108,042
Deposits	81,710	-	43,927	-	-	125,637
International Monetary Fund	-	-	413	1,535	35,500	37,448
Other liabilities	-	-	1,488	-	-	1,488
Provisions	-	-	97	-	-	97
TOTAL LIABILITIES	81,710	-	45,925	1,535	143,542	272,712
Liquidity gap 2009	(81,710)	-	(45,925)	(1,535)	(143,542)	(272,712)

(ii) Non-financial risks

Operational risk

Operational risk is the risk of loss due to human or system errors, incompatibility or failure of internal business processes, or external events. The Bank seeks to minimize losses from operational risk by establishing effective internal control systems which prevent or detect all errors and situations which might cause loss through failure of people or processes in such a way that losses are avoided or reduced to the minimum possible extent. The Bank has assigned the responsibility for managing operational risks to the management of the departments.
The assessment of risks in terms of their effects and probabilities of occurrence and the adequacy, effectiveness and efficiency of the controls established to mitigate the risks is done vide audits and risk assessments conducted by the Internal Audit and Risk Management Department(IARM).

Human Resource risk

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

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

Legal risk

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

Reputation risk

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

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

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

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

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

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

30 June 2010:	**Held for trading KShs million**	**Held-to-maturity KShs million**	**Loans and receivables KShs million**	**Available-for-sale KShs million**	**Other amortised cost KShs million**	**Total carrying amount KShs million**	**Fair value KShs million**
Assets							
Balances due from banking institutions and Gold holdings	33,515	235,459	15,708	-	-	284,682	284,682
International Monetary Fund	-	-	26,272	-	-	26,272	26,272
Items in the course of collection	-	-	316	-	-	316	316
Advances to Banks	-	-	31	-	-	31	31
Loans and advances	-	-	20,674	-	-	20,674	20,674
Other assets	-	-	-	-	2,462	2,462	2,462
Due from Government of Kenya	-	-	33,102	-	-	33,102	33,102
Total assets	**33,515**	**235,459**	**96,103**	**-**	**2,462**	**367,539**	**367,539**
Liabilities							
Currency in circulation	-	-	-	-	125,024	125,024	125,024
Deposits	-	-	-	-	143,228	143,228	143,228
International Monetary Fund	-	-	-	-	63,276	63,276	63,276
Other liabilities and provisions	-	-	-	-	9,888	9,888	9,888
Total liabilities	-	-	-	-	341,416	341,416	341,416

Assets							
Balances due from banking institutions and Gold holdings	**15,449**	**222,276**	**9,009**	**-**	-	**246,734**	**246,734**
International Monetary Fund	**-**	**-**	**914**	**-**	-	**914**	**914**
Items in the course of collection	**-**	**-**	**1,430**	**-**	-	**1,430**	**1,430**
Advances to Banks	**-**	**-**	**15,011**	**-**	-	**15,011**	**15,011**
Loans and advances	**-**	**-**	**8,317**	**-**	-	**8,317**	**8,317**
Other assets	**-**	**-**	**-**	**2,870**	-	**2,870**	**2,870**
Due from Government of Kenya	**-**	**-**	**33,329**	**-**	-	**33,329**	**33,329**
Total assets	15,449	222,276	68,010	2,870	-	308,605	308,605
Liabilities							
Currency in circulation	**-**	**-**	**-**	**-**	**108,042**	**108,042**	**108,042**
Deposits	**-**	**-**	**-**	**-**	**125,637**	**125,637**	**125,637**
International Monetary Fund	**-**	**-**	**-**	**-**	**37,448**	**37,448**	**37,448**
Other liabilities and provisions	**-**	**-**	**-**	**-**	**1,585**	**1,585**	**1,585**
Total liabilities	-	-	-	-	272,712	272,712	272,712

Valuation hierarchy

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

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

The table below shows the classification of financial instruments held at fair value into the valuation hierarchy set out below as at 30 June 2010:

30 June 2010:	Level 1 KShs million	Level 2 KShs million	Level 3 KShs million	Total KShs million
Assets				
Balances due from banking institutions and Gold holdings	**33,362**	**-**	**251,320**	**284,682**
Total assets	33,362	-	251,320	284,682

30 June 2009:	Level 1 KShs million	Level 2 KShs million	Level 3 KShs million	Total KShs million
Assets				
Balances due from banking institutions and Gold holdings	**15,449**	**-**	**231,285**	**246,734**
Total assets	15,449	-	231,285	246,734

The effective interest rates for the principal financial assets and liabilities at 30 June 2010 and 2009 were in the following ranges:

	2010	**2009**
Assets		
Government securities	6.64%	6.64%
Deposits with overseas correspondent banks		
- current accounts	0.0%	0.0%
- term deposits (USD)	0.36%	1.72%
- term deposits (Sterling Pounds)	0.48%	2.48%
- term deposits (Euro)F	0.54%	2.58%
Loans and advances - commercial banks	6.50%	8.50%
- Government of Kenya	6.50%	8.50%
- employees	3.0%	3.0%
Due from Government of Kenya	3.0%	3.0%
Liabilities		
- deposits	0.0%	0.0%

33 CONTINGENCIES

(i) The Bank is party to various legal proceedings with potential liability of KShs 496.8 million as at 30 June 2010(2009- KShs 496.5 million). Having regard to all circumstances and the legal advice received, the directors are of the opinion that these legal proceedings will not give rise to liabilities.

(ii) The Bank has applied for waiver of interest and penalties amounting to KShs 22,530,780 relating to PAYE and withholding tax arising from an assessment conducted by Kenya Revenue Authority. 32.5 % waiver was approved and the Bank has lodged another appeal requesting to be awarded full waiver and now awaiting the response. The directors are of the opinion that the liability will not crystallize because of the expected success of the request for waiver.

34 COMMITMENTS	**2010 KShs million**	**2009 KShs million**
(a) Capital: Authorised and contracted for	-	17
(b) Capital: Authorised and not contracted for		
Office furniture	1	491
Office equipment	6	1,291
Computer equipment	3	1,136
Computer equipment - SIMBA Software	-	677
Computer equipment - SIMBA Hardware	164	261
Fixtures & fittings	-	158
Motor vehicles	4	53
Consultancy contracts	-	358
Plot acquisition & development	-	650
Others	15	86
	193	**5,161**

35 OPERATING LEASE COMMITMENTS

AS LESSEE:

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

	2010 KShs million	**2009 KShs million**
One year	2	11
Between two and five years	10	7
Over five years	180	140
	192	**158**

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

36 TAXES

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

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