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**KENYA RAILWAYS
STAFF RETIREMENT BENEFITS
SCHEME**

**REPORTS AND
FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED
30 JUNE 2018**

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

REPORTS AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2018

CONTENTS	PAGES
Corporate Trustee and professional advisers	3
Report of the Corporate Trustee	4 - 6
Statement of Corporate Trustee's responsibilities	7
Independent auditors' report	8 - 10
Financial statements:	
Statement of changes in net assets available for benefits	11
Statement of net assets available for benefits	12
Statement of cash flows	13
Notes to the financial statements	14 - 27

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

CORPORATE TRUSTEE AND PROFESSIONAL ADVISERS

Corporate Trustee	Corporate & Pension Trust Services Limited 10th Floor, Landmark Plaza, Argwings Kodhek Road P O Box 52439 - 00200 Nairobi
Investment Manager	Co-op Trust Investment Services Limited Co-operative House, 13th Floor Haile Selassie Avenue P O Box 48231 - 00100 Nairobi
Custodian	KCB Bank Kenya Limited Custody Services KCB Towers, 7th Floor, Upper Hill Junction of Kenya Road and Hospital Road P O Box 30644 - 00100 Nairobi
Legal Advisors	Millimo, Muthomi & Co. Advocates Agip House, 6th Floor Flat 12 Haile Selassie Avenue P O Box 8154 - 00200 Nairobi
Auditors	Deloitte & Touche Certified Public Accountants (Kenya) Deloitte Place Waiyaki Way, Muthangari P O Box 40092 - 00100 Nairobi

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

REPORT OF THE CORPORATE TRUSTEE

The Corporate Trustee of Kenya Railways Staff Retirement Benefits Scheme (the "Scheme") presents the report together with the audited financial statements for the year ended 30 June 2018.

ESTABLISHMENT, NATURE AND STATUS OF THE SCHEME

Kenya Railways Staff Retirement Benefits Scheme was set up as a defined benefit Scheme vide a Trust Deed signed on 3 May 2006.

The main purpose of the Scheme is the provision of pension and other retirement benefits for employees of the sponsor upon their retirement from the sponsor's services and relief for the dependents of the deceased employees. For that purpose, the Trustees shall hold the contributions paid to them by the sponsor and the members and any other sums, investments and income and all lump sums representing the same upon trust for the respective persons for whose benefits such sums and other benefits are expressed to be payable in accordance with the provisions of the Deed and the Rules.

The Scheme's assets comprise mainly investment property which was transferred from the sponsor, Kenya Railways Corporation by a Kenya gazette notice in February 2007.

The affairs of the Scheme are monitored by a Corporate Trustee, appointed by the Sponsor, Kenya Railways Corporation.

CONTRIBUTIONS

The Scheme is closed and thus does not receive any contributions. However, given its nature, the sponsor is obliged to meet any actuarial deficits that could arise.

MEMBERSHIP

	2018 No.	2017 No.
Members as at start of year	8,415	9,645
Joiners	705	936
Leavers	(291)	(2,166)
At the end of the year	8,829	8,415

Included in the membership above are 1,110 suspended members. These are members who have not returned their pension census forms. The suspended members' benefits continue to accrue and they will be reinstated and paid their accrued benefits once they return the census forms.

There are 1,127 (2017 – 1,189) deferred pensioners included in the members above. These are members currently in the employment with Kenya Railways Corporation. On retirement, the members are eligible to pension benefits from Kenya Railways Corporation.

Joiners relate to employees who used to work for Kenya Railways Corporation up to 2006 and their dependents who had not been included in the list of pensioners since they had not provided required documents to the Scheme to be included as members. It is expected that more members will join the Scheme in future when suspended members return pension census forms.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

REPORT OF THE CORPORATE TRUSTEE (Continued)

PENSION PAYMENTS

The Corporate Trustee has undertaken various initiatives as disclosed in note 2 to the financial statements to improve the Scheme's liquidity position and settle the pension arrears.

CORPORATE TRUSTEE

The Corporate Trustee is responsible for the security of the Scheme's assets and as such regularly reviews the arrangements relating to custody, security and disposition of the assets. The Corporate Trustee holds regular meetings to discuss the affairs of the Scheme and to deal with any other discretionary matters.

The current Corporate Trustee is shown on page 2.

The statement of changes in net assets on page 11 shows an increase in the net assets of the Scheme for the period of Sh 756,889 (2017: a decrease of 1,339,625,000) and the statement of net assets on page 12 shows that the Scheme's net assets as at 30 June 2018 amounted to Sh 30,305,732 (2017: Sh 29,548,862,000).

INVESTMENT

We confirm that there is no self-investment, nor have the Scheme's assets been used as security or collateral on behalf of the employer or any connected business or individual. As disclosed on note 15 to the financial statements some of the Scheme's investment property has been pledged to secure borrowings by the Scheme.

The scheme is self-administered.

Currently, there are injunctive orders against four (4) properties for disposal namely; Nairobi Railway Club, Makongeni, Mobray and Muthurwa as per HCCC No 294 of 2012, Erdemann Property 1047 Limited vs The Registered Trustees of Kenya Railways Staff Retirement Benefits Scheme & 1 Other. The Plaintiff seeks both injunctive orders and award of damages for loss of business and breach of contract in the sum of Sh 26 Billion. However, the Scheme has appealed for the release of all the four (4) properties.

ACTUARIAL POSITION

The Scheme is required to be subjected to a triennial valuation by independent actuaries to fulfil the statutory requirements under the Retirement Benefits Act.

Actuarial valuation of Kenya Railways Staff Retirement Benefits Scheme was undertaken for the period ended 30 June 2017 by Kenbright Actuarial & Financial Services Limited.

In accordance with average experience of other similar Schemes assets are all taken at 80% of the values shown in the statement of net assets at the date of valuation. Other assets are taken at the values shown in the statement of net assets as at 30 June 2017.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME
REPORT OF THE CORPORATE TRUSTEE (Continued)

Sh'000

The results of the valuation are summarised below:

Value placed on Scheme assets	24,300,894
Value of liabilities:	
Deferred members	1,296,267
Future benefits to current pensioners:	
Pensioners on payroll	6,864,083
Beneficiaries (dependants in receipt of pension)	178,594
Suspended pensioners	336,514
	8,675,458
*Reserves	1,544,970
Total liabilities and reserves	10,220,428
Actuarial surplus	14,080,466
Funding level (ratio of Scheme assets to accrued past service liabilities)	237%

*Reserves have been made mainly for mortality longevity, future joiners and pension increase arrears.

STATUTORY ASPECTS

The Retirement Benefits Authority (RBA) allows a maximum investment of 30% of the Scheme's funds in immovable property. The Scheme currently holds about 99.80% of its total assets as immovable property.

The Scheme is therefore not in compliance with the stipulated regulation.

The Corporate Trustee is taking the necessary steps to ensure that the management of the fund and its assets comply with the Retirement Benefits Act 1997 and the Retirement Benefits Regulations 2000.

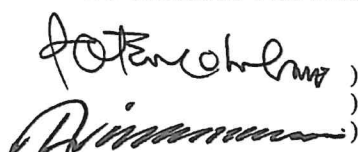
AUDITORS

Deloitte & Touche have expressed their willingness to continue in office as the Scheme's auditors.

FURTHER INFORMATION

Individual members of the Scheme are welcome to obtain further information about the Scheme. The Scheme's Chief Executive Officer will be pleased to answer any queries, general or about individual entitlements to benefits, which can be sent to him at the Scheme's offices.

BY ORDER OF THE CORPORATE TRUSTEE


) Corporate Trustee

28 September 2018

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

STATEMENT OF CORPORATE TRUSTEE'S RESPONSIBILITIES

The Kenyan Retirement Benefits Act requires the Corporate Trustee to prepare financial statements for each financial year which show a true and fair view of the financial transactions of the Scheme for the period and of the disposition of its assets and liabilities as at period end. It also requires the Corporate Trustee to ensure that the Scheme keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the Scheme. The Corporate Trustee is also responsible for safeguarding the assets of the Scheme, and for taking reasonable steps for the prevention and detection of fraud and error.

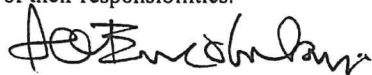
The Corporate Trustee accepts responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and the Scheme's rules except for the departure from certain provisions of International Accounting Standard No. 40 (IAS 40) on Investment Property and International Financial Reporting Standard No. 13 (IFRS 13) on Fair Value Measurement as explained in note 1 to the financial statements. They also accept responsibility for:

- (i) designing, implementing and maintaining such internal control as they determine necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error;
- (ii) selecting suitable accounting policies and applying them consistently; and
- (iii) making accounting estimates and judgements that are reasonable in the circumstances.

The corporate trustee certifies that to the best of their knowledge and belief, the information furnished to the auditors for the purpose of the audit was correct and complete in every aspect. The corporate trustee is of the opinion that the financial statements give a true and fair view of the financial affairs of the Scheme and of its operating results.

The corporate trustee acknowledges that 99.80% of the Scheme's investments are held in immovable properties and has undertaken various initiatives to improve the Scheme's liquidity.

The corporate trustee acknowledges that the independent audit of the financial statements does not relieve them of their responsibilities.



Corporate Trustee

28 September 2018

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

Report on the Audit of the Financial Statements

Qualified Opinion

We have audited the financial statements of Kenya Railways Staff Retirement Benefits Scheme (the "Scheme"), set out on pages 11 to 27, which comprise the statement of net assets available for benefits as at 30 June 2018, and the statement of changes in net assets available for benefits and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph below, the financial statements give a true and fair view of the financial transactions of the Scheme during the year ended 30 June 2018 and of the disposition of its assets and liabilities as at that date, other than liabilities to pay pensions and benefits falling due after the end of the year in accordance with International Financial Reporting Standards and the requirements of the Kenyan Retirement Benefits Act.

Basis for Qualified Opinion

Non-compliance with International Accounting Standard No. 40 (IAS 40), Investment Property, and International Financial Reporting Standard No. 13 (IFRS 13), Fair Value Measurement

As disclosed in note 10 to the financial statements, most of the Scheme's investment properties are carried at forced sale value. Moreover, a full valuation of most of the Scheme's investment properties has not been carried out at the end of the reporting period. This is not consistent with the requirements of IAS 40 and IFRS 13 which requires that the fair value of the investment property shall reflect market conditions at the end of the reporting period and that fair value of an investment property should be determined based on highest and best use of the property respectively. Due to lack of adequate information, we were unable to determine the financial effects on the financial statements of the non-compliance with IAS 40 and IFRS 13 with respect to valuation of investment properties which are carried at Sh 33,547,994,000 in the financial statements.

We conducted our audit in accordance with International Standards on Auditing ("ISA"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of this report. We are independent of the Scheme in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)* together with the ethical requirements that are relevant to our audit of the financial statements in Kenya. We have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME (Continued)

Report on the Audit of the Financial Statements (Continued)

Emphases of matter

We draw your attention to the following:

- a) Non-compliance with the Retirement Benefits Act- the Retirement Benefits Authority Investment Guidelines require that investments in immovable property in Kenya be limited to a maximum of 30% of the Scheme's investments. As at 30 June 2018, 99.80% of the Scheme's investments were in immovable assets.
- b) Note 2 to the financial statements which gives disclosures on the liquidity position of the Scheme. Due to the high concentration of the Scheme's assets in immovable property as discussed above and injunctive orders against disposal of the Scheme's properties valued at Sh. 21,379,901,000 as disclosed in note 10. These conditions indicate a material uncertainty on the Scheme's ability to meet its obligations as they fall due.
- c) Note 10 to the financial statements which gives disclosures on investment properties valued at Sh. 9,363,693,000 whose titles are not in the Scheme's name and there are injunctive orders against disposal of the Scheme's properties valued at Sh. 21,379,901,000 as per court case reference HCCC No 294 of 2012, Erdemann Property 1047 Limited vs Kenya Railways Staff Retirement Benefits Scheme & 1 Other.

Our opinion is not modified in respect of these matters.

Other Information

The Corporate Trustees is responsible for the other information, which comprises the Report of the Corporate Trustees as required by the Retirement Benefits Act. The other information does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Trustee for the Financial Statements

The Corporate Trustees is responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenyan Retirement Benefits Act, and for such internal controls as the Corporate Trustee determines are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Corporate Trustee is responsible for assessing the Scheme'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 corporate trustee either intends to liquidate the Scheme or to cease operations, or has no realistic alternative but to do so. Those charged with governance are responsible for overseeing the Scheme's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our 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 our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF
KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME (Continued)

Report on the Audit of the Financial Statements (Continued)

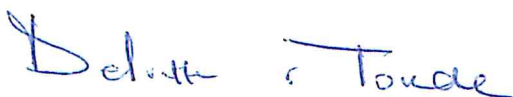
Auditor's Responsibilities for the Audit of the Financial Statements (Continued)

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We 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 our 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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Scheme's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Trustees.
- Conclude on the appropriateness of the Trustees' 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 Scheme's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Scheme 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.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

The engagement partner responsible for the audit resulting in this independent auditors' report is CPA Fred Aloo P/No 1537.



Certified Public Accountants (Kenya)

Nairobi, Kenya

28 September 2018

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS FOR THE YEAR ENDED 30 JUNE 2018

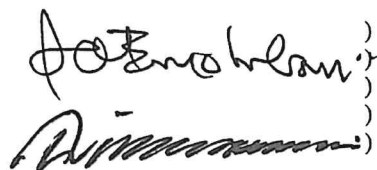
	Note	2018 Sh'000	2017 Sh'000
DEALINGS WITH MEMBERS			
Pension payment	4	(922,106)	(972,573)
RETURN/(LOSS) ON INVESTMENTS PROPERTY			
Rental income		546,661	485,968
Property management expenses	5	(803,828)	(784,343)
Forced sale value gain on investment property	10	2,260,600	125,600
Gain on disposal of investment property		3,600	-
NET RETURN/(LOSS) ON INVESTMENT PROPERTY		2,007,033	(172,775)
LOSS ON OTHER INVESTMENTS			
Investment management expenses	6	(95)	(132)
OTHER INCOME	7	8,193	-
Administrative expenses	8	(303,794)	(148,151)
Finance costs	9	(32,342)	(45,994)
NET INCREASE/(DECREASE) IN NET ASSETS FOR THE YEAR	16	756,889	(1,339,625)
NET ASSETS AVAILABLE FOR BENEFITS AT THE BEGINNING OF THE YEAR		29,548,862	30,888,487
NET ASSETS AVAILABLE FOR BENEFITS AT THE END OF THE YEAR		30,305,751	29,548,862

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS AS AT 30 JUNE 2018

	Note	2018 Sh'000	2017 Sh'000
Assets			
Investment property	10	33,547,994	31,503,794
Equipment	11	868	1,189
Receivables and prepayments	13	27,962	127,447
Bank balance		38,432	4,594
Total assets		<u>33,615,256</u>	<u>31,637,024</u>
Liabilities			
Payables	14	3,139,735	1,950,018
Bank borrowings	15	169,770	138,144
Total liabilities		<u>3,309,505</u>	<u>2,088,162</u>
NET ASSETS AVAILABLE FOR BENEFITS		<u><u>30,305,751</u></u>	<u><u>29,548,862</u></u>
REPRESENTED BY:			
FUND BALANCE	16	<u><u>30,305,751</u></u>	<u><u>29,548,862</u></u>

The financial statements on pages 11 to 27 were approved by the corporate trustee on 28 September 2018 and were signed by:



KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2018

	Note	2018 Sh'000	2017 Sh'000
Cash flows from operating activities			
Other income	7	8,193	-
Benefits paid		(576,245)	(404,732)
Other expenses paid		(295,882)	(932,188)
Net cash used in operating activities		(863,934)	(1,336,920)
Cash flows from investing activities			
Rental income and deposits received on property		646,169	1,466,490
Proceeds from sale of investment property		220,000	-
Purchase of equipment	11	(69)	(798)
Net cash generated from investing activities		866,100	1,465,692
Cash flows from financing activities			
Proceeds from borrowings	15	-	229,766
Interest expense	15	32,342	45,994
Loan valuation fees	15	3,316	-
Repayment of borrowings	15	(3,986)	(183,610)
Net cash generated from financing activities		31,672	92,150
Net increase in cash and cash equivalents		33,838	220,922
Cash and cash equivalent at beginning of the year		4,594	(216,328)
Cash and cash equivalent at end of the year		38,432	4,594
Represented by:			
Bank balance		38,432	4,594

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2018

1 ACCOUNTING POLICIES

Statement of compliance

Except for the departure from certain provisions of the International Accounting Standards No. 40 (IAS 40) on Investment Property and International Financial Reporting Standard No. 13 (IFRS 13) on Fair Value Measurement, the financial statements are prepared in accordance with International Financial Reporting Standards and the requirements of the Kenyan Retirement Benefits Act.

Adoption of new and revised International Financial Reporting Standards (IFRSs)

(i) New standards and amendments to published standards effective for the year

At the date of authorisation of these financial statements, various revised standards and interpretations were issued and effective. These standards and interpretations did not result in changes in the Scheme's accounting policies or result in any material impact on the financial statements of the Scheme.

(ii) New and amended interpretations in issue but not yet effective in the year

At the date of authorisation of these financial statements, various revised standards and interpretations were in issue but not yet effective. The adoption of these standards and interpretations when effective are not expected to result in changes in the Scheme's accounting policies or result in any material impact on the financial statements of the Scheme.

(iii) Early adoption of standards

The Scheme did not early adopt any new or amended standards in 2018.

Basis of preparation

The financial statements are prepared under the historical cost convention as modified for the revaluation of investment properties and financial instruments. The principal accounting policies adopted remain unchanged from the previous year and are set out below:-

Benefits

Benefits payable are recognised in the period they fall due.

Rental income

Rental income is recognized on a straight-line basis over the term of the relevant lease.

Investment income

Interest income is accrued on a time basis, by reference to the principal outstanding at the effective interest rate applicable.

Dividend income

Dividend income from investment is recognized when the Scheme's right to receive payment as a shareholder has been established.

Taxation

The Scheme is a registered pension fund and is exempt from income tax under the Income Tax (Retirement Benefits) rules 1994.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

1 ACCOUNTING POLICIES (Continued)

Financial instruments

Financial assets and liabilities are recognised on the Scheme's statement of net assets when the Scheme becomes a party to the contractual provisions of the Instruments.

(i) Financial assets

Classification

The Scheme classifies its financial assets into the following categories: Financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale assets. Management determines the appropriate classification of its investments at initial recognition.

Government securities

Government securities comprise treasury bills and treasury bonds, which are issued by the Government of Kenya. Treasury bills are held to maturity and are stated at face value less unearned discount while treasury bonds are held for trading and are stated at fair value.

Receivables

Trade receivables are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts. Trade receivables are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the receivable, and that the loss event has an impact on the future cash flows on the receivable that can be estimated reliably.

Objective evidence that trade receivables are impaired could include default or delinquency by a customer, indications that a customer will enter bankruptcy as well as observable changes in national or local economic conditions that correlate with default on receivables. Bad debts are written off when all reasonable steps to recover them have failed.

Bad debts are written off in the year in which they are identified.

(ii) Financial liabilities

Financial liabilities are stated at amortised cost. Amortised cost of a financial liability is the amount at which the financial liability was measured at initial recognition less principal repayments, plus accrued interest on the outstanding principal.

Accounts payable

The liabilities for accounts payable are carried at cost, which is measured at the fair or contractual value of the consideration to be paid in future in respect of goods and services supplied by the suppliers, whether billed or not, to the Scheme.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in statement of changes in net assets over the period of the borrowings using the effective interest method. Borrowings are classified as current liabilities unless the Scheme has an unconditional right to defer settlement of the liability for more than 12 months after the reporting period.

Investment property

Investment property, which is property held to earn rentals and/or for capital appreciation, is measured initially at its cost, including transaction costs. Subsequent to initial recognition, part of the investment property is measured at fair value or at forced sale value. Gains and losses arising from changes in the fair value of investment property are dealt with in statement of changes in net assets in the period in which they arise.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

3 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Scheme's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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

Equipment

Estimates are made by the corporate trustees in determining the useful lives and residual values of equipment based on the intended use of the assets and the economic lives of those assets. Subsequent changes in circumstances such as technological advances or prospective utilisation of the assets concerned could result in the actual useful lives or residual values differing from initial estimates.

4 PENSION PAYMENTS

Pension payments represent pensions paid to members of the Scheme who are retired employees of Kenya Railways Corporation as per the Scheme rules.

	2018 Sh'000	2017 Sh'000
5 PROPERTY MANAGEMENT EXPENSES		
Land rates – current year accrual	21,407	16,299
– arrears accrual	70,156	112,514
– penalties accrual	611,566	601,190
Legal charges	63,047	23,245
Casual wages	12,191	12,142
Valuation fees	12,653	11,970
Estate water bills	9,084	4,820
Other expenses	2,138	1,603
Repair and maintenance	1,470	442
Estate demolition costs	117	118
	<u>803,828</u>	<u>784,343</u>
6 INVESTMENT MANAGEMENT EXPENSES		
Custodial fees	<u>95</u>	<u>132</u>
7 OTHER INCOME		
Miscellaneous income	8,174	-
Interest income from cash and call deposits	19	-
	<u>8,193</u>	<u>-</u>

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2018 Sh'000	2017 Sh'000
8 ADMINISTRATIVE EXPENSES		
Fund administration cost	43,714	66,216
Staff cost	44,546	49,503
Increase in provision for bad and doubtful debt	176,617	11,833
Pension bank transfer commission	8,041	8,065
Retirement Benefit Authority Levy - current year	5,000	5,000
- penalties	23,250	3,500
Audit fees	2,236	2,182
Miscellaneous expenses	-	1,380
Depreciation (note 11)	390	439
Penalties	-	33
	<u>303,794</u>	<u>148,151</u>
9 FINANCE COST		
Interest on borrowings	<u>32,342</u>	<u>45,994</u>
10 INVESTMENT PROPERTY		
At forced sale value		
L.R 209/11953 - Nairobi Railway Club, Nairobi **	13,000,000	13,000,000
L.R 209/6829 - Makongeni Estate, Nairobi **	5,865,901	5,865,901
L.R 209/6502 (Part) - Muthurwa Estate, Nairobi* **	2,450,000	2,450,000
L.R. No. 209/19382 - Ngara Railway Estate – Nairobi	2,178,400	2,178,400
L.R 209/12088 - Landmawe, Nairobi*	1,655,923	1,655,923
L.R 209/12178 - Upper Hill (Part), Nairobi*	1,155,000	1,155,000
L.R 209/11954/2 (Part) - HQ (Eastern "Wing including Block D) Nairobi*	1,138,400	1,138,400
L.R 209/6506 - Matumbato, Nairobi ***	2,070,000	721,600
L.R 209/6507 - Matumbato, Nairobi	1,070,000	349,600
L.R 209/378/5 - Hurlingham Nairobi*	170,000	170,400
L.R 1/422 - Ngong Road, Nairobi*	185,000	104,800
L.R 1/423 - Ngong Road, Nairobi* ***	-	104,800
L.R 1/420 - Kindaruma Road, Nairobi*	93,600	93,600
L.R 1/437 - Kindaruma Road, Nairobi **	64,000	64,000
	<u>31,096,224</u>	<u>29,052,024</u>
At open market value		
L.R 209/12401 - Goods Shed Area, Nairobi*	2,000,000	2,000,000
L.R XXVI/941 - Chambilo, Mombasa	451,770	451,770
	<u>2,451,770</u>	<u>2,451,770</u>
	<u>33,547,994</u>	<u>31,3503,794</u>

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	2018 Sh'000	2017 Sh'000
10 INVESTMENT PROPERTY (Continued)		
Movement in investment properties		
At the beginning of the year	31,503,794	31,378,194
Forced sale value gains	2,260,600	125,600
Disposal	(216,400)	-
At the end of the year	<u>33,547,994</u>	<u>31,503,794</u>

The investment properties were revalued by Knight Frank Limited registered valuers on 30 June 2011. Since then, the following properties have been revalued as indicated below:

Revalued and carried at forced sale value:

- L.R. No. 209/6505 Matumbato, Upperhill by Gimco Limited in 2015;
- L.R. No. 209/11953 Nairobi Railway Club by Rubyland Limited in 2015;
- L.R. 209/378/5 Hurlingham by Rubyland Limited in 2016;
- L.R. 209/6506 - Matumbato, Nairobi by Prestige Management Valuers Limited in 2018;
- L.R. 209/6507 - Matumbato, Nairobi, by Rubyland Limited in 2017 and;
- L.R. 1/422 - Ngong Road, Nairobi by Rubyland Limited in 2017.

Revalued and carried at open market value

- L.R. No. 209/12401 Goods Shed Area, Nairobi by Gimco Limited in 2015;
- L.R. No. XXVI/237 Chambilo, Mombasa by Gimco Limited in 2015;

* Included in investment properties as at 30 June 2018 are properties valued at Sh 9,363,693,200 (2017: Sh 9,388,293,200) whose titles are not in the Scheme's name. These were however transferred to the Scheme by Kenya Railways Corporation via a Kenya Gazette notice of 7 September 2006.

According to the Legal Notice No. 169 of September 2006, the trustees of the Scheme were vested with 5 Acres of Good Shed property although the actual allotment size to the sponsor Kenya Railways Corporation was 8.11 Acres. It is on the basis of 5 acres the valuation was done and adopted by the Trustees. The corporate trustee is pursuing the transfer of titles and these processes are in different stages of completion.

** Currently, there are injunctive orders against disposal of the Scheme's properties valued at Sh 21,379,901,000 (2017: Sh 21,379,901,000) as per court case reference HCCC No 294 of 2012, Erdemann Property 1047 Limited vs Kenya Railways Staff Retirement Benefits Scheme & 1 Other.

*** Investment property L.R. 1/423 - Ngong Road, Nairobi was sold in the year under review. The loan from KCB Bank Kenya Limited is secured by legal charge over L.R. No. 209/6506 Upperhill, Nairobi.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

11 EQUIPMENT

	Computers Sh'000	Office equipment and furniture Sh'000	Total Sh'000
Cost			
At 1 July 2016	5,819	4,559	10,378
Additions in the year	602	196	798
At 30 June 2017	6,421	4,755	11,176
As at 1 July 2017	6,421	4,755	11,176
Additions in the year	69	-	69
At 30 June 2018	6,490	4,755	11,245
Depreciation			
As at 1 July 2016	5,531	4,017	9,548
Charge for the year	271	168	439
At 30 June 2017	5,802	4,185	9,987
As at 1 July 2017	5,802	4,185	9,987
Charge for the year	276	114	390
At 30 June 2018	6,078	4,299	10,378
Net book value			
At 30 June 2018	412	456	868
At 30 June 2017	619	570	1,189

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

12 COMPUTER SOFTWARE

The Scheme has computer software whose original cost is Sh 10,000,000 which is fully amortised. The software is in respect of the day to day running of the Scheme and is still in use.

13 RECEIVABLES AND PREPAYMENTS

	2018 Sh'000	2017 Sh'000
Receivables arising from disposal of property	105,904	105,903
Other receivables	108,573	109,432
Rent receivable	140,234	62,964
Provision for doubtful receivables	(326,768)	(150,852)
Interest income receivable	19	-
	<u>27,962</u>	<u>127,447</u>

Other receivables relate to amounts due from the former Ministry of Local Government, amounting to Sh 105,000,000, prepayments of Sh 3,573,000.

The amount due from the former Ministry of Local Government is still outstanding due the restructuring of ministries under the new constitution making it difficult to establish which ministry should settle the debt. The amount has been fully provided for on the basis that it might take long to recover as a specific budgetary allocation is required in the new ministry.

Receivables arising from disposal of investment property relate to amounts due from the following:

- Kenya Power and Lighting Limited to whom Makongeni L.R. No. 209/6829-part and LR No. 209/65/02 were sold to in 2008 and 2014 respectively. The land rates on the property are still owing to Nairobi City County hence title has not yet been transferred for the debtor to settle the outstanding balance. The outstanding balance amounts to Sh 26,000,000.
- Mahadi Investment Limited to whom Valley Road - Kindaruma Road LR no 209/1064 was sold to in 2014. The debtor continues settling the balance according to the payment plan. The outstanding balance amounts to Sh 79,902,200.

14 PAYABLES

	2018 Sh'000	2017 Sh'000
Accruals and other payables	577,549	533,061
Accrual for land rates, arrears and penalties	1,598,241	833,907
Benefits payable	744,704	398,843
Penalties on RBA levy payable	121,750	97,750
Deposits	53,703	48,635
Retirement Benefit Authority (RBA) levy payable	40,000	35,000
Leave provision	3,788	2,822
	<u>3,139,735</u>	<u>1,950,018</u>

Accruals and other payables includes amounts due to Flexus Estate amounting to Sh 21,250,000 that relates to a deposit they made with respect to the sale of Mobray Court (L.R. No. 1/437 - Kindaruma Road) that did not materialise since the property has a court injunction against disposal of the mentioned properties as per HCCC No 294 of 2012, Erdemann Property 1047 Limited vs Kenya Railways Staff Retirement Benefits Scheme & 1.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

15 BANK BORROWINGS (Secured)

	2018 Sh'000	2017 Sh'000
Analysis of changes in bank borrowings:		
At 1 July	138,144	229,766
Loan repayment	(3,986)	(137,616)
Valuation fee charged to loan	3,316	-
Accrued Interest	32,296	45,994
	<u>169,770</u>	<u>138,144</u>
At 30 June	169,770	138,144
Maturity analysis		
Repayable within 12 months	<u>169,770</u>	<u>138,144</u>

The loan is from KCB Bank Kenya Limited and is secured by legal charge over L.R. No. 209/6506 Matumbato, Upperhill, Nairobi.

The effective interest rate on loan on 30 June 2018 was 24% (2017: 24%). This includes a nominal rate of 14% p.a. and a default rate of 10% p.a.

	2018 Sh'000	2017 Sh'000
16 FUND BALANCE		
Opening fund balance	29,548,862	30,888,487
Net (decrease)/increase in net assets for the year	756,889	(1,339,625)
	<u>30,305,751</u>	<u>29,548,862</u>

17 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

	2018 Sh'000	2017 Sh'000
Key management remuneration:		
Salaries and other benefits	<u>15,547</u>	<u>15,959</u>

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18 FINANCIAL RISK MANAGEMENT

The sponsor, Kenya Railways Corporation, transferred investment property to the Scheme to cover the liabilities of the Scheme at its inception.

The Scheme's main source of revenue is therefore rental income from the investment properties as well as proceeds from the disposal of property. The Scheme also generates revenues by investing in various income generating activities which involve trading in the stock exchange, government and other securities. These activities expose the fund to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign and interest rates. The Scheme'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 corporate trustee together with the investment manager under policies approved by the corporate trustee. The investment manager reviews the market trends and information available to evaluate the potential exposures. They then arrive at strategies to mitigate against market risks. The corporate trustee provides principles for overall risk management, as well as policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, use of derivative and non-derivative financial instruments and investing excess liquidity. The Scheme also follows guidelines issued by the Retirements Benefits authority in respect of maximum investment in different types of investments.

A Market risk

(i) Foreign exchange risk

The Scheme does not hold any off shore investment or investments denominated in foreign currencies, thus it's not exposed to foreign exchange risk.

(ii) Price risk

The Scheme's exposure to equity securities price risk is insignificant.

As at 30 June 2018, if the market price of investment property were to appreciate/depreciate by 5% with all other variables held constant, the impact on return on investment the year would have been higher by Sh 1,605,970,000 (2017 – Sh 1,575,190,000).

(iii) Interest rate risk

The Scheme does not hold any interest bearing assets, therefore it is not exposed to interest rate risk.

B Credit risk

Credit risk refers to the risk that counterparty will default on its contractual obligations resulting in financial loss to the company.

Credit risk arises from bank balances, fixed deposits, interest bearing investments, deposits with banks, and receivables. As part of the credit risk management system, the Investment Manager and the Corporate Trustee monitor and review information on significant investment.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18 FINANCIAL RISK MANAGEMENT (Continued)

B Credit risk (continued)

The amount that best represents the Scheme's maximum exposure to credit risk at 30 June is made up as follows:

	Fully performing Sh'000	Past due Sh'000	Impaired Sh'000	Total Sh'000
30 June 2018				
Receivables	23,483	331,247	(326,768)	27,962
Bank balances	38,432	-	-	38,432
	<u>61,915</u>	<u>331,247</u>	<u>(326,768)</u>	<u>66,394</u>
30 June 2017				
Receivables	170,482	109,273	(150,852)	128,903
Bank balances	4,594	-	-	4,594
	<u>175,076</u>	<u>109,273</u>	<u>150,852</u>	<u>133,497</u>

Bank balances is held with reputable financial institutions that have high credit ratings.

C Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Scheme is required to make periodic payment in respect of pensions to members and is therefore exposed to the risk of difficulty in raising funds to make such payments. It therefore invests a portion of its assets in investments that are readily convertible to cash but do not earn interest. About 99.8% of the Scheme's portfolio is made up investment property which is not readily liquid. The corporate trustee has however made plans to dispose some of the investment property as well as improve rent collections on its existing properties in order to increase the Schemes liquidity. Disposal of the some of the property is a viable option for raising liquidity as the Schemes portfolio comprises of prime property.

The table below shows the Scheme's remaining contractual maturity of its financial liabilities. The table has been drawn up based on the undiscounted cash flows.

	Less than 1 month Shs'000	Between 1 – 3 months Shs'000	Over 3 months Shs'000	Total Shs'000
At 30 June 2018				
Benefits payable	64,688	193,557	486,459	744,704
Creditors and other payables	-	28,250	3,111,485	3,139,735
Bank borrowing	-	-	169,770	169,770
	<u>64,688</u>	<u>221,807</u>	<u>3,767,714</u>	<u>4,054,209</u>

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

18 FINANCIAL RISK MANAGEMENT (Continued)

C Liquidity risk (continued)

	Less than 1 month Shs'000	Between 1 – 3 months Shs'000	Over 3 months Shs'000	Total Shs'000
At 30 June 2017				
Benefits payable	-	-	398,843	398,843
Creditors and other payables	-	35,001	1,443,468	1,478,469
Bank overdraft	-	-	138,144	138,144
	<u>-</u>	<u>35,001</u>	<u>1,980,455</u>	<u>2,015,456</u>
	=====	=====	=====	=====
			2018 Sh'000	2017 Sh'000
19 CAPITAL COMMITMENTS				
Authorised but not contracted for			-	-
			=====	=====
20 OPERATING LEASE RECEIVABLE				
Amounts receivable in respect of obligations under operating leases:				
Within one year			404,324	355,326
Over one year			113,874	84,810
			<u>518,198</u>	<u>440,136</u>
			=====	=====
21 CONTINGENT LIABILITIES				
Legal suits			26,000,000	26,000,000
			=====	=====

Currently, there are injunctive orders against four (4) properties for disposal namely; Nairobi Railway Club, Makongeni, Mubray and Muthurwa as per HCCC No 294 of 2012, Erdemann Property 1047 Limited vs The Registered Trustees of Kenya Railways Staff Retirement Benefits Scheme & 1 Other. The Plaintiff seeks both injunctive orders and award of damages for loss of business and breach of contract in the sum of Shs 26 Billion. However, the Scheme has appealed for the release of the four (4) properties.

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

22 ACTUARIAL VALUATION AND STATEMENT

The Scheme operates on a defined benefits basis and its assets are held in funds managed by an independent investment manager.

The Scheme is required to be subjected to a triennial valuation by independent actuaries to fulfil the statutory requirements under the Retirement Benefits Act.

An actuarial valuation of Kenya Railways Staff Retirement Benefits Scheme was undertaken for the period ended 30 June 2017 by Kenbright Actuarial & Financial Services Limited.

The results of the valuation are summarised below:

	Sh'000
Value placed on Scheme assets	24,300,894
Value of liabilities:	
Deferred members	1,296,267
Future benefits to current pensioners:	
Pensioners on payroll	6,864,083
Beneficiaries (dependants in receipt of pension)	178,594
Suspended pensioners	336,514
	8,675,458
*Reserves	1,544,970
Total liabilities and reserves	10,220,428
Actuarial surplus	14,080,466
Funding level (ratio of Scheme assets to accrued past service liabilities)	237%

*Reserves have been made mainly for mortality longevity, future joiners and pension increase arrears.

The Retirement Benefits Rules and Regulations 2000, require all funds in Kenya to satisfy a minimum funding requirement of 100% of the fund's accrued liabilities. The funding level disclosed for the Scheme at 237% at this valuation was above the minimum funding requirement.

23 FAIR VALUE OF NON-FINANCIAL ASSETS

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Scheme takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

The investment properties were revalued by Knight Frank Limited registered valuers on 30 June 2011. Since then, the following properties have been revalued as indicated below:

Revalued and carried at forced sale value:

- L.R. No. 209/6505 Matumbato, Upperhill by Gimco Limited in 2015;
- L.R. No. 209/11953 Nairobi Railway Club by Rubyland Limited in 2015;

KENYA RAILWAYS STAFF RETIREMENT BENEFITS SCHEME

NOTES TO THE FINANCIAL STATEMENTS (Continued)

23 FAIR VALUE OF NON-FINANCIAL ASSETS (Continued)

- L.R 209/378/5 Hurlingham by Rubyland Limited in 2016;
- L.R 209/6506 - Matumbato, Nairobi by Prestige Management Valuers Limited in 2018;
- L.R 209/6507 - Matumbato, Nairobi, by Rubyland Limited in 2017 and;
- L.R 1/422 - Ngong Road, Nairobi by Rubyland Limited in 2017.

Revalued and carried at open market value

- L.R. No. 209/12401 Goods Shed Area, Nairobi by Gimco Limited in 2015;
- L.R. No. XXVI/237Chambilo, Mombasa by Gimco Limited in 2015;

This is not consistent with International Accounting Standard No 40, Investment Property which requires investment property carried at fair value to be revalued at the end of each reporting period. The investment property values are based on the forced sale value obtained during this valuation.

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the fund's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges.
- 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).
- 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. This hierarchy requires the use of observable market data when available. The Scheme considers relevant and observable market prices in its valuations where possible.

The following table shows an analysis of investment property recorded by level of the fair value hierarchy:

	Level 1 Shs '000'	Level 2 Shs '000'	Level 3 Shs '000'	Total Shs '000'
At 30 June 2018				
Total investment property	-	-	33,547,994	33,547,994
	=====	=====	=====	=====
At 30 June 2017				
Total investment property	-		31,503,794	31,503,794
	=====	=====	=====	=====

24 REGISTRATION

The Scheme is registered in Kenya under the Retirement Benefits Act.

25 CURRENCY

The financial statements are presented in Kenya Shillings rounded to the nearest thousands (Sh'000) which is also the functional currency.