REPUBLIC OF KENYA

OFFICE OF THE AUDITOR-GENERAL

*Enhancing Accountability*



# REPORT

# OF



# THE AUDITOR-GENERAL

# ON

# THE FINANCIAL STATEMENTS OF CENTRAL BANK OF KENYA

# FOR THE YEAR ENDED 30 JUNE 2019

# CENTRAL BANK OF KENYA

## ANNUAL REPORT
## AND
## FINANCIAL STATEMENTS

## FOR THE YEAR ENDED
## 30 JUNE 2019

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

## SENIOR MANAGEMENT

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

## HEADS OF DEPARTMENT

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

## REGISTERED OFFICE AND PRINCIPAL PLACE OF BUSINESS

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

## BRANCHES

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

## CURRENCY CENTRES

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

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

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

## SUBSIDIARY

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

## PRINCIPAL LAWYERS

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

## AUDITOR

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

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

1. Statement of Corporate Governance

The Central Bank of Kenya (the "Bank"/"CBK") is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act (the "Act") provides that the Board of Directors (the "Board") shall be composed of a Chairperson, a Governor, Principal Secretary to The National Treasury who is a non-voting member and eight Non-Executive Directors. The law requires that the President appoints the Chairman and Governor after a competitive process and approval of Parliament. Other than the Principal Secretary to The National Treasury who is an ex-officio member, all the Non-Executive Directors of the Board are also appointed by the President with the approval of Parliament. All the Board members are appointed for a term of four (4) years each and are eligible for reappointment provided that no Board member holds office for more than two (2) terms.

All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent oversight.

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

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

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

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

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

1.1. Board of Directors (continued)

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

1.2. Secretary to the Board

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

1.3. Audit Committee

The members of the Audit Committee in the year ended 30 June 2019 were Mr. Samson K. Cherutich (Chairman), Mr. Ravi J. Ruparel, Ms. Charity S. Kisotu, Mrs. Nelius W. Kariuki and Mrs. Rachel B. Dzombo. The members are all Non-Executive Directors with experience in Accounting, Auditing, and Financial Management. The Committee meets once every two (2) months and as necessary. The Terms of Reference of the Audit Committee cover two (2) major areas, namely; Internal Control System (internal audit, risk management & compliance) and Financial Reporting and Related Reporting Practices.

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

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

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

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

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

1.4. Human Resources Committee (HRC)

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

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

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

1.4. Human Resources Committee (HRC) (continued)

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

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

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

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

## 1.5. Monetary Policy Committee (MPC)

Section 4D of the Central Bank of Kenya (Amendment) Act 2008 establishes the Monetary Policy Committee (MPC). The MPC is responsible for formulating monetary policy and is required to meet at least once every two (2) months. The MPC comprises the Governor who is the Chairman, the Deputy Governor who is the Deputy Chairperson, two (2) members appointed by the Governor from the CBK, four (4) external members appointed by the Cabinet Secretary for the National Treasury, and the Principal Secretary for the National Treasury or his Representative. External members of the MPC are appointed for an initial period of three (3) years each and may be reappointed for another final term of three (3) years. The quorum for MPC meetings is five (5) members, one of whom must be the Chairman or Deputy Chairperson.

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

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

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

## 1.5. Monetary Policy Committee (MPC) (continued)

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

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

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

## 1.6. Management Structure

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

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

## 1.7. Code of Ethics

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

## 1.8. Internal Controls

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

## 1.9. Authorizations

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

## 1.10. Internal Audit and Risk Management

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

1.11. Transparency

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statements. In addition, the Bank issues policy briefs to The National Treasury on both the Monetary and Fiscal policies. On an annual basis, the Financial Statements of the Bank are published in the Kenya Gazette and are also placed in the Bank's website.

2.0 Financial Performance

The Bank's financial performance is affected by the Monetary Policy stance undertaken, interest rates and exchange rate changes. The Bank's financial performance is presented on page 12 of these financial statements.

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

During the financial year ended 30 June 2019, the Bank's operating surplus before unrealized gains / (losses) was KShs 21,016 million (2018: KShs 16,101 million). Interest income of KShs 23,347 million (2018: KShs 20,097 million) rose due to the higher interest rates on US Dollar denominated reserves instruments plus higher reserve levels. As a result of a weaker Kenya Shilling to the US Dollar an unrealized foreign exchange gain of KShs 5,122 million was recorded during the year ended 30 June 2019 (2018: loss of KShs 18,690 million). The Bank also recorded a fair value gain on fixed income securities of KShs 7,005 million (2018: loss of KShs 2,073 million). The gain recorded during the year has been presented in other comprehensive income.

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

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

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

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

1. INCORPORATION

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

2. PRINCIPAL ACTIVITIES

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

3. RESULTS AND SURPLUS

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

4. BOARD OF DIRECTORS

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

5. AUDITOR

The Bank is audited by the Auditor General in accordance with *Section 12 of the Public Audit Act* and the *Central Bank of Kenya Act*.

By Order of the Board

Kennedy Abuga
Board Secretary

9 September 2019

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

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

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

(ii) Selecting and applying appropriate accounting policies; and

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

The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial position of the Bank as at 30 June 2019 and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the *Central Bank of Kenya Act*.

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

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

| | |
|---|---|
| Chairman, Board of Directors | Patrick Njoroge<br>Governor |
| Mr. Mohammed Nyaoga | Dr. Patrick Njoroge |
| 9 September 2019 | 9 September 2019 |

# REPUBLIC OF KENYA

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OFFICE OF THE AUDITOR-GENERAL

*Enhancing Accountability*

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Monrovia Street
P.O. Box 30084-00100
NAIROBI

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

REPORT ON THE FINANCIAL STATEMENTS

### Opinion

The accompanying consolidated financial statements of Central Bank of Kenya set out on pages 12 to 85, which comprise the consolidated statement of financial position as at 30 June 2019, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Ernst and Young LLP auditors appointed under Section 23 of the Public Audit Act, 2015 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

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

### Basis for Opinion

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

### Key Audit Matters

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

**Other Matter**

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

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

**2. Lack of the Second Deputy Governor**

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

**Other Information**

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

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

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

**Conclusion**

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

**Basis for Conclusion**

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

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

## Conclusion

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

## Basis for Conclusion

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

## Responsibilities of Management and Those Charged with Governance

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

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

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

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

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

## Auditor-General's Responsibilities for the Audit

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

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

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

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

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

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

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Banks' ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Bank to express an opinion on the financial statements.

- Perform such other procedures as I consider necessary in the circumstances.

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

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

**Nancy Gathungu**
**AUDITOR-GENERAL**

**Nairobi**

**30 July 2020**

CENTRAL BANK OF KENYA
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 30 JUNE 2019

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

CENTRAL BANK OF KENYA
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2019

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

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

Chairman of the Board
Mr. Mohammed Nyaoga

Patrick Njoroge
Governor
Dr. Patrick Njoroge

CENTRAL BANK OF KENYA
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 30 JUNE 2019

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

CENTRAL BANK OF KENYA
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)
FOR THE YEAR ENDED 30 JUNE 2019

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

CENTRAL BANK OF KENYA
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 2019

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

## 1. GENERAL INFORMATION

Central Bank of Kenya (the "Bank"/"CBK") is established under Article 231 of the Constitution of Kenya. The Central Bank of Kenya is responsible for formulating monetary policy, promoting price stability, issuing currency and performing other functions conferred on it by the Act of Parliament. The Bank is wholly owned by the Government of Kenya and is domiciled in Kenya. The Bank acts as banker, advisor and agent of the Government of Kenya.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### (a) Basis of preparation

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

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

New and amended standards and interpretations

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

Several other amendments and interpretations apply for the first time in 2018, but do not have an impact on the financial statements of the Bank. The Bank has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective. The new standards and amendments effective of as of 1 July 2018 are listed below:

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

New and amended standards and interpretations (continued)

*IFRS 9 Financial Instruments (continued)*

Changes to classification and measurement

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

The IAS 39 measurement categories of financial asset (fair value through profit or loss (FVPL), available for sale (AFS), held-to-maturity and amortised cost) have been replaced by:
- Debt instruments at amortised cost
- Debt instruments at fair value through other comprehensive income (FVOCI), with gains or losses recycled to profit or loss on derecognition
- Equity instruments at FVOCI, with no recycling of gains or losses in profit or loss on derecognition
- Financial assets at FVPL

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

Changes to the impairment calculation

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

*IFRS 7R*
To reflect the differences between IFRS 9 and IAS 39, IFRS 7 Financial Instruments: Disclosures was updated and the Bank has adopted it, together with IFRS 9, for the year beginning 1 July 2018. Changes include:
- Transition disclosures, as shown in Note 2(c).
- Detailed qualitative and quantitative information about the ECL calculations, such as the assumptions and inputs used are set out in Note 29.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

New and amended standards and interpretations (continued)

Standards issued but not yet effective

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

Effective for annual periods beginning on or after 1 January 2019

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

Effective for annual periods beginning on or after 1 January 2020

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

Effective for annual periods beginning on or after 1 January 2021

- IFRS 17 Insurance Contracts

Deferred effective date

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

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

*IFRS 16, 'Leases'*

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards issued but not yet effective (continued)

*IFRS 16, 'Leases'(continued)*

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

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

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

*Amendments to IAS 19: Plan Amendment, Curtailment or Settlement*

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

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards issued but not yet effective (continued)

*Amendments to IFRS 9: Prepayment Features with Negative Compensation*

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures (continued)

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

L&R: Loans and receivables
AC: Amortised cost
AFS: Available-for-sale
FVTPL: Fair value through profit or loss
FVOCI: Fair value through other comprehensive income

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Transitional disclosures (continued)

A. Balances due from banking institutions, due from Government of Kenya, securities and advances to banks, loans and advances and funds held with IMF classified as loans and receivables as at 30 June 2018 are held to collect contractual cash flows and give rise to cash flows representing solely payments of principal and interest. These are classified and measured as debt instruments at amortised cost beginning 1 July 2018.

B. Quoted debt instruments classified as financial assets at fair value through profit or loss as at 30 June 2018 were classified and measured as Debt instruments at fair value through other comprehensive income beginning 1 July 2018. The Bank expects not only to hold the assets to collect contractual cash flows, but also to sell a significant amount on a relatively frequent basis. The Bank's quoted debt instruments are internally managed fixed income securities and fixed income securities managed by World Bank that passed the SPPI test.

C. Equity investments in non-listed companies classified as AFS financial assets as at 30 June 2018 were classified and measured as Equity instruments designated at fair value through other comprehensive income beginning 1 July 2018. The Bank elected to classify irrevocably its non-listed equity investments under this category at the date of initial application as it intends to hold these investments for the foreseeable future. There were no impairment losses recognised in profit or loss for these investments in prior periods.

D. The Bank has not designated any financial liabilities as at fair value through profit or loss. There are no changes in classification and measurement for the Bank's financial liabilities.

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

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

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) Transitional disclosures (continued)

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary, Kenya School of Monetary Studies, as at 30 June 2019. Kenya School of Monetary Studies is wholly owned by the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

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

The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.
Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(e) Functional currency and translation of foreign currencies

*Functional and presentation currency*

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

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured.

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

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

(f) Accounting for currency expenses

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments

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

Policy applicable from 1 July 2018

Financial assets

*Initial recognition and measurement*

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

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

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

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

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

*Subsequent measurement*

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

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

Financial assets at amortised cost (debt instruments)

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

*Subsequent measurement (continued)*

Financial assets at fair value through OCI (debt instruments)

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

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

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

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

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

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

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

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

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading, financial assets designated upon initial recognition at fair value through profit or loss, or financial assets mandatorily required to be measured at fair value. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments. Financial assets with cash flows that are not solely payments of principal and interest are classified and measured at fair value through profit or loss, irrespective of the business model. Notwithstanding the criteria for debt instruments to be classified at amortised cost or at fair value through OCI, as described above, debt instruments may be designated at fair value through profit or loss on initial recognition if doing so eliminates, or significantly reduces, an accounting mismatch.

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

*Classes of financial instruments*

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

*Impairment of financial assets*

Overview of Expected Credit Loss (ECL) principles

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

*Impairment of financial assets (continued)*

Measurement of ECL

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

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

Credit impaired financial assets

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

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

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

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

Presentation of allowance for ECL in the statement of financial position

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial assets (continued)

*Derecognition*

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

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

Or

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

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

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

Write-offs

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy applicable from 1 July 2018 (continued)

Financial liabilities

*Initial recognition and measurement*

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

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

*Subsequent measurement*

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

Financial liabilities at fair value through profit or loss

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

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

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

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

Loans and borrowings

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

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

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

*Derecognition*

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018

Financial assets

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

*Financial assets at fair value through profit or loss*

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

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

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

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

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

*Loans and receivables*

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

Financial assets (continued)

*Available-for-sale financial assets*

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period.

Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value re-measurements are included in other comprehensive income.

Financial liabilities

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

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

Determination of fair value

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

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

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

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

De-recognition

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

Classes of financial instruments

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

Impairment of financial assets

(i) Loans and receivables

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

(ii) Available for sale financial assets

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Financial instruments (continued)

Policy before 1 July 2018 (continued)

Offsetting financial instruments

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

(h) Sale and repurchase agreements

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

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

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

(i) Cash and cash equivalents

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

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

(j) Property and equipment

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Property and equipment (continued)

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

| Asset classification | Useful life | Depreciation rate |
|---|---|---|
| Leasehold land | Over the period of the lease | |
| Buildings | 20 years | 5% |
| Motor vehicles | 4 years | 25% |
| Furniture and equipment | 5 - 10 years | 10-20% |
| Computers | 4 years | 25% |

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

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

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

(k) Intangible assets

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

(i) It is technically feasible to complete the software product so that it will be available for use;
(ii) Management intends to complete the software product and use or sell it;

- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and,

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

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(l) Impairment of non-financial assets

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

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

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

(m) Employee benefits

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

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

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

The assets of the scheme are held by the Bank in an independent trustee administered fund.

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Employee benefits (continued)

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

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

(n) Income tax

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

(o) Provisions

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

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

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

(p) Surplus funds

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

(q) Share capital

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

(r) Leases

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

*Bank as lessee*

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

*Bank as lessor*

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(s) Interest income and expense

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

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

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

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

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

(t) Fee and commission income

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

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

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

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

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

(v) Currency in circulation

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(w) Deferred currency expenses

The Bank's inventory is comprised of new currency notes issued. Inventories are stated at the sum of the production costs. Cost is determined using the first-in, first-out (FIFO) method.

Bank notes printing expenses and coin minting costs for each denomination which include ordering, printing, minting, freight, insurance and handling costs are initially deferred. Based on the currency issued into circulation, the respective proportional actual costs incurred are released to profit or loss from the deferred costs account. The deferred amount is recognised as 'deferred currency expenses' in other assets and represents un-issued bank notes and coins stock.

(x) Loan due from the Government of Kenya

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

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

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

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

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

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

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

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

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

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

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

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

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

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

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

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

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

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

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

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

*Post-retirement benefits*

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 20 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

*Fair value of financial assets*

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques. See Note 30 for additional disclosures.

*Property and equipment*

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

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

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

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

## 5. INTEREST EXPENSE

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Interest expense calculated using the effective interest method | | |
| Interest on monetary policy issues - investments by banks | 1,089 | 452 |
| Interest expense - IMF | 403 | 429 |
| | 1,492 | 881 |

## 6. (a) FEES AND COMMISSION INCOME

| | | |
|---|---|---|
| FEES AND COMMISSION INCOME | 3,000 | 3,000 |

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

### (b) NET TRADING INCOME

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Net gain on sale of foreign exchange currencies | 8,933 | 4,547 |
| Net gain on disposal of financial assets at fair value through other comprehensive income | 1,166 | - |
| Net loss on held for trading financial assets | - | (302) |
| | 10,099 | 4,245 |

Net trading income increased by KShs 5,854 million to KShs 10,099 million (2018: KShs 4,245 million) due to increased Government payments during the year.

## 7. OTHER INCOME

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Licence fees from commercial banks and foreign exchange bureaus | 281 | 271 |
| Penalties from commercial banks and foreign exchange bureaus | 420 | 21 |
| Rent income from Thomas De La Rue Kenya Limited | 2 | 2 |
| Kenya School of Monetary Studies operating income - hospitality services and tuition fee | 371 | 330 |
| Gain on disposal of property and equipment | 10 | 6 |
| KEPSS Billing revenue | 280 | - |
| Miscellaneous income | 7 | 16 |
| | 1,371 | 646 |

## 8. CREDIT LOSS EXPENSE

The table below shows the ECL charges on financial instruments for the year:

| | | |
|---|---|---|
| Impairment losses on staff loans (Note 14) | (12) | 35 |
| Impairment losses on balances due from banking institutions (Note 11) | 49 | - |
| Impairment losses on securities and advances to banks (Note 13) | 2,326 | - |
| Impairment losses on debt instruments at fair value through other comprehensive income | 2 | - |
| | 2,365 | 35 |

## 9. (a) OPERATING EXPENSES

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Employee benefits (Note 9(b)) | 4,570 | 3,429 |
| Currency production expenses | 2,214 | 2,028 |
| Property maintenance and utility expenses | 1,602 | 1,361 |
| Depreciation (Note 18) | 1,246 | 873 |
| Amortisation (Note 19) | 134 | 23 |
| Provision for impairment loss on other assets (Note 17(a)) | 16 | 15 |
| Auditor's remuneration | 11 | 11 |
| Transport and travelling | 229 | 146 |
| Office expenses | 303 | 274 |
| Postal service expense | 214 | 190 |
| Legal and professional fees | 517 | 437 |
| Other administrative expenses | 1,888 | 2,184 |
| | 12,944 | 10,971 |

### (b) EMPLOYEE BENEFITS

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Wages and salaries | 4,036 | 3,454 |
| Pension costs - Defined contribution plan | 388 | 315 |
| Medical expenses | 330 | 285 |
| Other staff costs | 313 | 223 |
| Directors' emoluments (Note 28(ii)) | 79 | 69 |
| Net income relating to the retirement benefit asset (Note 20) | (576) | (917) |
| | 4,570 | 3,429 |

## 10. CHANGES IN FAIR VALUE OF INVESTMENTS

(a) Fair value changes on financial assets held for trading

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Internally managed portfolio | - | (1,907) |
| Externally managed portfolio - RAMP | - | (166) |
| | - | (2,073) |

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

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Internally managed portfolio | 6,468 | - |
| Externally managed portfolio - RAMP | 537 | - |
| | 7,005 | - |

## 11. BALANCES DUE FROM BANKING INSTITUTIONS

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Current accounts | 67,162 | 29,877 |
| Foreign currency denominated term deposits | 354,329 | 450,641 |
| Accrued interest on term deposits | 743 | 1,148 |
| Special project accounts | 95,282 | 17,328 |
| Domestic foreign currency cheque clearing | 25,107 | 23,831 |
| Repos clearing and regional central banks | 341 | 162 |
| | 542,964 | 522,987 |
| Allowance for impairment | (115) | - |
| | 542,849 | 522,987 |

## 11. BALANCES DUE FROM BANKING INSTITUTIONS (continued)

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

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

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

Special project accounts relate to amounts received by the Government of Kenya (or its ministries) for specific projects or purposes. An equal and corresponding liability is recorded and disclosed under "Deposits from banks and government" (Note 23).

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

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

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

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

## 13. SECURITIES AND ADVANCES TO BANKS

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

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

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

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

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

| Year ended 30 June 2019 | Maturity period | | | |
|---|---|---|---|---|
| | 1-3 months KShs' million | 3-12 months KShs' million | Over 1 year KShs' million | Total KShs' million |
| Treasury bills discounted | 569 | 1,955 | - | 2,524 |
| Treasury bonds discounted | 911 | 100 | 7,443 | 8,454 |
| Accrued interest bonds discounted | - | 257 | - | 257 |
| Repo treasury bills & bonds (Injection) | 20,100 | - | - | 20,100 |
| Accrued interest repo | 46 | - | - | 46 |
| Due from commercial banks | 1,418 | - | - | 1,418 |
| Liquidity support framework | 34,110 | - | - | 34,110 |
| | 57,154 | 2,312 | 7,443 | 66,909 |

| Year ended 30 June 2018 | 1-3 months KShs' million | 3-12 months KShs' million | Over 1 year KShs' million | Total KShs' million |
|---|---|---|---|---|
| Treasury bills discounted | 15 | 6 | 7 | 28 |
| Treasury bonds discounted | 176 | 941 | 8,353 | 9,470 |
| Accrued interest bonds discounted | - | 277 | - | 277 |
| Repo treasury bills & bonds (Injection) | 19,400 | - | - | 19,400 |
| Accrued interest repo | 43 | - | - | 43 |
| Due from commercial banks | 1,520 | - | - | 1,520 |
| Liquidity support framework | 7,765 | - | - | 7,765 |
| | 28,919 | 1,224 | 8,360 | 38,503 |

## 14. LOANS AND ADVANCES

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

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

| | 2019 | 2018 |
|---|---|---|
| Fixed income securities - Internally managed portfolio | 471,929 | - |
| Fixed income securities under World Bank RAMP | 32,604 | - |
| | 504,533 | - |

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

| | 2019 | 2018 |
|---|---|---|
| Fixed income securities - Internally managed portfolio | - | 369,733 |
| Fixed income securities under World Bank RAMP | - | 30,600 |
| | - | 400,333 |

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

## 16. UNLISTED EQUITY INVESTMENTS

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

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

## 17. (a) OTHER ASSETS

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

All other assets balances are recoverable within one year.

| | | |
|---|---|---|
| The movement in the allowance for impairment losses is as follows: | | |
| At the beginning of the year | 4,929 | 4,914 |
| Increase in impairment allowance (Note 8) | 16 | 15 |
| At 30 June | 4,945 | 4,929 |

### (b) GOLD HOLDINGS

| | | |
|---|---|---|
| Gold holdings | 81 | 71 |

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

## 18. PROPERTY AND EQUIPMENT

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

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

## 18. PROPERTY AND EQUIPMENT (continued)

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

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

18. PROPERTY AND EQUIPMENT (continued)

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

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

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property is based on the going rentals for similar properties within the same location.
- The Bank has taken into account comparable values of similar properties (plot, construction standards, design, lay out, size, location, current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

The Bank is in possession of all titles deeds and occupies all the properties.

19. INTANGIBLE ASSETS

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

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

## 20. RETIREMENT BENEFIT ASSET

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

| The principal actuarial assumptions at the reporting date were: | 2019 | 2018 |
|---|---|---|
| Discount rate (p.a.) | 12.90% | 13.30% |
| Salary increase (p.a.) | 7.00% | 7.00% |
| Future pension increases | 3.00% | 3.00% |

## 20. RETIREMENT BENEFIT ASSET (continued)

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

Plan assets are distributed as follows:

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

Sensitivity of principal actuarial assumptions:

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

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

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

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

## 21. DUE FROM GOVERNMENT OF KENYA

| | 2019 KShs' million | 2018 KShs' million |
|---|---|---|
| Overdraft | 57,327 | 56,849 |
| Government loan | 22,229 | 23,339 |
| | 79,556 | 80,188 |

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

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

## 22. CURRENCY IN CIRCULATION

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

## 23. DEPOSITS FROM BANKS AND GOVERNMENT

| | 2019 | 2018 |
|---|---|---|
| Local commercial banks clearing accounts and cash ratio reserve | 270,262 | 166,772 |
| Local banks foreign exchange settlement accounts | 24,511 | 21,753 |
| External banks foreign exchange settlement accounts | 183 | 134 |
| Other public entities and project accounts | 108,595 | 28,698 |
| Government of Kenya | 337,449 | 366,930 |
| | 741,000 | 584,287 |

## 24. OTHER LIABILITIES

| | 2019 | 2018 |
|---|---|---|
| Impersonal accounts | 2,587 | 3,743 |
| Sundry creditors | 3,513 | 2,934 |
| Refundable deposits | 224 | 231 |
| Leave accrual | 177 | 156 |
| Gratuity to staff members | 20 | 55 |
| | 6,521 | 7,119 |

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

25 (a) SHARE CAPITAL

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

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

(b) GENERAL RESERVE FUND

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

(c) FAIR VALUE RESERVE

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

(d) REVALUATION RESERVE

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

(e) CONSOLIDATED FUND

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

## 26. CASH GENERATED FROM OPERATIONS

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

## 27. CASH AND CASH EQUIVALENTS

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

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

(b) Changes in liabilities arising from financing activities

| | 2019 | 2018 |
|---|---|---|
| At 1 July | 100,284 | 115,125 |
| Cash flow items: | | |
| Repayments | (16,615) | (14,311) |
| Foreign exchange changes | (16) | (530) |
| At 30 June | 83,653 | 100,284 |

## 28. RELATED PARTY TRANSACTIONS

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

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

(i) Loans

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

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

Transactions entered into with the Government include:

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

28. RELATED PARTY TRANSACTIONS (continued)

(vi) Kenya Deposit Insurance Corporation (KDIC)

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

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

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

The staff of the Corporation are contractually employees of Central Bank but seconded to the Corporation. Salaries of these staff are met by the Central Bank and fully reimbursed by the Corporation. In the year under review, salaries paid to the staff of the Corporation by the Central Bank amounted to KShs 218 million (2018: KShs 270 million).

(vii) Kenya School of Monetary Studies (KSMS)

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

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

During the year under review, the school's physical developments projects were significantly completed.

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

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

The pension schemes (that is, the defined benefit and defined contribution schemes) are managed and administered by the Secretariat appointed by the sponsor. The costs of their operations are fully reimbursed to the Bank on a regular basis.

## 29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

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

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

### (a) Strategy in using financial instruments

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

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

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

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

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

### (b) Risks facing the Bank

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

Financial risks include:
- Credit risk
- Market risk:
- Liquidity risk

Non-financial risks include:
- Operational risk
- Human resource risk
- Legal risk
- Reputation risk

## 29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (i) Credit risk

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

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

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

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

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

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

## 29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (i) Credit risk (continued)

Credit quality analysis

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

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Credit quality analysis (continued)

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Collateral and other credit enhancements

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

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

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

Inputs, assumptions and techniques used for estimating impairment

*Significant increase in credit risk*

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

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

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

*Credit risk grades/ratings*

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

*Credit risk grades/ratings (continued)*

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

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

*PD estimation process*

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

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

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

*Determining whether credit risk has increased significantly*

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

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

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

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

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

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

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

*Definition of default*

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

*Definition of default (continued)*

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

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

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

*Incorporation of forward-looking information*

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

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

*Measurement of ECL*

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

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

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

*Measurement of ECL* (continued)

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

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

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

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

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

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

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

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

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

| | Stage 1 Individual | Stage 2 Individual | Stage3 Individual | Total |
|---|---|---|---|---|
| Debt instruments at fair value through other comprehensive income | KShs' million | KShs' million | KShs' million | KShs' million |
| Gross carrying amount as at 1 July 2018 | 400,333 | - | - | 400,333 |
| New assets originated or purchased | 418,501 | - | - | 418,501 |
| Asset derecognized or repaid | (328,580) | - | - | (328,580) |
| Changes to contractual cashflows due to modifications not resulting in derecognition | 14,279 | - | - | 14,279 |
| At 30 June 2019 | 504,533 | - | - | 504,533 |
| Balances due from banking institutions | | | | |
| Gross carrying amount as at 1 July 2018 | 522,987 | - | - | 522,987 |
| Changes to contractual cashflows due to modifications not resulting in derecognition | 19,977 | - | - | 19,977 |
| At 30 June 2019 | 542,964 | - | - | 542,964 |
| Securities and advances to banks | | | | |
| Gross carrying amount as at 1 July 2018 | 37,609 | - | 894 | 38,503 |
| New assets originated or purchased | 528,899 | - | - | 528,899 |
| Asset derecognized or repaid | (497,133) | - | (360) | (497,493) |
| Transfer to Stage 3 | (677) | - | 677 | - |
| At 30 June 2019 | 68,698 | - | 1,211 | 69,909 |
| Other assets | | | | |
| Balance as at 1July 2018 | 960 | | 4,937 | 5,897 |
| New assets originated or purchased | 46 | - | - | 46 |
| Transfer to Stage 3 | (16) | - | 16 | - |
| Changes to contractual cashflows due to modifications not resulting in derecognition | (668) | - | - | (668) |
| As at 30 June 19 | 322 | - | 4,953 | 5,275 |

| Loans and advances | Stage 1 Collective KShs' million | Stage 2 Collective KShs' million | Stage3 Collective KShs' million | Total KShs' million |
|---|---|---|---|---|
| Gross carrying amount as at 1 July 2018 | 2,490 | 11 | 3,587 | 6,088 |
| New assets originated or purchased | 1,219 | - | - | 1,219 |
| Asset derecognized or repaid | (455) | (3) | (30) | (488) |
| Transfer to Stage 2 | (17) | 17 | - | - |
| At 30 June 2019 | 3,237 | 25 | 3,557 | 6,819 |

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

*Loss allowance (continued)*

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk

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

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

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

Year ended 30 June 2019

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

## 29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (i) Credit risk (continued)

Concentrations of credit risk (continued)

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

Year ended 30 June 2018

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

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

Year ended 30 June 2019

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(i) Credit risk (continued)

Concentrations of credit risk (continued)

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

Year ended 30 June 2018

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk

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

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

Non-trading portfolios primarily arise from the interest rate management of the Bank's investment and monetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's internally managed debt instruments at amortised cost and World Bank RAMP financial assets.

*Interest rate risk*

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

*Interest rate risk (continued)*

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

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

*Interest rate risk (continued)*

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

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

*Foreign exchange risk*

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

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2019. Included in the table are the Bank's financial instruments categorised by currency:

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

29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

(ii) Market risk (continued)

*Foreign exchange risk (continued))*

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

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

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

## 29. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

### (iii) Liquidity risk

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

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

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

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

## 30. FAIR VALUE OF ASSETS AND LIABILITIES

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

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

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

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

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

### b) Fair value hierarchy

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

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

## 30. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

### b) Fair value hierarchy (continued)

| Year ended 30 June 2019 | Level 1 KShs' million | Level 2 KShs' million | Level 3 KShs' million |
|---|---|---|---|
| Assets measured at fair value: | | | |
| Property and equipment | | | |
| -Land and buildings | - | - | 17,168 |
| Debt instruments at fair value through other comprehensive income | 504,533 | - | - |
| Equity instruments at fair value through other comprehensive income | - | - | 9 |
| Gold holdings | 81 | - | - |
| Assets for which fair values are disclosed: | | | |
| Securities and advances to banks (rediscounted treasury bonds) | 9,158 | - | - |
| Loans and advances | - | 2,377 | - |
| Due from Government of Kenya | - | 71,419 | - |
| Liabilities for which fair values are disclosed: | | | |
| Due to International Monetary Fund | - | 65,996 | - |

| Year ended 30 June 2018 | Level 1 KShs' million | Level 2 KShs' million | Level 3 KShs' million |
|---|---|---|---|
| Assets measured at fair value: | | | |
| Property and equipment | | | |
| -Land and buildings | - | - | 16,265 |
| Financial assets at fair value through profit or loss | 400,333 | - | - |
| Investment securities - available-for-sale | - | - | 9 |
| Gold holdings | 71 | - | - |
| Assets for which fair values are disclosed: | | | |
| Securities and advances to banks (rediscounted treasury bonds) | 9,888 | - | - |
| Loans and advances | - | 2,688 | - |
| Due from Government of Kenya | - | 71,430 | - |
| Liabilities for which fair values are disclosed: | | | |
| Due to International Monetary Fund | - | 74,394 | - |

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

30. FAIR VALUE OF ASSETS AND LIABILITIES (continued)

b) Fair value hierarchy (continued)

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

*Comparable method for valuation of land and buildings*

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

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

| LEVEL 2 | Valuation technique | Significant observable inputs | Range (weighted average) Interest rate |
|---|---|---|---|
| Loans and advances | DCF | Interest rate | 12% |
| Due from Government of Kenya | DCF | Interest rate | 9% |
| Due to IMF | DCF | Interest rate | 2% |

| LEVEL 3 | Valuation technique | Significant unobservable inputs | Range (weighted average) |
|---|---|---|---|
| Land and buildings | Market comparable approach and Depreciated replacement cost | Comparable sales of similar properties in the neighbourhood | - |

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

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

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

## 31. CONTINGENT LIABILITIES AND COMMITMENTS

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

At 30 June 2019, the Bank had capital commitments of KShs 7,833 million (2018: KShs 6,412 million) in respect of property and equipment purchases.

Operating lease commitments - Bank as lessee

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

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

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

## 32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

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

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

## 32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (continued)

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