

REPUBLIC OF KENYA



KENYA NATIONAL AUDIT OFFICE

**REPORT  
OF  
THE CONTROLLER  
AND AUDITOR-GENERAL**

**ON**

**THE FINANCIAL STATEMENTS OF  
TELKOM (K) LIMITED FOR THE YEAR  
ENDED 30 JUNE 2006**



## **KENYA NATIONAL AUDIT OFFICE**

### **REPORT OF THE CONTROLLER AND AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF TELKOM (K) LIMITED FOR THE YEAR ENDED 30 JUNE 2006**

The financial statements of Telkom Kenya Limited set out on pages 5 to 34, which comprise the balance sheet as at 30 June 2006, and the income statement, 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 have been audited on my behalf by PKF Kenya, auditors appointed under section 39 of the Public Audit Act, 2003. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit, were obtained.

#### **Directors' responsibilities for the financial statements**

The directors are responsible for the preparation of financial statements which give a true and fair view of the Company's state of affairs and its operating results in accordance with the 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 misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### **Respective Responsibilities of the Controller and Auditor General**

My responsibility is to express an independent opinion on the financial statements based on the audit. The audit was conducted in accordance with the International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed with a view to obtaining reasonable assurance that the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal 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 company's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors, as well as evaluating the overall presentation of the financial statements. I believe the audit provides a reasonable basis for my opinion.

**1.0. Non-compliance with International Financial Reporting Standards and International Accounting Standards**

**1.1. International Accounting Standard No. 28**

Contrary to the requirements of International Accounting Standard No.28 on 'Accounting for Investments in Associates', the investments in Kenya Postel Directories Limited 40% as associate of the company, has not been accounted for under the equity method. Management has not quantified the effect of this non-compliance on the consolidated financial statements.

**1.2. International Accounting Standard No.12**

As indicated in the accounting policy on taxation in the financial statements, no provision has been made for deferred tax contrary to the requirements of International Accounting Standard No. 12 on 'Income Taxes'. Management has not quantified the effect of this departure on the financial statements.

**1.3. International Accounting Standard No.17**

Leasehold land has not been separately accounted for as prepaid operating lease rentals as required by International Accounting Standard No.17 on 'Leases'. Management has not quantified the effect of this departure on the financial statements.

**1.4. International Accounting Standard No. 24**

The requirements of International Accounting Standard No.24 on 'Related Party Disclosures' have not been fully complied with as disclosures have not been made for some related party transactions and balances.

**1.5. International Accounting Standard No. 19**

Provision for outstanding leave and long term service dues has not been made as required by International Accounting Standard No.19 on 'Employee Benefits'. Management has not quantified the effect of this departure on the financial statements.

**2.0. Cash and Bank Balances**

The difference of KShs.808 million between the balance of 'Cash in Transit' included in cash and bank balance in the financial statements as at 30 June 2005 of Kshs.228 million and the opening balance taken up as at 1 July 2005 of

Kshs.1,096 million could not be verified due to lack of adequate supporting documentation. Further, it was not possible to verify how the overdraft balances of Kshs.505 million, as confirmed by the bankers of the company, have been accounted for in the absence of adequate records and documentation. 'Cash' amounting to Kshs.77 million could also not be verified in the absence of adequate supporting documentation. Similarly, payments and withdrawals from the bank amounting to Kshs.158 million during the year could not be verified. In addition, outstanding items from the reconciliation between the cash book and bank statements have not been adjusted for in the accounting records. This has resulted in the overstatement of 'Bank Balances' by Kshs.54 million based on the financial records of the company. No provisions have been made in the financial statements with regard to cash in transit balances which are long outstanding. This has resulted in the overstatement of the cash in transit balance, included under cash and cash equivalents, by Kshs.190 million at the year end.

### **3. Turnover**

The completeness of income from public payphones could not be verified in the absence of a reconciliation of the difference of Kshs.444 million between the revenue as per the billing system of Kshs.677 million and actual revenue reported of Kshs.233 million. Further, the Integrated Service Digital Network (ISDN) debit adjustments amounting to KShs.34 million during the year could not be verified in the absence of adequate supporting documentation. In addition, the completeness of 'Other Income' received amounting to Kshs.75 million could not be verified in the absence of supporting documents. Total income from various sources is overstated by Kshs.256 million.

### **4.0. Creditors**

**4.1.** The accuracy, validity and completeness of VAT payable account, included under 'Creditors' at Kshs.2,881 million could not be confirmed due to lack of a reconciliation of the difference of Kshs.538 million between the output credits posted to the VAT payable account during the year amounting to Kshs.1,698 million and those reported in the VAT 3 returns of 1,160 million. Further, the validity and completeness of amounts payable to local and overseas suppliers amounting to Kshs.1,945 million included under 'Creditors' could not be verified in the absence of reconciliations between balances as per the financial records of the company and suppliers statements. In addition, the validity and completeness of revenue creditors amounting to Kshs.273 million included under 'Creditors' could not be confirmed in the absence of adequate supporting documentation.

**4.2.** The completeness of Postal Corporation of Kenya balance of Kshs.559 million included in 'Creditors' could not be verified in the absence of direct confirmation from Postal Corporation of Kenya. Further, the difference of Kshs.175 million between the balances in subsidiaries as included in the accounting records of the company of KShs.1,279 million and as disclosed in the accounting records of the subsidiaries of Kshs.

1,104 million could also not be confirmed in the absence of a reconciliation. In addition, the completeness, validity and existence of other creditors described as institutions – insurance companies and co-operatives, salary suspense and vocational leave suspense included under 'Creditors' at Kshs.812 million could not be verified in the absence of confirmation of balances by the salaries department .

- 4.3. The completeness of Communications Commission of Kenya balance of Kshs.1,729 million included in 'Creditors' could not be confirmed in the absence of direct confirmation from Communications Commission of Kenya. In addition, the difference of Kshs.51 million, in telephone revenue creditors, could also not be verified in the absence of reconciliation between the balances as disclosed in the accounting records of the company of Kshs.302 million and the underlying records of Kshs.251 million.
- 4.4. The completeness, validity and existence of other creditors (described as suspense) included under 'Creditors' which include a trial balance difference of Kshs.1,357million could not be confirmed as at 30 June 2006.
- 4.5. International and other sundry creditors, included in 'Creditors' in the balance sheet as at 30 June 2006 were overstated by Kshs.39 million and interconnect creditors, included in 'Creditors' in the balance sheet as at 30 June 2006 were overstated by Kshs.459 million.

#### **5.0. Property, Plant and Equipment**

- 5.1. The existence and the accounting treatment of plant and machinery, acquired through credit notes issued during 2005 to customers amounting to KShs.59 million could not be confirmed due to lack of adequate supporting documentation.
- 5.2. It was not possible to verify the difference of Kshs.173 million between additions to plant and machinery as per schedules provided by the fixed asset department of Kshs.1,099 million and costs as per the financial statements of Kshs.1,272 million. In addition the completeness of land, buildings, plant and machinery included in the balance sheet as at 30 June,2006, could also not be confirmed in the absence of a reconciliation of a difference of KShs.283 million between the fixed assets listed in the land, buildings, plant and machinery fixed assets register of Kshs.30,645 million and assets as per the financial statements of Kshs.30,362 million.
- 5.3. The completeness, valuation and existence of furniture and equipment, included under property, plant and equipment in the balance sheet as at 30 June 2006, at net book value of Kshs.384 million could not be verified in the absence of a fixed assets register in respect of furniture and office equipment. In addition, the ownership of properties, included under

property, plant and equipment in the balance sheet as at 30 June 2006 amounting to Kshs.489 million which were vested to Telkom Kenya Limited on 1 July 1999, could not be confirmed as the company does not have the original titles for all properties.

## **6.0. Debtors**

- 6.1.** The existence and valuation of current debtors included in 'Debtors', could not be verified in the absence of a reconciliation of the difference amounting to Kshs.62 million between the trade debtors balance as per the financial statements of Kshs.6,066 million and the underlying records balance of Kshs.6,004 million. Further, the adequacy of provisions for bad and doubtful debts amounting to Kshs.15,209 million could not be confirmed in the absence of listings of related debtors supporting this amount. Moreover, prior year adjustment of KShs.473 million credited against provision for bad and doubtful debts could not be verified due to lack of supporting documentation. Additionally, it was not possible to confirm the existence of sundry debtors and prepayments amounting to Kshs.1,446 million, included in 'Debtors', in the absence of adequate supporting records and documentation. It was also not possible to verify and confirm receipt of goods and services due to lack of information as to whether such goods or services were subsequently received in respect of advance payments made amounting to Kshs.1,446 million.
- 6.2.** The completeness of amounts due from Kenya Postel Directories Limited could not be confirmed in the absence of a reconciliation of a difference of Kshs.653 million between the amounts confirmed of Kshs.378 million and amounts reported of Kshs.1,032 million. Also, the completeness of staff loans could not be verified in the absence of a reconciliation of a difference of Kshs.165 million between the staff loan listings of Kshs.895 million and the amounts reported of Kshs.1059 million. In addition, the existence of other debtors amounting to Kshs.1,633 million, included in 'Debtors', could not be confirmed in the absence of adequate supporting records and documentation.
- 6.3.** Provision for bad and doubtful debts, included under trade debtors is understated by Kshs.73 million. This has the effect of overstating debtors and understating the loss for the year by a similar amount. Moreover debtors amounting to Kshs.639 million as per the accounting records have not been accounted for. In addition, Kensat debtors included in 'Debtors' in the balance sheet as at 30 June 2006 were overstated by Kshs.104 million.

## **7. Pensions**

The completeness and validity of the balance payable on account of the pension and provident fund schemes could not be verified, in the absence of a confirmation by Teleposta Pension Scheme. In addition, the accuracy of the

pension and provident fund balances reported in the Company's financial statements of Kshs.3,976 million could not be confirmed in the absence of an updated actuarial valuation. The last such valuation for Kshs.6,044 million was done as at 30 June 2004, which has also not been accounted for in the books of Telkom as at 30 June 2006.

#### **8. Loans**

The completeness and valuation of loan balances amounting to Kshs.83 million could not be verified in the absence of independent balance confirmations from the financiers.

#### **9. Stocks**

The physical quantities of stocks amounting to Kshs.1,880 million, included in the balance sheet as at 30 June 2006, could not be verified as the company did not carry out a physical count of stocks at the year-end. In the absence of adequate stock records, there were no alternative audit procedures that could be adopted. Further, the basis of valuation and adequacy of the provisions for stock obsolescence at the year end could also not be verified in the absence of adequate supporting documentation and stock listings.

#### **10. Other investments**

The ownership and valuation of 'Other Investments' amounting to Kshs.126 million could not be verified in the absence of adequate supporting documentation. As a result of this, it was not possible to verify the appropriateness of the accounting treatment of these investments. Additionally, the difference of Kshs.517 million could not be verified in the absence of reconciliation between the investment in subsidiaries included in the accounting records of the company of Kshs.2,149 million and as disclosed in the accounting records of the subsidiaries of Kshs.2,667 million.

#### **11. Expenses**

The difference of Kshs.355 million between total costs capitalized during the year and included in the property, plant and equipment at Kshs.3,877 million and the total expenses as per the Cost Statement extractions of 4,232 million could not be verified in the absence of a reconciliation. In addition, it was not possible to verify whether other expenses have been completely accounted for in the accounting records of the company in the absence of a reconciliation of a difference of Kshs.92 million between the financial statements and the accounting records. Further, the validity for 'Consultancy and agency charges' amounting to 33 million and included in administration expenses incurred during the year of Kshs.3,038 million could not be verified due to lack of supporting documentation.

## **12. Corporation Tax Liability**

It was not possible to verify corporate tax figure to the profit and loss account for the year amounting to Kshs.766 million and the corresponding amount included in the balance sheet, due to the absence of adequate supporting documentation. In the absence of adequate records, it was also not possible to state whether any additional penalties and interest on the assessment by Kenya Revenue Authority have been accounted for during the year ended 30 June 2006. In addition, tax liabilities including penalties and interest amounting to Kshs.15,311 million as at the 30 June 2005, as assessed by the company's tax agents and agreed with the Kenya Revenue Authority have not been provided for in the financial statements. This has the effect of overstating the revenue reserves by an equivalent amount.

## **13. Contingent Liabilities**

All of the required confirmations from the company's legal representatives of ongoing or threatened litigation claims against the company were not provided for audit verification and it was therefore not possible to verify the completeness of the reported liabilities and contingent liabilities.

## **14. Investment in Subsidiaries**

### **14.1 Gilgil Telecommunications Industries Limited**

Investment in subsidiaries, in the company's balance sheet, amounting to Kshs. 5,879 million as at 30 June 2006, includes an amount of Kshs.880 million being 100% ownership of Gilgil Telecommunications Industries Limited. The financial statements of Gilgil Telecommunications Industries Limited indicate that the company has consistently registered significant losses for the last six years since 1999. The value of the investment is therefore doubtful and may not be recoverable. No provision has been made for this diminution in value in the financial statements.

### **14.2 Kenya College of Telecommunications Technology Limited**

Investment in subsidiaries, in the company's balance sheet, amounting to Kshs. 5,879 million as at 30 June 2006, includes an amount of KShs.1,269 million being 100% ownership of Kenya College of Telecommunications Technology Limited. The financial statements of Kenya College of Telecommunications Technology Limited indicates that the company has consistently registered significant losses, is unable to pay its creditors and its continued existence as a going concern is dependent upon the support of the parent company and its creditors. The value of the investment is therefore doubtful and may not be recoverable. No provision has been made for this diminution in the financial statements.

## **Opinion**

Except for the effect of any adjustments that may be necessary to the Company's financial statements as a result of the matters referred to in the preceding paragraphs, in my opinion, proper books of account have been kept and the accompanying financial statements give a true and fair view of the state of affairs of the Company as at 30 June 2006 and of its loss and cash flows for the year then ended in accordance with the International Financial Reporting Standards, except as reported under paragraph 1, and comply with the Companies Act (Cap. 486 of the Laws of Kenya).

## **Emphasis of Matter**

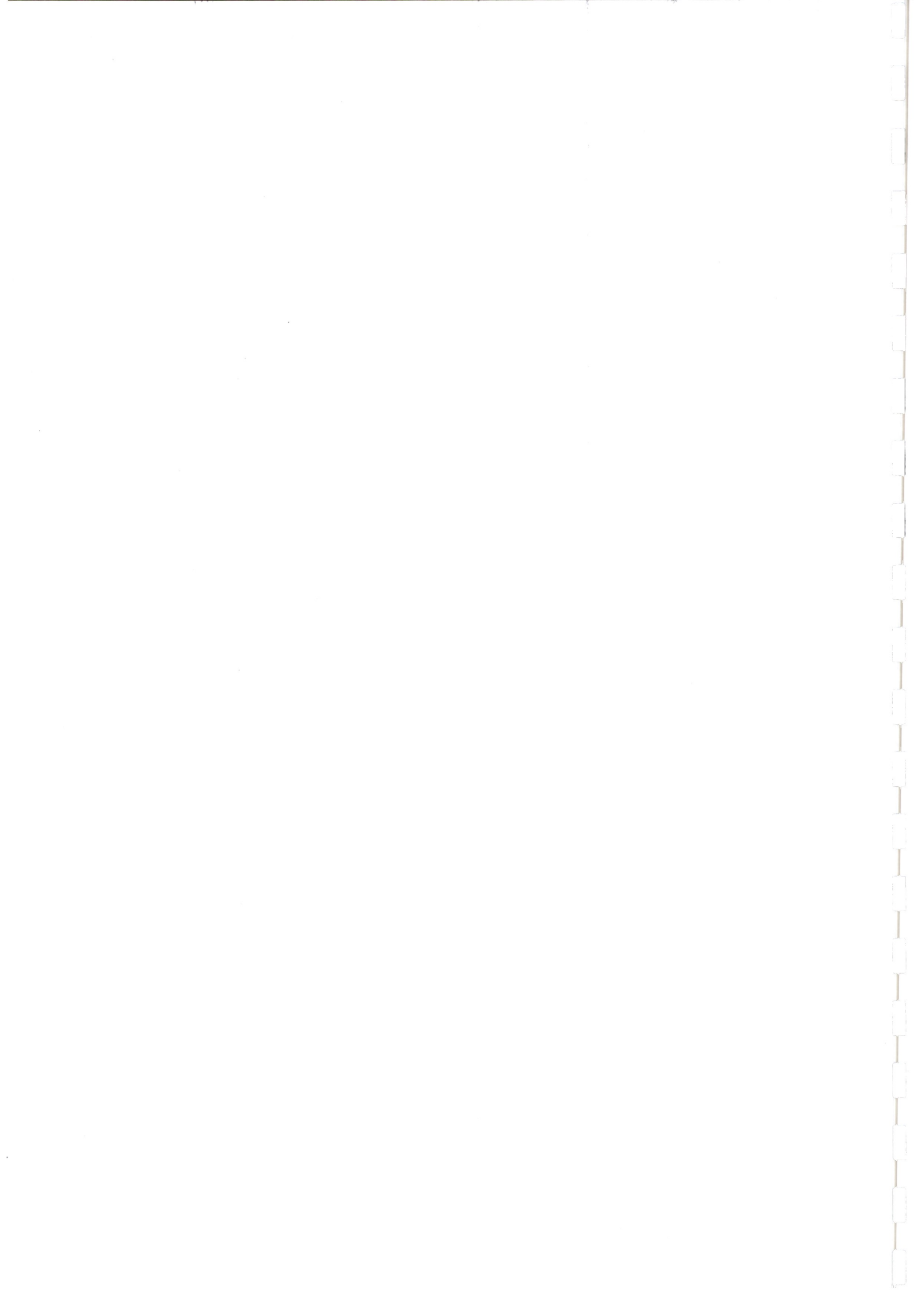
Without qualifying my opinion, I draw attention to Note no. 23 to the financial statements which indicates that the Government disbursed a loan of Kshs.2,609 million (US\$ 33,000,000) to Telkom Kenya Limited in 2001 that was repayable fully within two weeks of completion of the intended sale of the Safaricom shares to a strategic partner. The loan carried an interest rate of 7.5% per annum with additional interest of 9.5% becoming chargeable on payments delayed based on the agreed repayment plan. Having defaulted on the repayment of this loan, the Company has entered into negotiations with the Government to vary the terms of the loan and have therefore not provided for the penal interest since 2001 estimated at Kshs.1,190 million. Negotiations are in progress and the Government has to date not enforced the repayment clause. Resolution of this matter could have an effect on the results and financial position of the Company.



**P.N. KOMORA**  
**CONTROLLER AND AUDITOR GENERAL**

Nairobi

20 June 2007



**BOARD PAPER NO 262/2006**

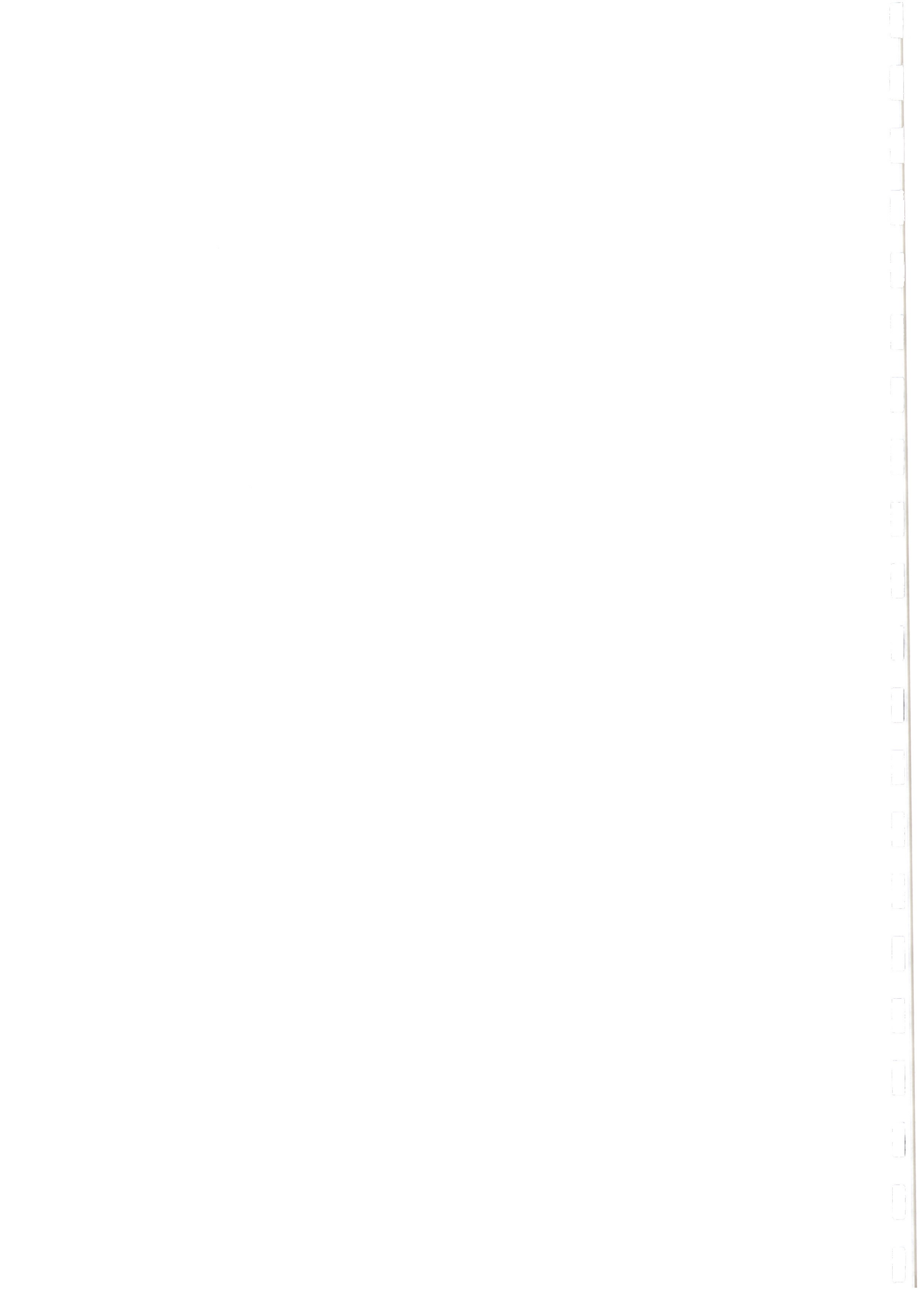


**ANNUAL REPORT AND FINANCIAL STATEMENTS**

**FOR THE PERIOD ENDING 30 JUNE 2006**

**Date**

**November 2006**



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**TELKOM KENYA LIMITED**  
**DIRECTORS, OFFICERS AND ADMINISTRATION**

Wilson N. Ayah	Chairman
Sammy K. Kirui	Managing Director
J.J Kinyua	PS MOF
Esther Koimett	Alt. Director MOF
Eng. James Rege	PS MOI&C (Replaced 6th December 2005 )
Dr. Bitange Ndemo	PS MOI&C (Appointed 6th December 2005)
Felix Mugabe	Alt. Director MOI&C
Bishop Otanga	Director
Martin Malinda	Director
Nicholas Nganga	Director
Grace Chomba	Director

**SECRETARY**

P.B. Jilani

**AUDITOR**

Controller And Auditor General  
Aniversary Towers  
P.O. Box 30084  
University Way  
Nairobi

**REGISTERED OFFICE & PRINCIPAL PLACE OF BUSINESS**

Telkom Kenya Limited  
GPO/Telposta Towers  
Kenyatta Avenue  
P.O. Box 30301  
Nairobi

**BANKERS**

Kenya Commercial Bank Limited  
Kencom House  
Moi Avenue  
P.O. Box 30081  
Nairobi

**ADVOCATES**

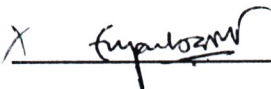
The company engages different advocates depending on the nature of professional services required.

**TELKOM KENYA LIMITED**  
**STATEMENT OF DIRECTORS RESPONSIBILITIES**

The Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of each financial year and of its operating results for that year. It also requires the Directors to ensure that the Company keeps proper accounting records, which disclose with reasonable accuracy at any time the financial position of the company. They are also responsible for safeguarding the assets of the Company.

The directors accept responsibility for the annual financial statements which have been prepared using appropriate accounting policies supported by reasonable and prudent judgements and estimates, in conformity with generally accepted accounting practice and the requirements of the Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the Company 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.

Nothing has come to the attention of the directors to indicate that the Company will not remain a going concern for at least the next twelve months from the date of this statement.

Director X 

Date 30<sup>th</sup> November 2006

Director 

Date 30<sup>th</sup> November 2006

**TELKOM KENYA LIMITED**  
**COMPANY PROFIT AND LOSS ACCOUNT**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

	Notes	Jun-2006 Kshs Million	Jun-2005 Kshs. Million
Turnover		14,354	17,657
Administration expenses		(3,038)	(2,978)
Operational expenses		(1,940)	(3,948)
Other operating expenses	2(a)	(11,944)	(14,135)
		<b>(16,922)</b>	<b>(21,061)</b>
<b>Profit/(Loss) from operations</b>		(2,568)	(3,404)
Net finance cost	3(a)	(776)	(696)
<b>Profit/(Loss) before tax</b>		<b>(3,344)</b>	<b>(4,100)</b>
Other income	4(a)	2,166	602
Exceptional Item	6	(400)	-
<b>Profit/(Loss) before tax</b>		(1,578)	(3,498)
Tax	8(a)	766	764
<b>Net profit/(loss)</b>		<b>(812)</b>	<b>(2,734)</b>

The company profit and loss account is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 12 to 34.

**TELKOM KENYA LIMITED**  
**CONSOLIDATED PROFIT AND LOSS ACCOUNT**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

		<b>Jun-2006</b>	<b>Jun-2005</b>
		<b>Kshs Million</b>	<b>Kshs. Million</b>
Turnover		49,007	47,652
Administration expenses		(5,301)	(4,476)
Operational expenses		(6,576)	(10,815)
Other operating expenses	<b>2(b)</b>	(26,240)	(25,158)
		<b>(38,116)</b>	<b>(40,449)</b>
Profit/(Loss) from operations		10,890	7,203
Net finance cost	<b>3(b)</b>	(1,511)	(2,232)
Profit/(Loss) before tax		<b>9,379</b>	<b>4,971</b>
Other income	<b>4(b)</b>	371	602
Exceptional Item	<b>6</b>	400	-
Profit/(Loss) before tax		<b>9,350</b>	<b>5,573</b>
Tax	<b>8(b)</b>	(3,369)	(2,260)
Profit after tax before minority interest		<b>5,981</b>	<b>3,313</b>
Minority Interest	<b>22</b>	(3,537)	(2,511)
Profit/(loss) after tax and minority interest		<b>2,444</b>	<b>802</b>

The consolidated profit and loss account is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 12 to 34.

**TELKOM KENYA LIMITED**  
**COMPANY BALANCE SHEET AS AT 30 JUNE 2006**

ASSETS	NOTES	Jun-2006 Kshs. Millions	Jun-2005 Kshs. Millions
<b>Non current assets</b>			
Property, plant and equipment	9(a)	31,057	32,359
Investment in subsidiaries	10	5,879	5,879
Investment in associate	12	9	9
Other investments	13	126	132
Other assets	14(a)	737	1,285
		<b>37,809</b>	<b>39,664</b>
<b>Current Assets</b>			
Stocks	15(a)	1,880	1,464
Debtors	16(a)	21,270	22,367
Current A/C Receivable		1,104	1,066
Bank deposits	17	441	251
Bank balances and cash		1,213	739
<b>TOTAL ASSETS</b>		<b>25,908</b>	<b>25,887</b>
		<b>63,717</b>	<b>65,551</b>
<b>EQUITY AND LIABILITIES</b>			
Capital and reserves			
Government interest	19	21,075	21,075
Reserves	21(a)	9,030	9,841
		<b>30,105</b>	<b>30,916</b>
<b>Non current liabilities</b>			
Government loan	23	2,609	2,609
Long term loans	24	870	530
Pensions	25	949	1,384
		<b>4,428</b>	<b>4,523</b>
<b>Current liabilities</b>			
Creditors	26(a)	23,516	21,892
Current account payable (Safaricom)		204	1,859
Corporation tax	27	2,874	3,640
KPTC Corporation tax	28	1,648	1,648
Bank overdraft	29	943	1,073
		<b>29,184</b>	<b>30,112</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>63,717</b>	<b>65,551</b>

The company balance sheet is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 12 to 34.

Director

*[Signature]*  
30<sup>th</sup> November 2006

Director

*[Signature]*  
30<sup>th</sup> November 2006

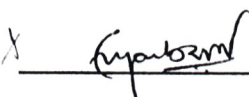


**TELKOM KENYA LIMITED**  
**CONSOLIDATED BALANCE SHEET AS AT 30 JUNE 2006**


ASSETS	NOTES	Jun-2006 Kshs. Million	Jun-2005 Kshs. Million
<b>Non current assets</b>			
Property, plant and equipment	9(b)	67,926	64,427
Intangible assets	11	2,598	2,923
Investment in associate	12	9	9
Other investments	13	126	132
Other assets	14(b)	737	1,285
		<b>71,396</b>	<b>68,776</b>
<b>Current Assets</b>			
Stocks	15(b)	3,281	2,318
Debtors	16(b)	23,984	23,610
Bank deposits		4,892	252
Bank balances and cash		1,625	2,139
Escrow Account	18	-	25
		<b>33,781</b>	<b>28,344</b>
<b>TOTAL ASSETS</b>		<b>105,177</b>	<b>97,120</b>
<b>EQUITY AND LIABILITIES</b>			
Capital and reserves			
Government interest	19	21,075	21,075
Grants	20	2	2
Reserves	21(b)	15,218	12,774
Minority interest	22	13,020	9,483
Share premium		3,850	3,850
		<b>53,165</b>	<b>47,184</b>
<b>Non current liabilities</b>			
Government loan	23	2,609	2,609
Long term loans	24	870	530
Pensions	25	1,208	1,601
Commercial Paper	18	6,198	5,726
		<b>10,885</b>	<b>10,466</b>
<b>Current liabilities</b>			
Creditors	26(b)	33,812	33,091
Corporation tax		4,636	3,640
KPTC Corporation tax	28	1,648	1,648
Bank overdraft	29	1,032	1,091
		<b>41,127</b>	<b>39,470</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>105,177</b>	<b>97,120</b>

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 12 to 34.

Director

  
30<sup>th</sup> November 2006<sup>8</sup>

Director

  
30<sup>th</sup> November 2006

**TELKOM KENYA LIMITED**  
**COMPANY CASH FLOW STATEMENT**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

	NOTES		<b>Jun-2006</b>
			Kshs. Million
<b>Net cash generated from operating activities</b>	<b>30(a)</b>	<b>3,000</b>	<b>1,066</b>
Corporation Tax paid		-	-
Net cash from operating		<b>3,000</b>	<b>1,066</b>
<b>Investing Activities</b>			
Purchase of Investments		-	
Purchase of Fixed Assets		(1,562)	(1,605)
Disposal of Fixed Assets		-	774
Net cash from Investing		<b>(1,562)</b>	<b>(831)</b>
<b>Financing Activities</b>			
Interest Paid		(630)	(367)
Interest Received		(14)	64
Net cash from Financing		<b>(644)</b>	<b>(303)</b>
Net change in cash and cash equivalents		795	(68)
Cash at the beginning of the period		(82)	(110)
<b>Cash at the end of the year</b>		<b>713</b>	<b>(178)</b>



**TELKOM KENYA LIMITED**  
**CONSOLIDATED CASH FLOW STATEMENT**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

	NOTES		Jun-2006 Kshs. Million
<b>Net cash generated from operating activities</b>	<b>30(b)</b>	<b>19,619</b>	<b>21,259</b>
Corporation Tax paid		(2,374)	(765)
		<b>17,245</b>	<b>20,494</b>
 <b>Investing Activities</b>			
Purchase of Investments			
Purchase of Fixed Assets		(11,616)	(18,748)
Disposal of Fixed Assets		-	774
Net cash from Investing		<b>(11,616)</b>	<b>(17,974)</b>
 <b>Financing Activities</b>			
Interest Paid		(1,268)	(367)
Interest Received		14	64
Net cash from Financing		<b>(1,254)</b>	<b>(303)</b>
 Net change in cash and cash		 4,375	 2,217
Cash at the beginning of the		1,324	1,291
<b>Cash at the end of the year</b>		<b>5,699</b>	<b>3,508</b>



**TELKOM KENYA LIMITED**  
**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

<b>(a) Company</b>	<b>Government Interest</b>	<b>Retained surplus</b>	<b>Revaluation Reserve</b>	<b>Total</b>
	Kshs. Million	Kshs. Million	Kshs. Million	Kshs. Million
Balance as at 1 <sup>st</sup> July 2005	21,075	8,908	933	30,916
Retained profit/(loss)	-	(812)	-	(812)
<b>At 30<sup>th</sup> June 2006</b>	<b>21,075</b>	<b>8,096</b>	<b>933</b>	<b>30,105</b>

<b>(b) Group</b>	<b>Government Interest</b>	<b>Retained surplus</b>	<b>Revaluation Reserve</b>	<b>Total</b>
	Kshs. Million	Kshs. Million	Kshs. Million	Kshs. Million
Balance as at 1 <sup>st</sup> July 2005	21,075	11,841	933	33,849
Retained profit/(loss)	-	2,444	-	2,444
<b>At 30<sup>th</sup> June</b>	<b>21,075</b>	<b>14,285</b>	<b>933</b>	<b>36,293</b>

Both the company and the group statement of changes in equity are to be read in conjunction with the notes to and forming part of the financial statements set out on pages 12 to 34.



**TELKOM KENYA LIMITED**  
**NOTES TO THE FINANCIAL STATEMENT**  
**FOR THE PERIOD ENDING 30 JUNE 2006**

**1. SIGNIFICANT ACCOUNTING POLICIES**

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

**a) Basis of Preparation**

The financial statements have been prepared in accordance with International Financial Reporting Standards under the historical cost convention modified by the revaluation of Plant, Property and Equipment.

**b) Consolidation Principles**

The financial statements include those of the company, the Kenya College of Communication Technology Ltd. (KCCT), Gilgil Telecomms Industries Limited (GTI) and Safaricom Limited (SCL).

The financial year end of Safaricom Limited is 31<sup>st</sup> March and the financial statements as at 31<sup>st</sup> March 2005 have been incorporated into these accounts. Also consolidated are its unaudited Management financial statements for the three month period ending 30<sup>th</sup> June, 2005 which is the financial year end of the parent company. Jambo Telkom a wholly owned subsidiary of TKL commenced operations in October 2005. The financial statements of this subsidiary will be consolidated upon full transfer of assets and operations to the subsidiary from TKL, the parent company. The results of Kenya Postel directories an associate company in which TKL owns 40% of the shares have been accounted for under the cost method of accounting. The following associated company have not been consolidated:-

“ Erigtel Limited in which TKL's shareholding amounts to **49%**. The value of TKL's investment in this company, Kshs.60 million, is deemed to be irrecoverable and has therefore been fully provided in these accounts.

**c) Turnover**

Turnover represents revenue accruing upon billings from the major services, namely domestic and international telephone, telex, interconnect services, Kenpac, Kenline, Jambonet and Kenstream, exclusive of value added tax and is recognised at the time of billing.

It does not include the value of TKL's own use of telephone and other related services. Airtime revenue from the prepaid services is recognised when used by the customer.

**d) Foreign Currency Transactions**

All assets and liabilities expressed in foreign currencies are translated into Kenya Shillings at the exchange rate ruling at the balance sheet date. Foreign currency transactions conducted during the year in foreign currencies are converted at the rates ruling at the date of transaction. The resulting differences are dealt with in the profit and loss account.



**e) Property, Plant and Equipment**

Items of property, plant and equipment are stated at cost or valuation less accumulated depreciation and impairment. Cost comprises purchase price, including import duties and non-refundable purchase taxes and directly attributable costs of bringing an asset to working condition for its intended use. Depreciation is calculated to write off the cost or valuation of fixed assets on a straight-line basis over the expected remaining useful lives of the specific assets. Indicative rates are as follows:-

	<b>Useful lives (in years)</b>
Freehold land	No depreciation
Leasehold land	Over the period of the lease
Buildings	1 -50 years
Motor vehicles	2 -10 years
Furniture and fixtures	1 -11 years
Computers	5 years
Plant and machinery	1 -25 years

**f) Impairment of Property, Plant and**

The carrying amounts of assets mentioned in Note (e) above are reviewed at each balance sheet date to determine whether these exceed the recoverable amounts in which case an impairment loss is recognised.

**g) Investments**

Investments are stated at the following values:

- “ Satellite and cable investments are stated at cost and depreciated over the useful life of the cable, appropriate provisions and write-offs are made where necessary.
- “ Other unquoted investments are stated at the lower of cost and management’s opinion of net realisable value
- “ Quoted investments are stated at closing market value on the balance sheet date.

**h) Stocks**

Stocks are valued at the lower of cost and net realisable value. Cost is determined on a weighted average basis or where this is not available, depreciated replacement cost.

If the purchase or production cost is higher than net realisable value, stocks are written down to net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less estimated cost of completion and selling expenses.

**i) Trade and Other Debtors**

Trade and other receivables are stated at nominal value, less provision for any amounts expected to be irrecoverable.



**j) Taxation**

The tax charge for the year has been estimated on the adjusted group accounting profit in accordance with tax legislation. Deferred tax has not been computed.

**k) Net Financial Costs**

Finance costs incurred on the issue of Commercial Paper (medium Term floating rate secured notes) in June 2001 and July 2002 by Safaricom Ltd have been capitalised and are being amortised over the 5 year term of the paper. Net financial costs include interest payable on borrowings as well as interest receivable on funds invested outside the group.

**l) Amortisation of Licence Fee**

The cellular phone licence fee in SCL is being amortised over 15 years (the term of the licence), proportionate to the number of projected subscribers on the network in each year.

The projected subscribers for the first years are taken from the Business Plan with full network maturity being reached in Year 5 (i.e. year 5 to 15 will incur the same charge).

**m) Cash and Cash Equivalents**

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, bank balances, and deposits held at call with the banks net of bank overdrafts.

**2 OTHER OPERATING EXPENSES****(a) Company**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Licences	484	606
International Services	1,221	1,667
Rental	228	240
Maintenance	2,148	2,232
Training	90	161
Sales & Marketing	678	455
Interconnect charges	2,619	4,300
Utilities	263	265
Miscellaneous	111	114
Provision for Depreciation	2,696	2,745
Pension Costs	761	860
Provisions for bad & doubtful debts	645	548
Investment write-back	-	(58)
<b>Total</b>	<b>11,944</b>	<b>14,135</b>



**(b) Group**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Licences	1,393	1,472
International Services	1,497	1,670
Rental	585	767
Maintenance	2,788	2,375
Training	140	209
Sales & Marketing	6,724	768
Interconnect charges	2,185	6,815
Utilities	451	321
Miscellaneous	144	150
Provision for Depreciation	8,442	8,197
Amortisation -licence	325	146
Investment write back	-	(58)
Pension Costs	849	1,774
Provisions for bad & doubtful debts	719	552
<b>Total</b>	<b>26,240</b>	<b>25,158</b>

**3 NET FINANCE COSTS****(a) Company**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Interest payable	630	815
Foreign exchange loss	146	(119)
<b>Total</b>	<b>776</b>	<b>696</b>

**(b) Group**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Interest payable	1,268	1,492
Foreign exchange loss	243	(114)
Financing costs		854
<b>Total</b>	<b>1,511</b>	<b>2,232</b>



**4 OTHER INCOME****(a) Company**

		<b>Jun-2006</b>	<b>Jun-2005</b>
		<b>Kshs' Million</b>	<b>Kshs' Million</b>
Services to PCK		11	8
Services to SCL		31	37
Maintenance revenue		100	105
Sale of sundry equipment and stores		31	62
Interest on staff loans		60	64
Application, licensing		1	2
KPD retention and dividends		68	57
Insurance GPA claims		11	16
Miscellaneous		37	251
Dividend income	5(a)	1,816	-
<b>Total</b>		<b>2,166</b>	<b>602</b>

**(b) Group**

		<b>Jun-2006</b>	<b>Jun-2005</b>
		<b>Kshs' Million</b>	<b>Kshs' Million</b>
Services to PCK		11	8
Services to SCL		31	37
Maintenance revenue		100	105
Sale of sundry equipment		31	62
Interest on staff loans		60	64
Application, licensing and		1	2
KPD retention		68	57
Insurance GPA claims		11	16
Miscellaneous		37	251
Dividend Income	5(b)	21	-
<b>Total</b>		<b>371</b>	<b>602</b>



**5 DIVIDEND INCOME****(a) Company**

	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Kenya Postel Directories	21	-
Safaricom	1,795	-
Total	<b>1,816</b>	-

The Safaricom dividend has been offset against the Safaricom interconnect creditors in total.

**(b) Group**

	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Kenya Postel Directories	21	-
Total	<b>21</b>	-

**6 EXCEPTIONAL ITEM Ksh. 400 MILLION**

This relates to the first phase of human resource restructuring for those who left service by 30 June 2006.

**7 PROFIT BEFORE TAX**

	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Company profit before tax is arrived at after charging:		
Staff costs	4,553	5,875
Depreciation	2,696	2,745
Director emoluments		
- Fees	1	3
- Other	1	2
Auditors remuneration		
- Current period	9	11

**Staff numbers**

The number of employees engaged by the group as at 30<sup>th</sup> June 2006 was analysed as follows: **16,177**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>No. of Employees</b>	<b>No. of Employees</b>
Telkom Kenya Ltd (TKL)	14,806	17,328
Kenya College of Communication Technology	503	529
Gilgil Telecomms Industries Ltd	-	339
Jambo Telkom	21	-
Safaricom	847	696
<b>Total</b>	<b>16,177</b>	<b>18,892</b>

All the staff in GTI were laid off in June 2006.

**8 INCOME TAX EXPENSE****(a) Company**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs'</b>
Current tax charge/(credit)	<b>(766)</b>	<b>(764)</b>

**(b) Group**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Current tax charge/(credit)	<b>3,369</b>	<b>2,260</b>

The tax charge for the year has been estimated on the adjusted taxable profits. No provision has been made for interest and penalties amounting to **Kshs 21 Billion** due to late payments on the 1998/1999, 1999/2000, 2001/2002 and 2003/2004 tax liabilities as the same are in the process of being waived by the Government as part of the restructuring of the company.

## 9 PROPERTY, PLANT AND EQUIPMENT

(a) Company	Land and Buildings	Plant & Machinery	Motor Vehicle	Furniture & Office Equipment	Total
	Kshs' Million	Kshs' Million	Kshs' Million	Kshs' Million	Kshs' Million
At 1 <sup>st</sup> July 2005	5,981	40,811	792	862	48,446
Other Adjustments	(49)	(42)	(82)	-	(173)
Additions	63	1,273	143	83	1,562
Disposals					
<b>At 30 June 2006</b>	<b>5,994</b>	<b>42,042</b>	<b>853</b>	<b>945</b>	<b>49,834</b>
<b>Depreciation</b>					
At 1 <sup>st</sup> July 2005	533	14,551	543	454	16,081
Adjustments	(3)	(80)	(81)	-	(164)
Charge for the year	70	2,603	80	108	2,861
Disposals					
<b>At 30 June 2006</b>	<b>600</b>	<b>17,074</b>	<b>542</b>	<b>562</b>	<b>18,777</b>
<b>At 30 June 2006</b>	<b>5,394</b>	<b>24,968</b>	<b>311</b>	<b>384</b>	<b>31,057</b>
<b>At 1st July 2005</b>	<b>5,392</b>	<b>26,307</b>	<b>252</b>	<b>408</b>	<b>32,359</b>

(b) Group	Land and Buildings	Plant & Machinery	Motor Vehicle	Furniture & Office Equipment	Total
	Kshs' Million	Kshs' Million	Kshs' Million	Kshs' Million	Kshs' Million
At 1 <sup>st</sup> July 2005	8,344	72,916	1,031	2,613	84,904
Adjustments	(49)	1,205	(82)	(1,247)	(173)
Additions	413	19,923	190	180	20,706
Disposals	-	-	0	-	-
<b>At 30<sup>th</sup> June 2006</b>	<b>8,708</b>	<b>94,044</b>	<b>1,139</b>	<b>1,545</b>	<b>105,436</b>
<b>Depreciation</b>					
At 1 <sup>st</sup> July 2005	1,162	25,680	697	1,532	29,070
Adjustments	(3)	795	(81)	(875)	(164)
Charge for the year	250	8,088	119	148	8,605
Disposals	-	-	0	-	-
<b>At 30<sup>th</sup> June 2006</b>	<b>1,409</b>	<b>34,563</b>	<b>734</b>	<b>804</b>	<b>37,510</b>
<b>At 30 June 2006</b>	<b>7,299</b>	<b>59,481</b>	<b>405</b>	<b>741</b>	<b>67,926</b>
<b>At 1st July 2005</b>	<b>7,154</b>	<b>55,868</b>	<b>319</b>	<b>1,086</b>	<b>64,427</b>

**Property titles**

The group does not have titles for some of its properties, as summarised below

	Properties	Value
	Number	Kshs.million
Registered	181	
Unregistered: - In Nairobi	-	
- Outside Nairobi	171	
Total properties as at 30 June 2006	352	6,147
Total properties owned	352	6,147

Property valuation of **Ksh. 6,147 Million** does not include any capital cost incurred on the properties or depreciation since 1<sup>st</sup> July, 1999 the due date the properties were transferred to TKL.

**10 INVESTMENT IN SUBSIDIARIES**

These are stated at cost and include

Company	Key activity	Beneficial ownership	Company Kshs.million
KCCT Ltd	Manpower Training	100%	1,269
Gilgil Telecomms Industries Ltd	Assembly of Telecomms equipment	100%	880
Safaricom Ltd (SCL)	Cellular phone operator	60%	3,730
Jambo Telkom Ltd (JTL)	Internet service provider	100%	5,879

**The investment in SCL comprises**

Transfer of mobile phone assets at Net value	1,189
Shareholders loan (US \$33 million)– acquisition of licence	2,541
	<b>3,730</b>

The formal vesting of assets and liabilities to Jambo Telkom has not been done. The assets of the company are still included in those of TKL the parent company.

No provision has been made in the accounts for the precarious financial position of GTI and KCCT, as their status is being addressed in the Corporate restructuring of Telkom Kenya limited.



**11 INTANGIBLE ASSET**

The intangible asset comprises the cost of the mobile phone licence issued to SCL by the Communications Commission of Kenya. The term of the licence is 15 years effective 1<sup>st</sup> July 1999. The cost of the licence is being amortised with effect from the date SCL commenced trading, 26<sup>th</sup> May 2000. A reconciliation of the balance is as follows:-

<b>Group</b>	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Cost of the licence (US\$ 55 million)	4,235	4,235
Deduct amortisation	(1,637)	(1,312)
	<b>2,598</b>	<b>2,923</b>

**12 INVESTMENT IN ASSOCIATE**

<b>Group &amp; Company</b>	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Kenya Postel Directories Limited 40%.	9	9

The investment in the associated company is carried at cost.

**13 OTHER INVESTMENTS**

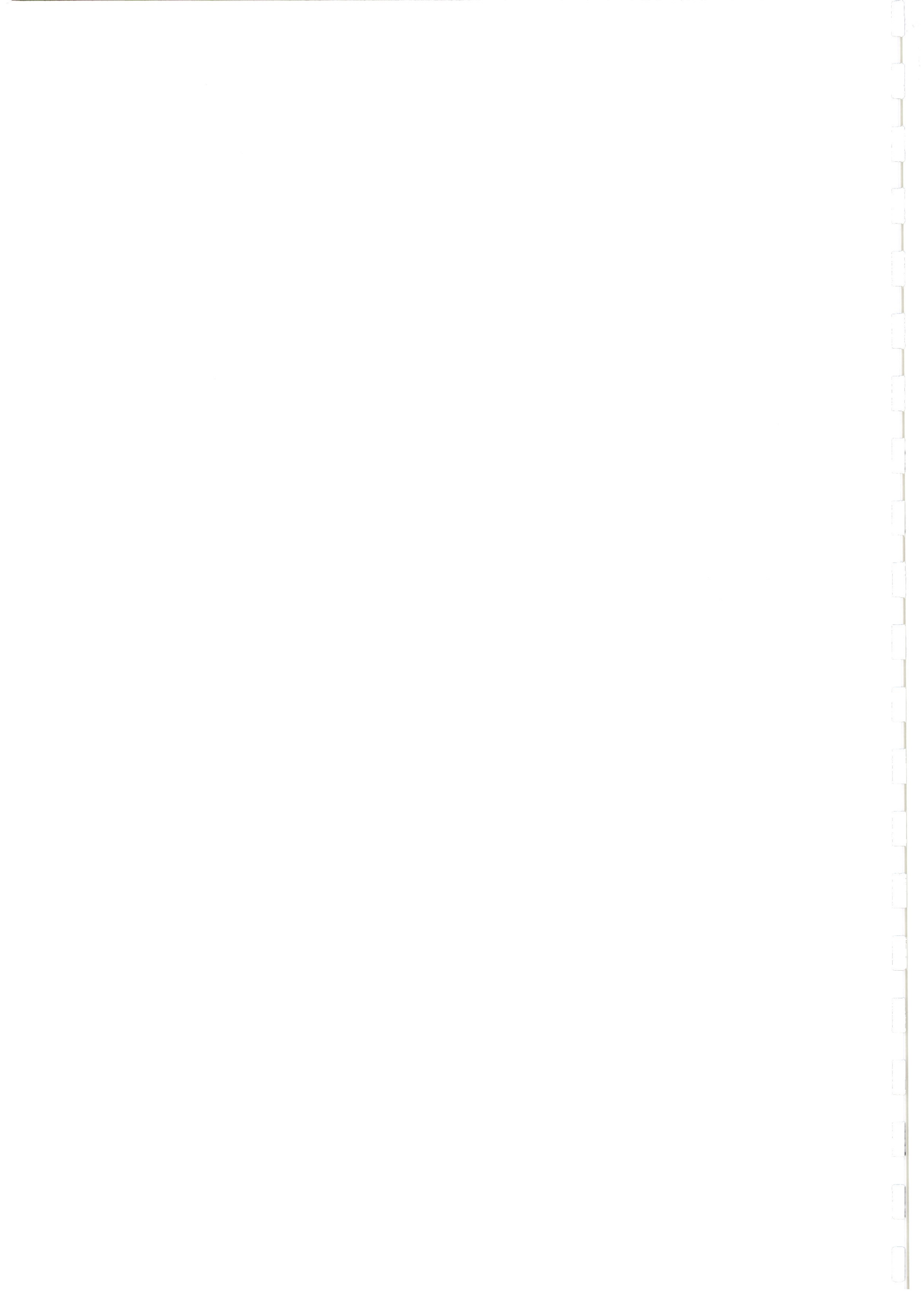
<b>Group and Company</b>	<b>Jun-2006</b> <b>Kshs' Million</b>	<b>Jun-2005</b> <b>Kshs' Million</b>
Gross value	237	848
LESS:		
Provisions	(105)	(105)
Disposals	-	(669)
Write back (Consolidated Bank)	-	58
Exchange adjustment	(5)	
<b>Net</b>	<b>126</b>	<b>132</b>

**14 OTHER ASSETS**

<b>(a) Company</b>	<b>Jun-2006</b> <b>Kshs.million</b>	<b>Jun-2005</b> <b>Kshs.million</b>
Total staff loans	1,242	1,458
Deduct current	(381)	(27)
Non current	861	1,431
Less: provisions	(124)	(146)
<b>Net staff loans</b>	<b>737</b>	<b>1,285</b>



<b>(b) Group</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs.million</b>	<b>Kshs.million</b>
Total staff loans	1,242	1,603
Deduct current	(381)	(27)
Non current	861	1,576
Less: provisions	(124)	(291)
<b>Net staff loans</b>	<b>737</b>	<b>1,285</b>
<b>15 STOCKS</b>		
<b>(a) Company</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs.Million</b>	<b>Kshs.Million</b>
Engineering parts	1,755	1,351
Furniture and equipment	37	34
Consumables and miscellaneous	87	79
	<b>1,880</b>	<b>1,464</b>
<b>(b) Group</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs.Million</b>	<b>Kshs.Million</b>
Engineering parts	1,755	2,194
Furniture and equipment	37	34
Consumables and miscellaneous	1,488	90
	<b>3,281</b>	<b>2,318</b>
<b>16 DEBTORS</b>		
<b>(a) Company</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Local debtors	27,083	27,042
Deduct provisions	(13,905)	(14,069)
<b>Net</b>	<b>13,178</b>	<b>12,974</b>
International debtors	4,034	5,522
Deduct provisions	(1,304)	(721)
<b>Net</b>	<b>2,730</b>	<b>4,801</b>
<b>Total service</b>	<b>15,908</b>	<b>17,775</b>
Non operational debtors	1,629	2,834
Sundry debtors and prepayments	3,352	1,731
Staff Loans and advances	381	27
	<b>5,362</b>	<b>4,592</b>
<b>Total</b>	<b>21,270</b>	<b>22,367</b>



<b>(b) Group</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Local debtors	28,305	28,040
Deduct provisions	(13,905)	(14,069)
<b>Net</b>	<b>14,400</b>	<b>13,971</b>
International debtors	4,034	5,522
Deduct provisions	(1,304)	(721)
<b>Net</b>	<b>2,730</b>	<b>4,801</b>
<b>Total service</b>	<b>17,130</b>	<b>18,772</b>
Non operational debtors	3,121	3,080
Sundry debtors and prepayments	3,352	1,731
Staff Loans and advances	381	27
	<b>6,854</b>	<b>4,838</b>
<b>Total</b>	<b>23,984</b>	<b>23,610</b>

The Company policy is not to provide for Bad and Doubtful debts relating to Government and Parastatals' accounts. This policy is supported by previous debt swap arrangements with Government as follows;

- April 1999, Kshs 4.9 billion government debt offset against Government on lent loans of Kshs 26 billion.
- Ongoing debts swap arrangement where already Kshs 3.2 billion has been agreed for accounts outstanding as at June 2003.
- Government is also considering effecting debt swap in the ongoing restructuring of Telkom Kenya limited.

The Government as the sole shareholder of Telkom Kenya Limited has given an undertaking in certain circumstances to settle some of the parastatal debts in the event of default. Consequently, Government and parastatal debtors are deemed secured and not provided for in the accounts

## 17 BANK DEPOSITS

### Group and Company

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Deposits in failed financial	487	487
Deduct provision	(487)	(487)
Other fixed deposits	441	251
<b>Total</b>	<b>441</b>	<b>251</b>

The bank deposits, other than those in failed financial institutions, have been provided to secure specific letters of credit. The weighted average effective interest rate on these deposits at year-end was **8.5%**.

**18 ESCROW ACCOUNT/COMMERCIAL PAPER**

In June 2001 SCL borrowed Kshs 4,000 million from the public and institutional investors through the issue of commercial paper, a medium term floating rate secured note. This facility was drawn in the year ended 30<sup>th</sup> June 2003. Further, on July 24<sup>th</sup> 2002, Safaricom obtained a Ksh 2,500 million term loan from a syndicate of local banks.

The amount is shown as due on an escrow account, the debtor being the bank which facilitated the issue of the paper.

The medium term note and the bank borrowings all have a tenor of five years. They are secured by a fixed and floating charge over Safaricom's assets, undertaking and property, both present and future, including a charge over the Euro Escrow bank account and a charge over all the issued shares of the company. The interest on the Euro term loan is payable semi annually at a margin of 1.5% over the reference European Inter Bank Offer Rate. Interest on the shilling term loan and the medium note is paid quarterly in arrears based on a mark up of 1% above the prevailing Treasury bill rate. Finance costs incurred on the issue is amortised over the term of the paper.

The notes will be redeemed in six semi-annual instalments as shown below.

<b>Date</b>	<b>Repayments %</b>
30 <sup>th</sup> September 2003	10
31 <sup>st</sup> March 2004	10
30 <sup>th</sup> September 2004	19
31 <sup>st</sup> March 2005	19
30 <sup>TH</sup> September 2005	21
31 <sup>st</sup> March 2006	21
	<b>100</b>

On 31 March 2006 SCL paid off all the outstanding loan balances on the medium term note on the bank borrowings as follows:

- The balance on the Euro 35 million term loan facility.
- The balance on the Sh. 2,500 million facility.
- The balance on the sh. 4,000 million medium term note matured on 31 March 2006 and was paid off.

**New loan facility of Sh. 12,000 million**

During march 2006 SCL obtained a new loan facility of Sh. 12,000 million from a syndicate of international banks. The loan is secured on a fixed and floating charge over the companys property and assets, both present and future and the issued share capital of the company.

SCL had drawn down an amount of Sh.5,000 million from the new loan as at 31 March 2006. The loan period is five years and repayment of the principal will start in April 2008.

The interest for the new loan will be payable quarterly at a margin of 1% over the reference 91 day treasury bill rate.

**19 GOVERNMENT INTEREST**

The **Kshs 21.1 billion** represents the Government of Kenya's interest resulting from the conversion to equity of GOK on-lent loans to KPTC of **Kshs 26 billion**, inclusive of interest, this amount being reduced by **Kshs 4.9 billion** for service debt owed to KPTC by Government ministries and departments at the time of conversion. Government interest has not been translated to share capital. The share capital of the company is as follows:-

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs</b>	<b>Kshs</b>
<b>Authorised</b>		
5,000 ordinary shares of Kshs 20 each	100,000	100,000
<b>Issued and fully paid</b>		
100 ordinary shares of Kshs 20 each	2,000	2,000

**20 GRANTS**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
KCCT hostel	2	2

The grants comprises a donation for hostel construction of shillings 3 million. It is amortised annually at the rate of 2% (Shs. 60,000) and is charged to accumulated depreciation.

**21 RESERVES****(a) Company**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
As at 01 July 2005	9,841	12,574
Retained profit for the year	(812)	(2,733)
<b>As at 30 June 2006</b>	<b>9,030</b>	<b>9,841</b>

**(b) Group**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
As at 01 July 2005	12,774	11,973
Retained profit for the year	2,444	801
<b>As at 30 June 2006</b>	<b>15,218</b>	<b>12,774</b>

**22 MINORITY INTEREST**

Minority interest comprises:

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Shareholders loan	1,694	1,694
Reserves	7,789	5,278
Profit & Loss	3,537	2,511
	<b>13,020</b>	<b>9,483</b>

**23 GOVERNMENT LOAN**

In 2000 the Government of Kenya (GOK) lent TKL US \$ 33 million. At 30 June 2000, the loan was represented by a Gok promissory note and was subsequently disbursed to TKL on 29 June 2001. TKL on-lent the entire amount to SCL to pay for its mobile phone licence.

In the books of TKL, the loan amount is included in the cost of investment in SCL, per Note 9. In SCL's books, this loan ranks *pari passu* with a similar shareholders loan of US\$22 million received from Vodafone Kenya Ltd for the purpose. The loan to SCL is interest free and subordinated to all other loan obligations of the company.

The agreement between TKL and GoK in respect of this loan was signed in July 2001. The agreement provides that interest will be payable at **7.5% per annum** with effect from the disbursement date and that the principal amount and accrued interest would be repaid in one instalment within two weeks of completion of the intended sale of the new TKL shares to a strategic partner.

The agreement further stipulates that, in the event the sale was not concluded by 30 September 2001, the terms of repayment would be renegotiated immediately and, unless otherwise agreed in writing, the full amount of the loan was to be considered due and payable as of that date.

However GOK has not enforced this repayment clause and has requested the company to make repayment proposals. The company has done so, and the key proposals made are as follows:

- ◆ The principal amount and any accrued interest be converted to government equity.
- ◆ That if TKL is not privatized, the principal amount of **Kshs 2,608,881,000.00** be repaid over a ten (10) years period beginning 1<sup>st</sup> July, 2007.

Negotiations with the Government on the repayment of this loan have not been concluded. However it is expected that the status of this loan will be addressed by the Government restructuring of the company.

**24 LONG TERM LOANS**

Company and Group	Jun-2006	Jun-2005
	Kshs' Million	Kshs' Million
Commercial loans	-	-
GOK guaranteed loans	870	530
<b>Total loans</b>	<b>870</b>	<b>530</b>

**(a) Amounts falling due within one year**

Details	Commercial loans	GOK Guaranteed loans	Safaricom Loan	Total
	(Ksh Million)	(Ksh Million)	(Ksh Million)	(Ksh Million)
Principal due	630	334	-	964
Interest	-	227	1,174	1,401
Redemption Arrears	-	2,400	-	2,400
Management Charges	-	374	-	374
<b>Total</b>	<b>630</b>	<b>3,335</b>	<b>1,174</b>	<b>5,139</b>

**(b) Amounts falling due after one year Kshs' million**

Details	Commercial loans	GOK Guaranteed Loans	Safaricom Loan	Total
1-2 years	-	-	-	-
2-5 years	-	-	-	-
Over 5 years	-	870	2,609	3,478
<b>Total</b>	<b>-</b>	<b>870</b>	<b>2,609</b>	<b>3,478</b>

These loans are unsecured and will be payable under terms to be agreed with Government. Included in this category is the Safaricom loan amounting to Ksh **2.61 billion**.

**25 PENSIONS****(a) National Social Security Fund**

This is a statutory defined contribution pension scheme in which both the employer and employee contribute equal amounts. The amount contributed during the period has been charged to the profit and loss account.



**(b) Telposta Pension Fund and Teleposta Provident Fund**

Two new retirement benefit plans were established on 1<sup>st</sup> July 1999 as part of the restructuring of the defunct KPTC. These are the Telposta Pension Scheme (TPS) and the Telposta Provident Fund (TPF). The Scheme and the Fund operate retrospectively and supersede the former KPTC pension and provident fund regulations, which have been revoked.

Current membership comprises of employees of TKL, GTI, and KCCT and retired KPTC pensioners.

Certain assets of Telkom division of KPTC were transferred to TPS and TPF on 30<sup>th</sup> June 1999 to cover the accumulated liability of TKL arising in respect of past service. However, the assets did not fully fund the liability, hence the deficit of **Kshs 6.044 billion**, based on the valuation as at 30<sup>th</sup> June 2004.

Current contributions to the Fund and the Scheme are based on salary, as follows:-

	Pension Scheme	Provident Fund
Employee contribution	7.5%	7.5%
Employer contribution	26.8%	10.6% - 18.1%

The total amount charged to the profit and loss account is **Kshs 394 million**.

**26 CREDITORS**

(a) Company	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Trade creditors	5,431	5,709
Taxes	2,883	2,392
Stores and expense creditors	1,945	1,851
Loans due within one year - Note 24	5,139	5,137
Pensions	3,027	2,658
Sundry creditors	5,090	4,145
<b>Total</b>	<b>23,516</b>	<b>21,892</b>

(b) Group	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Trade creditors	14,554	14,919
Taxes	3,841	2,392
Stores and expense creditors	1,945	1,851
Loans due within one year - Note 24	5,139	5,137
Pensions	3,027	2,658
Sundry creditors	5,305	6,134
<b>Total</b>	<b>33,812</b>	<b>33,091</b>



**27 TKL CORPORATION TAX**

Company	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Opening balance 1.7.2005	3,640	4,405
Charge/Credit for the period	(766)	(765)
Less: payments made		
<b>Balance at 30.06.2006</b>	<b>2,874</b>	<b>3,640</b>

The tax charge for the period has been estimated on the adjusted group taxable profit.

**28 KPTC CORPORATION TAX**

	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Opening Balance	1,648	1,648
Less payments during the year	-	-
<b>Closing Balance</b>	<b>1,648</b>	<b>1,648</b>

**29 BANK OVERDRAFT**

Bank overdraft facilities are secured by a legal charge over several of the company's properties.

**30 NOTES TO CASH FLOW STATEMENT**

Reconciliation of net profit before tax to net cash flows from operating activities.

(a) Company	Jun-2006 Kshs. Million	Jun-2005 Kshs. Million
Profit before tax	(1,578)	(1,804)
Adjustments for:-		
Depreciation charges – Fixed	2,864	2,745
Interest paid	630	367
Interest received	14	(64)
Provision for bad & doubtful	645	545
Net Exchange loss/ (Gain)	6	-
Operating profit before working capital changes	<b>2,581</b>	<b>1,789</b>
Decrease/(Increase) in stocks	(415)	(64)
Decrease/(Increase) in debtors	962	(1,645)
Increase/(Decrease) in creditors	(127)	986
Operating profit after working capital changes	<b>3,000</b>	<b>1,066</b>



<b>(b) Group</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	Kshs. Million	Kshs. Million
Profit before tax	9,350	7,297
Adjustments for:-		
Depreciation charges – Fixed	8,442	11,006
Interest paid	1,268	367
Interest received	(14)	(64)
Provision for bad & doubtful	719	545
Net Exchange loss/ (Gain)	5	-
Operating profit before working capital changes	<b>19,770</b>	<b>18,955</b>
Decrease/(Increase) in stocks	(963)	(166)
Decrease/(Increase) in debtors	(545)	(1,291)
Increase/(Decrease) in creditors	1,357	3,761
Operating profit after working capital changes	<b>19,619</b>	<b>21,259</b>

### 31 FINANCIAL INSTRUMENTS.

Exposure to credit, rate and currency risk arise in the normal course of the group's business

#### Credit risk

Management has a credit policy in place and the exposure to credit is monitored on an ongoing basis. All subscribers are required to place cash deposit with the group before credit facilities are granted. Prepaid telephone services have also been introduced to further minimise credit risk. Investments are allowed only in liquid securities with reputable financial institutions. At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset

#### Interest rate risk

The following table indicates applicable interest rates in respect of the group's income –earning financial assets and interest bearing liabilities at the balance sheet date.

	<b>Note</b>	<b>Interest rate</b>
Bank deposit	16	3% - 5%
Bank balances and cash	-	Nil
Commercial	17	1% above treasury bills rate
Government loan	22	7.5%
Long term loans	23	0% to 9.2% (details on Note 24)
Bank overdraft	28	Base rate (10 % at 30 <sup>th</sup> June 2006).
Short term loan		Base rate plus 1%

The principal terms applicable for the financial assets and interest bearing liabilities are disclosed in the respective notes in these financial statements.



**Foreign currency risk**

The group incurs foreign currency risk on sales, purchase and borrowings that are denominated in a currency other than the Kenya shilling. The currencies giving rise to this risk are primarily US dollars, Euros, Dutch Guilders and Japanese Yen. In respect of assets and liabilities denominated in foreign currency, receipts act as a hedge against liabilities.

**Fair values**

The fair value of the group's financial assets and liabilities is estimated at the respective carrying

**32 RELATED PARTY TRANSACTIONS**

The company controls the following organizations

K.C.C.T	100%
G.T.I	100%
Safaricom	60%
JTL	100%

The following transactions were carried out with related parties:-

**Remuneration**

The total remuneration of directors and senior management of the group is as follows:

Company	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Directors	4	5
Senior management	55	89
	<b>59</b>	<b>94</b>

**Loans****Company**

Directors

	Jun-2006 Kshs' Million	Jun-2005 Kshs' Million
Directors	-	-



**Sale of goods and services**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
K.C.C.T	13	9
G.T.I	3	1
Safaricom	1,106	1,038

Telephone billing done by TKL to its subsidiaries is through the normal course of business and there are no special intergroup concessions on the members of the group.

**Purchase of goods and services**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
K.C.C.T	119	53
G.T.I	-	-
Safaricom Ltd	2,129	3,230

**Current Account Transactions**

	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
K.C.C.T	2	49
G.T.I	38	82

**33 OPERATING LEASES.**

The group has leased office space at Telposta Towers and Safaricom House under operating leases. Leases for both premises run for an initial period of 6 years. Lease payments for Telposta Towers are increased every 2 years to reflect market rentals while rentals for Safaricom House are constant. None of the leases include contingent rentals. Non cancellable operating leases rentals are payable as follows:

<b>Company and Group</b>	<b>Jun-2006</b>	<b>Jun-2005</b>
	<b>Kshs' Million</b>	<b>Kshs' Million</b>
Less than one year	210	210
Between one and five years	489	489
	<b>699</b>	<b>699</b>



### 34 POST BALANCE SHEET EVENTS. PENSION LIABILITY ACTUARIAL VALUATION

Alexander Forbes Actuarial Services Ltd was commissioned to carry out a revaluation of TKL's Pension liability on 2005. The liability as at 30<sup>th</sup> June 2004 stood at **Kshs 6.044 billion**. The ongoing human resource restructuring will have a significant effect on this amount as most of the variables used in arriving at the projected pension such as age, number of years worked and last salary will change for the 11,853 employees who will be retrenched.

### 35 CONTINGENT LIABILITIES

Contingent liabilities comprise the following:-

#### (a) Tax matters

- ◆ Telkom Kenya Limited has engaged the services of Ernst and Young, Certified Public Accountants to act as its advisers in all tax matters. The firm is currently reviewing past tax liabilities indicated below with KRA with a view to agreeing on mitigation's and final amounts payable by the company.
  - ◆ Corporation tax matters of the former KPTC as at 30<sup>th</sup> June 1999 were agreed at **Kshs 3,673 million** with the KRA but currently amount to **Kshs1,648 Million as at 30<sup>th</sup> June 2004**. TKL is liable to pay penalties and interest on this amount principally due to delayed payments.
  - ◆ KRA has issued a demand for import duties amounting to **Kshs.104 million** in respect of equipment imported by KPTC and now vested in and used by TKL. Receipts for duty payments were issued to KPTC through third party clearing agents but KRA is unable to trace the receipt of such duty in its account. TKL and KRA are co-operating to resolve this matter.
  - ◆ KRA has also issued additional assessments in respect of VAT and PAYE amounting to **Kshs' 2.6 billion** and **kshs' 105 Million** respectively. TKL has through Ernst & Young appealed for waiver of the total amount on VAT including any related accrued interest and penalties.
  - ◆ Following an audit, KRA has issued a VAT notice of assessment for **Kshs.392 million** to GTI. Included therein are penalties and interest of **Kshs.355 million** of which application for remission will be made to the Minister for Finance upon full payment of the principal amount. GTI was yet to finalise payment of the outstanding amount as at 30<sup>th</sup> June 2005.
- No VAT is declared on training courses offered at KCCT but is declared on all other services rendered by KCCT.

#### (b) Litigation

There are potential liabilities in respect of various pending court cases arising in the normal course of business. The majority of these cases were taken over from the defunct KPTC. Management is of the opinion that these claims would not give rise to material liabilities.



**36 CAPITAL COMMITMENTS**

<b>Company and Group</b>	<b>Jun-2006 Kshs' Million</b>	<b>Jun-2005 Kshs' Million</b>
Contracted but not provided for		
Authorized but not contracted		
SCL	-	0
TKL	-	0
Authorized and contracted		
SCL	1,409	699
TKL	492	1454
<b>Total</b>	<b>1,901</b>	<b>2,153</b>

**37 INCORPORATION**

The Company is incorporated in Kenya under the Companies Act.

**38 CURRENCY**

These accounts are presented in Kenya shillings million (Kshs.million).

**39 LIST OF SIGNIFICANT SUBSIDIARIES**

<b>Name</b>	<b>Country of Incorporation</b>	<b>Ownership interest</b>
KCCT Ltd	Kenya	100%
Gilgil Telecomms Ltd	Kenya	100%
Safaricom Ltd	Kenya	60%
Jambo Telkom Ltd	Kenya	100%

