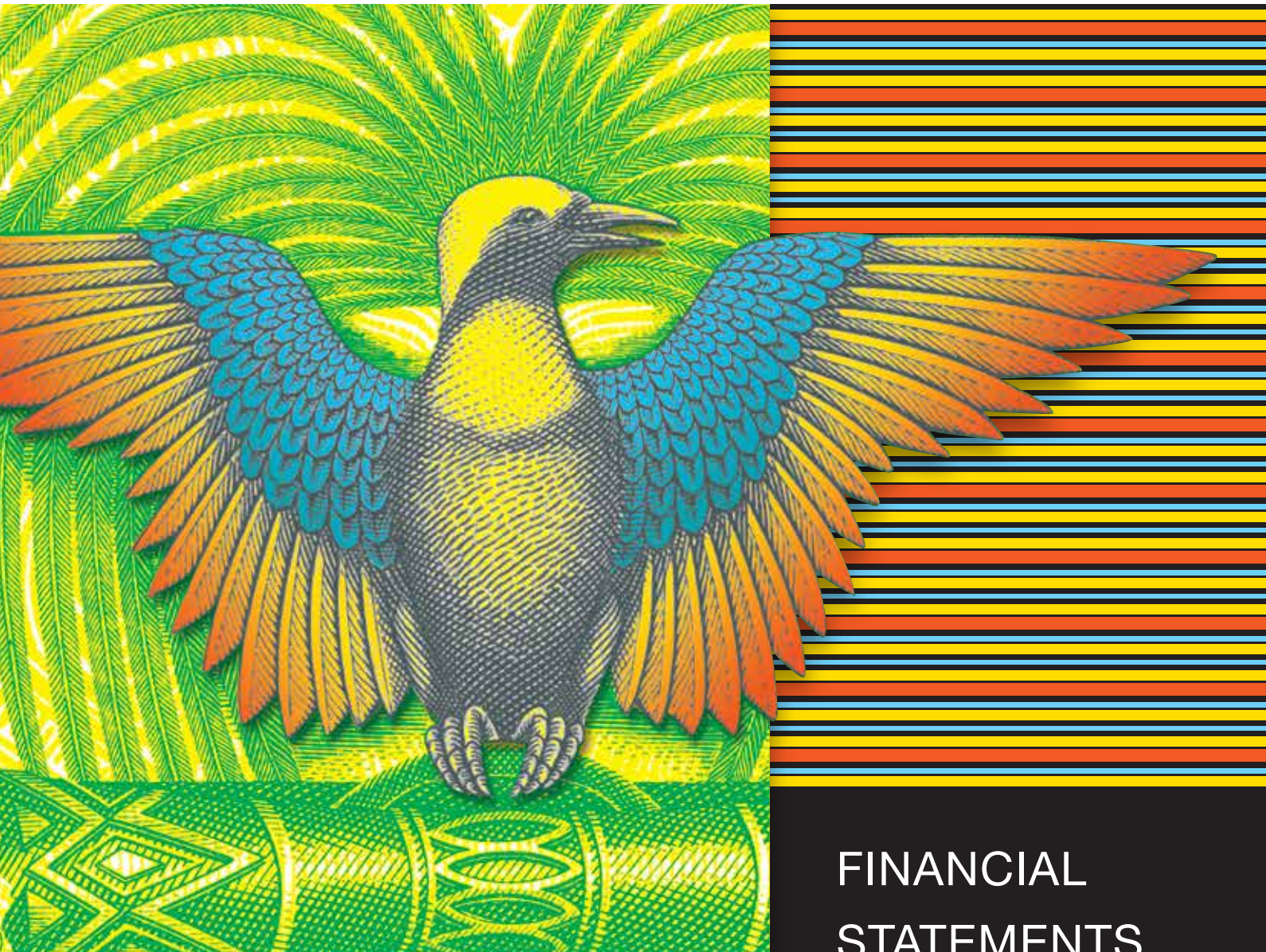




**Bank of Papua New Guinea**



**FINANCIAL  
STATEMENTS**

31 DECEMBER 2015



# Bank of Papua New Guinea

## REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2015

For the advantage of the people of Papua New Guinea, the objectives of the Central Bank are:

- (a) to formulate and implement monetary policy with a view to achieving and maintaining price stability; and
- (b) to formulate financial regulation and prudential standards to ensure stability of the financial system in Papua New Guinea; and
- (c) to promote an efficient national and international payments system; and
- (d) subject to the above, to promote macro-economic growth in Papua New Guinea.

*Central Banking Act, 2000*



Head Office	ToRobert Haus Douglas Street Port Moresby
Postal Address	PO Box 121 Port Moresby
Telephone	(675) 322 7200
Email	<a href="mailto:info@bankpng.gov.pg">info@bankpng.gov.pg</a>
Facsimile	(675) 321 1617
Website	<a href="http://www.bankpng.gov.pg">www.bankpng.gov.pg</a>

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# Governor's Foreword



Mr Loi M. Bakani CMG, Governor and Chairman of the Board

2015 was a year of much optimism as well as challenges for Papua New Guinea. It was the first full year of Liquefied Natural Gas (LNG) production and export for the country. PNG hosted the very successful XV Pacific Games and celebrated 40 years of independence.

The Government continued its expansionary fiscal policy to support economic activity. However low international commodity prices and the El Niño drought had adverse effects on Government revenue and economic activity and contributed to a slowdown in economic growth.

These developments posed challenges for the Bank of Papua New Guinea in carrying out its functions during the year. The Bank continued to undertake various initiatives to enhance the way it conducts its responsibilities of formulating and conducting monetary policy, supervising the financial system and improving the national payments system.

I am pleased to present in this Annual Report a summary of our activities and achievements as the Central Bank of Papua New Guinea during the year 2015.

PNG continued to experience a challenging domestic environment in 2015, exacerbated by developments abroad. While the economy grew for the 14th consecutive year, it was at a slower rate. Inflation was manageable at around 6 percent. The lower growth was mainly due to low commodity prices and lower production and exports of some agricultural commodities due to the El Niño drought as well as the temporary closure of two major operating mines. These factors partially offset a significant increase in LNG production and export and increased production of nickel and cobalt.

Low international commodity prices, the El Niño drought and the high demand for imported goods and services continued to have a detrimental impact on Government revenue and exerted downward pressure on the kina exchange rate. The Bank continued to support the foreign exchange market with foreign currency liquidity, resulting in a decline in the country's foreign exchange reserves. The ongoing shortage of foreign currency resulted in various practices in the domestic foreign exchange (FX) market. The Bank responded by announcing several foreign exchange control directives in March 2015 to ensure a smooth and orderly functioning of the FX market. The directives included banning the opening of onshore and offshore foreign currency accounts, ceasing unauthorised banking practice by foreign banks through their vostro accounts and stopping the outward remittance of kina.

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The high level of liquidity in the banking system, while not inflationary, remains an issue as it has weakened the monetary policy transmission mechanism. The Bank continued to review the effectiveness of the monetary policy signalling rate, the Kina Facility Rate (KFR) and plans to introduce changes to it in 2016.

Our 2012–2015 Strategic Plan ended in 2015 and during the year we started work on the next one for 2016–2020.


A successful workshop with Board members and senior staff was held in October to put together the next Strategic Plan. This followed an intensive consultative process with staff in the Bank. Key strategic initiatives and programs as well as business-as-usual activities were discussed for inclusion in the 2016–2020 Plan. The Plan will be launched in early 2016.

In the area of payment system, the third phase of the Kina Automated Transfer System (KATS) – Direct Credits went live in February 2015. Through the Direct Credits facility, commercial banks can transact with each other, making direct payments to their customers' accounts. Business houses, organisations and individuals can make direct payments using their funds in a bank account to an account held in another bank. This is another milestone achievement for the payment system in PNG.

Papua New Guinea's commitment to combatting money laundering and terrorist financing was cemented during the year, with the passing of the Anti-Money Laundering and Counter Terrorist Financing (AML/CTF) suite of legislation in July 2015. The Bank established the Financial Analysis and Supervision Unit (FASU), responsible for the analytical part of financial intelligence reporting by various money handling agencies. The Government, with support from Austrac, continues the work to release PNG from the 'grey' listing by the Financial Action Task Force.

With the enactment of a new Organic Law on Sovereign Wealth Fund (SWF) by Parliament in July 2015, we stand ready to assist in developing the necessary administrative structures to bring the PNG SWF into full operation.

We have made significant progress on our financial inclusion agenda. As part of the National Strategy for Financial Inclusion and Financial Literacy 2014 – 2015, we participated at various cultural shows in the provinces to educate the public on



We have made  
significant progress  
on our financial  
inclusion agenda.

financial literacy and awareness. In line with the aim of encouraging a savings culture in PNG, a special focus on school children during the year led to many students opening savings accounts.

The Institute of National Affairs conducted a study on financial inclusion and financial capability in Morobe and Madang provinces, with World Bank assistance and oversight by the Bank of PNG. The report on this study was launched in Port Moresby in November.

A World Bank sponsored review of the financial services sector was jointly conducted by Treasury Department and the Bank during the year. The review aimed to identify deficiencies in service delivery by the financial system in PNG, and pinpoint where the National Government and donors can fund those service gaps.

The Bank's currency operations came under the international spotlight in 2015. During the year we issued commemorative coins and banknotes for the XV Pacific Games as well as banknotes for Papua New Guinea's 40th anniversary of independence. In October, the multi-coloured commemorative 50 toea coin for the XV Pacific Games won the 'Best New Circulating Coin or Coin Series' award at the Coin Conference in Madrid, Spain. We also issued a commemorative coin for the University of Papua New Guinea's Golden Jubilee anniversary. In November we launched the construction of our currency distribution facility in Lae, the first such facility located outside Port Moresby.

In October 2015 we hosted a very successful SEACEN Executive Committee (EXCO) meeting, which was preceded by a high-level SEACEN-BIS Seminar. The meeting

## Governor's Foreword

attended by the Deputy Governors of SEACEN member countries followed on from our successful hosting of the SEACEN Board of Governors Meeting in November 2014. During these events we introduced paperless meetings with the use of Notebooks and iPads.

I acknowledge the ongoing cordial working relationships we have and support the Bank has received from our international partners, including the IMF, World Bank, Asian Development Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, SEACEN Centre, SEANZA, Australian Prudential Regulatory Authority, Pacific Technical Assistant Centre, Pacific Financial Inclusion Program, Alliance for Financial Inclusion and the United Nations Development Program and Austrac.

I would like to encourage staff to remain committed to our mission, vision and core values. The Bank will continue to deliver on its core objectives but this can only be achieved through a dedicated and skilled workforce. I acknowledge the importance of effective human resources practices, including continuous training and development to improve staff skills and knowledge. In 2015 staff attended industry-related courses, seminars, workshops and conferences and a few undertook formal studies, both in PNG and overseas. We continued the engagement of advisors from the Australian Business Volunteer (ABV) in various operations areas, including capacity building.

The Bank continues to support and sponsor charitable events, including fundraising for the Sir Buri Kidu Heart Foundation. In place of our independence anniversary celebrations, we donated gifts and food to the needy members of our community such as the Cheshire Home, Hope Worldwide, Friends That Care and the Children's Ward at the Port Moresby General Hospital.

During the year we lost a long-serving staff member and a member of the Board when they passed on, the latter whilst on duty travel. We pay our respects to them and thank their families for the support and time devoted to the Bank.

In November I received the Queen's Birthday Award of the Order of St. Michael and St. George (CMG) for service to banking. It was a proud moment for me, my family and for the Bank of PNG. I thank you all: my fellow Board members for your invaluable contribution and support throughout the year, the staff and management for your on-going commitment, and our families for their undivided support. Together, we will strive to improve and maintain the high standard and quality of performance expected of us and meet our vision of being "a contemporary central bank and regulator excelling in performing our core functions and making a distinct and valuable contribution to the financial stability and economic well-being of Papua New Guinea".

I look forward to 2016, another productive year as the start of implementation of the 2016-2020 Strategic Plan.

### **Loi M. Bakani CMG**

*Governor and Chairman of the Board and Registrar of Savings and Loan Societies*

# Highlights

## Commemorative Release

In 2015 the Bank released a number of commemorative coins. (see page 29)



Governor Mr Loi M. Bakani CMG with the Minister for Treasury Mr Patrick Pruaitch, Customs Commissioner Mr Ray Paul and Minister for Sports, Mr Justin Tkatchenko review the commemorative coins and notes launched to commemorate the XV Pacific Games.



The Bank issued commemorative notes and coins to mark the 40th anniversary of Papua New Guinea's independence and the XV Pacific Games.

The coloured 50 toea coin, released to celebrate the XV Pacific Games, won a prestigious international award. (see page 30)



Two commemorative coins marked the Golden Jubilee of the University of Papua New Guinea (UPNG). (see page 29)

## SEACEN Activities

The Bank plays an active role in South East Asian Central Banks (SEACEN) activities . In October the Bank hosted a high level SEACEN-BIS seminar, followed by the SEACEN EXCO annual meeting, as well as holding Committee member positions on the SEACEN Remuneration Committee and the SEACEN Funding Model Committee.



▲ Left to right: Attending the SEACEN Meeting, Vincent Lim and Vivien Ong from the Strategy Team at the SEACEN Centre and Assistant-Governor Elizabeth Genia.



◀ Delegates to the 14th SEACEN EXCO Annual Meeting and participants in the SEACEN-BIS seminar.



## Highlights

### The Bank marks PNG's 40th Anniversary

BPNG celebrated the Nation's 40th Anniversary of Independence with colourful displays of our diverse culture, including a bright new uniform. While it was 'business as usual', some of the office wear was very eye-catching!



### Financial Inclusion Program Success

2015 was a very successful year in moving forward with the financial inclusion agenda. Over 45,000 new bank accounts were opened during the year. Awareness activities were held in a number of regional centres. (see page 36)



### Financial Education Going Strong

The success of the Financial Education program was demonstrated during 2015 with mass graduation ceremonies held in Mt Hagan and Mul Baiyer District (pictured left) in Western Highlands Province, Tsak Valley in Enga Province and Kokopo in East New Britain Province.



## KATS Phase 3 Goes Live

With Direct Credits, the third stage of the Kina Automated Transfer System (KATS) going live in February, the Bank achieved another major milestone in the effectiveness of the national payments system. Commercial banks can now transact with each other to make direct payments to their customers' accounts. And bank customers can make direct payments from their bank accounts to an account held in another bank. (see page 28)

## National Survey on Financial Capability

The findings of the National Survey on Financial Capability, a collaboration between BPNG, the World Bank and the PNG Institute of National Affairs, was launched in November. (see page 37)

## Saving Young Minds

The Young Minds Savings Campaign continued to encourage young people to embrace a savings habit, through a series of visits to schools around PNG. (see page 37)



## Community Support Continues

The Bank supports a number of national, cultural, educational, sporting and health-related activities. (see page 46)

In honour of the Nation's 40th Anniversary, in 2015 the Bank made special donations. Pictured is the presentation of the Bank's K10,000 donation to Hope Worldwide PNG, which will contribute to the renovations of Hope's 9 Mile Urban Clinic.



The Bank again participated in Transparency International PNG's annual Walk Against Corruption.



Showing the Bank's keen interest in the Nation's sporting activities, Governor Bakani CMG and Bank staff took part in the festivities surrounding the baton relay for the XV Pacific Games in Port Moresby.



# Mission Vision Values

## Mission

The Bank of Papua New Guinea's MISSION is to serve the people of Papua New Guinea by conducting effective monetary policy and maintaining a sound financial system. We will act at all times to promote macro-economic stability, provide a first class payments system and help foster economic growth of our country.

## Vision

A contemporary central bank and regulator excelling in performing our core functions and making a distinct and valuable contribution to the economic well-being of Papua New Guinea.

## Values

With **INTEGRITY** we build good governance and credibility.

With **EFFICIENCY** we produce quality results, on time and on budget.

With **TRANSPARENCY** our decisions stand scrutiny.

Through **ACCOUNTABILITY** we take responsibility for our decisions and actions.

Through **TEAMWORK** we benefit from sharing skills, knowledge and experience.

Through **PROFESSIONALISM** we strive for best practice.

# Governance



Governor Loi M. Bakani CMG



Mr John Leahy



Bishop Denny Bray Guka



Mr Alex Tongayu



Mr Bart Philemon



Ms Betty Palaso



Mr Richard Kuna



Mr Benny Popoitai MBE



The late Mr Himson Waninara

Members of the Board  
of the Bank of Papua New Guinea  
31 December 2015

The principles and practice of good governance enable the Bank of Papua New Guinea to promote the integrity of the PNG financial system.

In line with the Bank's strategic plans and in compliance with the *Central Banking Act 2000* (CBA), good governance practice has been strengthened through a more effective organisational structure, improved management reporting systems and effective audit processes.

The Bank's governance practice starts with the Board. The Board and the Governor have distinct roles and act collaboratively to ensure the Bank performs its mandated functions and achieves its objectives.

The Board is responsible for determining the policies of the Bank, other than those related to monetary policy and financial system regulation, which are the direct responsibility of the Governor.

To embed good governance practices in all its work, the Board has developed and implemented the Board Charter.

## Composition of the Board

Under the terms of the CBA 2000, the Governor is an appropriately experienced person, appointed by the Head of State, vested with the responsibility of managing the Bank and directing its affairs. The Governor is also Chairman of the Board.

The Deputy Governor, appointed by the Governor in consultation with the Minister for Treasury, is a member of the Board and chairs the Board in the Governor's absence.

The other members of the Board include five ex officio members from a range of prominent institutions within the PNG community (civil, church, regulatory, workers' representation and industry bodies) and three members with relevant professional experience, appointed by the Minister. All Board members are required by statute to meet the key standards of good governance.

## Management structure

The Governor's direct reports are the Deputy Governor and four Assistant- Governors, the Internal Audit department and the Corporate Secretary.

Each Assistant-Governor is responsible for a functional group comprising related departments. The Governor has also established a number of inter-departmental management committees to perform various functional and management responsibilities.

## Funding

The Bank's independence, including financial independence from the Government, is essential to maintaining the integrity of its operation and policy decision-making. Under the terms of the CBA 2000, the Bank is a self-funding institution, with its own capital and reserves.

## The Board

### Governors

#### *Governor and Chairman*

#### **Loi M. Bakani CMG**

Mr Bakani CMG was appointed Governor of the Bank of Papua New Guinea and Chairman of the Bank Board in December 2009. He is also the Registrar of Savings and Loans Societies in PNG.

He is Chairman of PNG Institute of Banking and Business Management (IBBM), Chairman of the Centre for Excellence in Financial Inclusion (CEFI), the Alternate Governor to the IMF, Chairman of the Board of South East Asian Central Banks (SEACEN), the Co-Chair of the National Coordinating Committee for AML-CTF and Deputy Chairman of the Secretaries Committee on Sovereign Wealth Fund. He is also a Member of the PNG Institute of Directors (PNGID) and Deputy Chairman of the Advisory Board of Port Moresby Senior AFL Competition.

Mr Bakani was awarded the Order of St Michael and St George (CMG) in the 2015 Queens Birthday honours list, for services to banking.

He holds a Bachelor of Economics from the University of Papua New Guinea and a Masters degree in Commerce majoring in Economics from the University of Wollongong, Australia.

#### *Deputy Governor*

#### **Benny Popoitai MBE**

Mr Popoitai MBE was appointed Deputy Governor and Member of the Board in November 2000. His term in office concluded in November.

He is Chairman of the Microfinance Expansion Project and also President of the PNG Institute of Directors.

Mr Popoitai MBE holds a Bachelor of Economics with Honours from the University of Papua New Guinea.

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## Members of the Board

### Mr John Leahy

Mr Leahy was appointed ex officio to the Board in March 2008, in his capacity as President of the PNG Chamber of Commerce and Industry.

Mr Leahy is also a Director of a number of companies, including Brands International Ltd, Tasman Construction Ltd, Abelia Investments Ltd and Orion Project Services (PNG) Ltd.

He holds a Bachelor of Laws degree and a Bachelor of Jurisprudence degree from the University of NSW, Australia and a Graduate Certificate in Management from the Monash Graduate Business School, Australia.

He has been admitted to practise law in both NSW and PNG. Mr Leahy is presently in private practice as a lawyer in PNG.

### Bishop Denny Bray Guka

Bishop Guka was appointed as an ex officio member in February 2012, in his capacity as President of the PNG Council of Churches.

He is the Bishop of the Anglican Diocese of Port Moresby and is Vice-Chairman of Anglicare PNG. He is a Director of the Papua New Guinea Medical Board and the PNG Bible Society and Vice-Chairman of Coronation Primary School.

Bishop Guka's educational qualifications include Certificates in Theology and in Teaching.

### Mr Alex Tongayu

Mr Tongayu was appointed ex officio to the Board in November 2012 in his capacity as Acting Chairman of the Securities Commission of PNG.

Mr Tongayu holds a Bachelor of Laws from the University of Papua New Guinea.

### Mr Bart Philemon

Mr Philemon was appointed to the Board on 26 June 2013 as a ministerial appointee.

A former Member of Parliament for Lae-Open, he has held a number of ministerial posts in the PNG Government, including Minister of Foreign Affairs and Minister for Finance and Treasury. He is a Director of Highlands Pacific Limited, Oil Search Limited and Consort Shipping Limited.

Mr Philemon completed his secondary education at St Peters Lutheran College Brisbane, Australia.

### Ms Betty Palaso

Ms Palaso was appointed to the Board on 26 June 2013 as a ministerial appointee.

She is the Commissioner of the Internal Revenue Commission.

Ms Palaso has a Bachelor of Economics with Honours from the University of Papua New Guinea.

### Mr Himson Waninara

The late Mr Himson Waninara was appointed to the Board on 26 June 2013 as a ministerial appointee. He served as a Board member until his death in November 2015.

### Mr Daniel Biti

Mr Biti was appointed ex officio to the Board in November 2014 in his capacity as President of Certified Practising Accountants PNG. His term as Board member concluded in November 2015, at which time Mr Richard Kuna was appointed President of CPA PNG.

Mr Biti is Principal of Norengo Capacity Building Solutions and a Senior Technical Instructor with the PNG University of Technology.

He has a Bachelor of Commerce in Accounting from the University of Papua New Guinea.

## Mr Richard Kuna

Mr Kuna was appointed ex officio to the Board in November 2015 on his appointment as President of Certified Practising Accountants PNG.

He is a Partner with Kuna Taberia Kiruwi Accountants & Advisors. He is also a Board Member of the Accountants Registration Board of Papua New Guinea.

Mr Kuna has a Bachelor of Business in Accounting from the University of Technology, Sydney Australia and is a qualified Certified Practising Accountant.

## Board Meetings

The Board meets at least once every three months. The March 2015 meeting was held in Mt Hagen, Western Highlands Province. The June and December meetings were held in Port Moresby, National Capital District. The September meeting was held in Lorengau, Manus Province.

Board Member	Meetings Eligible to Attend	Meetings Attended
Mr Loi M. Bakani CMG	4	4
Mr Benny Popoitai MBE	3	3
Mr John Leahy	4	4
Bishop Denny Guka	4	4
Mr Alex Tongayu	4	4
Mr Bart Philemon	3	3
Ms Betty Palaso	4	3
Mr Himson Waninara*	3	3
Mr Daniel Biti	3	3
Mr Richard Kuna	1	1

\*Deceased November 2015

## Commitment to Corporate Governance and Transparency

### Within the Bank

The Bank convenes committees to perform specific functions for and on behalf of the Board. During 2015 the Committees were:

#### Board Audit & Governance Committee

The Board Audit & Governance Committee is charged with assisting the Board to ensure the Bank's performance in financial reporting, internal control and governance meets the required standards and expectations.

In line with best practice, the Committee comprised non-executive directors. During 2015 Mr Alex Tongayu chaired the Committee. The members of the Committee were Mr John Leahy, Mr Bart Philemon and Mr Richard Kuna.

#### Remuneration & Succession Planning Committee

The Remuneration & Succession Planning Committee is charged with ensuring the Bank meets good governance principles relating to employment terms and conditions for the Governor and staff.

During the year the Committee comprised non-executive directors, Mr John Leahy, who chaired the Committee, Ms Betty Palaso, Bishop Denny Guka and Mr Himson Waninara (until his death in November).

#### Internal Committees

Several internal committees continued through 2015, each with specific roles and responsibilities to ensure probity of the Bank's activities. They included the Executive Committee, the Monetary Policy Committee, the Currency Committee, the Investment Committee, the Tender Committee and the Budget Committee.

---

### **Internal Audit**

A strong and independent internal audit function is a key part of the Bank's overall commitment to good governance. Over the course of 2015 the Bank's internal audit focus was on several significant reviews, including:

- banking operations, including the Banking Services System
- corporate services
- IT and information security management
- management of foreign reserves
- Human Resources operations

### **Risk Management**

The Bank has been operating an Enterprise Risk Management (ERM) model for a number of years. The basis for ERM is to ensure the Bank is aware of risks associated with its core functions – monetary policy, financial stability and payment system – and has relevant policies and an effective framework to mitigate these risks.

During 2015 risk management activities included:

- Completing comprehensive risk identification and assessment for all functional units in Finance & Payments Group and Corporate Services Group
- Formulating unique risk profiles for these units.
- Conducting reviews of all Business Continuity Plans and Crisis Management Plans across the Bank
- Planning an off-site work recovery facility, to safeguard the Bank's ability to operate critical systems (such as payments, financial markets and financial administration systems) during a disaster
- Developing a Fraud Risk Management Policy
- Implementing risk assessments and reviews for ongoing and new projects, including the Lae Cash Distribution Facility, the proposed automation of the currency process and the Data Recovery Centre.

### **External Checks and Balances**

As part of its commitment to good governance, the Bank continues to ensure there are external verification measures in its operation. These include:

#### **Annual Financial Statements Audit**

The Bank must meet the statutory obligation of presenting its annual financial statements to the Auditor-General of Papua New Guinea for detailed inspection and audit.

#### **Employment Conditions**

An external agency, the Salaries and Conditions Monitoring Committee, is charged with the responsibility of ratifying changes to staff employment conditions.

#### **Peer Review**

The Bank of PNG actively seeks peer review on key decisions from the Reserve Banks of Australia and New Zealand and other regulatory authorities, such as the Australian Prudential Regulatory Authority (APRA).

The Bank's membership and participation in SEACEN activities provides another valuable forum through which central banking matters can be discussed.

#### **Co-operation with Government Agencies**

The Bank also works closely with other Government agencies to mitigate the risk of fraud and other threats to the financial and payments systems.

#### **Setting the Right Example**

The Bank's Values Statement provides clear guidance to Bank employees to conduct themselves with the highest standard of behaviour.



The Bank operates comprehensive financial accounting systems to record and summarise all operational transactions promptly and accurately.

Modern management accounting systems are applied to prepare budgets, monitor expenditure and make payments in relation to ongoing operations and investment projects.

The Board of the Bank of Papua New Guinea, in consultation with the Minister, determines the distribution of the Bank's operating profit, under the terms of the *Central Banking Act 2000*.

Non-operating profit, comprising net gains or losses from revaluation of foreign currency assets and liabilities and domestic investments, is not available for distribution to the Government.

## Operating Income

Total operating income for the year ended 31 December 2015 was K322 million, compared with K270 million in 2014. The income was derived mainly from interest on overseas investments, fees and commissions on foreign exchange trading and interest on domestic investments in government securities.

## Operating Expenditure

Total operating expenditure, comprising interest expense and general administration costs, was K183 million, up K2 million from 2014. The increase in expenditure was largely due to an increase in general administration costs, consisting of staff costs, Bank premises and equipment costs and production and circulation of currency.

## Distribution of Profit

K million	2011	2012	2013	2014	2015
Total comprehensive Income/(Loss)	(1,737.1)	39.7	608.1	139.5	680.7
Unrealised profit/(loss)	(1,729.5)	15.4	505.2	49.8	541.2
<b>DISTRIBUTABLE PROFIT/(LOSS)</b>	<b>(7.8)</b>	<b>24.3</b>	<b>102.9</b>	<b>89.7</b>	<b>139.5</b>
Transferred to:					
Currency Movement Reserve	-	-	-	-	-
Property Revaluation Reserve	-	-	15.6	-	-
Unrealised Profits Reserve	(1,714.3)	8.2	517.6	42.2	536.4
Gold Reserve	(15.2)	7.2	(28.0)	7.6	4.8
Retained Profit/(Loss)	(7.6)	24.3	102.9*	89.7	139.5
Gov't Consolidated Revenue account	-	-	-	-	20.0

\* In consultation with the Minister, the Bank paid a dividend of K102 million to the Government in December 2014 out of the retained profits from the 2013 financial year, in exchange for a promissory note issued pursuant to section 50 of the CBA.

## Net Operating Profit

The Bank recorded a net operating profit of K139.5 million for the 2015 year, compared to an operating profit of K89.7 million in 2014.

## Unrealised Gain/(Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K536.4 million for the year ended 31 December 2015, which was transferred to the Unrealised Profits/(Loss) Reserve. This was a direct result of the depreciation of the kina against most major currencies during the financial year. Gold valuation gain of K4.8 million was transferred to the Gold Reserve.

## Appropriation

In line with the provisions of the CBA, the Bank's Board is responsible for determining the amount distributable as dividend to the Government from the Bank's realised profits. These provisions require the Bank to consult with the Minister on the amount to be credited as the Bank's Retained Earnings, with any balance of net profits to be paid as dividend to the Government's Consolidated Revenue account.

However, if the Board believes the assets of the Bank are less than the sum of its liabilities and paid up capital, or would be after payment of dividend, no amount is to be paid into the Consolidated Revenue account. In addition, under the terms of Section 50(1) of the CBA, net profits arising from revaluations of the Bank's assets and liabilities and/or from foreign exchange movements shall not be available as a dividend to the Government and paid into the Consolidated Revenue account.

## 2016 Budget Forecast

	Budget 2016 (K million)	Actual 2015 (K million)
<b>Operating Income</b>		
Interest received – overseas	133.9	66.3
Interest received - domestic	183.3	234.6
International trading/foreign exchange fees	5.1	9.4
Other income	13.6	11.6
<b>TOTAL INCOME</b>	<b>336.0</b>	<b>321.9</b>
<b>Operating Payments</b>		
Interest expenses – domestic operations	86.4	53.6
Financial markets & external fund manager expenses	9.1	8.4
Staff costs	60.1	44.1
Staff training and development	7.0	3.6
Premises and equipment	16.9	16.8
Depreciation of property, plant and equipment	7.2	6.3
Amortisation of notes and coins production	11.2	11.5
Currency distribution expenses	1.7	0.6
Audit fee	1.4	1.4
Travel	9.1	7.0
Legal and consultancy fees	7.3	8.9
Board and meeting expenses	1.5	1.2
Information & communication technology	8.2	6.5
Special projects	6.5	3.2
Other expenses	15.4	9.3
<b>TOTAL PAYMENTS</b>	<b>248.9</b>	<b>182.4</b>
<b>NET OPERATING PROFIT/(LOSS)</b>	<b>87.1</b>	<b>139.5</b>

# Core Functions

## MONETARY POLICY

### MONETARY POLICY FORMULATION

The Bank formulates and implements monetary policy with a view to achieving and maintaining price stability as stipulated under the *Central Banking Act 2000*. During 2015 the Bank released two Monetary Policy Statements as required by the Act, on 31 March and 30 September.

A number of factors were taken into account in the formulation of monetary policy, including actual and projected developments in the global economy, domestic economic activity, the balance of payments, fiscal operations of the National Government and their potential impact on monetary aggregates, the exchange rate, interest rates, and ultimately inflation.

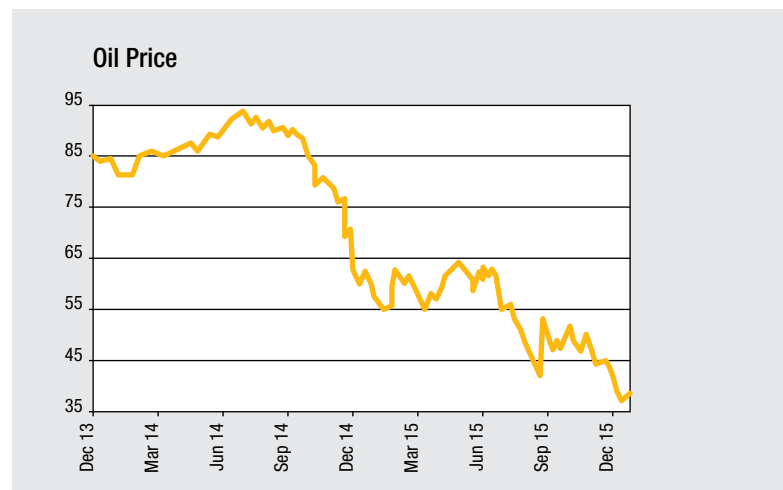
The Bank considered the same variables in setting the policy signalling rate, the Kina Facility Rate (KFR), on a monthly basis. Assessment of the quarterly Consumer Price Index (CPI) released by the National Statistical Office (NSO) and the monthly Retail Price Index (RPI) compiled by the Bank were also key inputs into setting the KFR.

The Bank's estimates and projections of gross domestic product (GDP), balance of payments and inflation were discussed in consultative meetings with the Department of Treasury. The Department then used the information as inputs into formulating fiscal policy, including the 2015 supplementary budget and the 2016 national budget.

Inflation for the first three quarters of the 2015 year was around 6.0 percent, within the Bank's inflation forecast for the year. Considering this, and consistent with the National Government's fiscal policy intention to stimulate economic activity after the LNG construction phase, the Bank continued to take a cautious approach by maintaining its neutral stance of monetary policy in 2015.

The major factors that influenced global financial markets in 2015 were the fall in oil prices, slowing economic growth in China and the diverging monetary policies among major central banks.

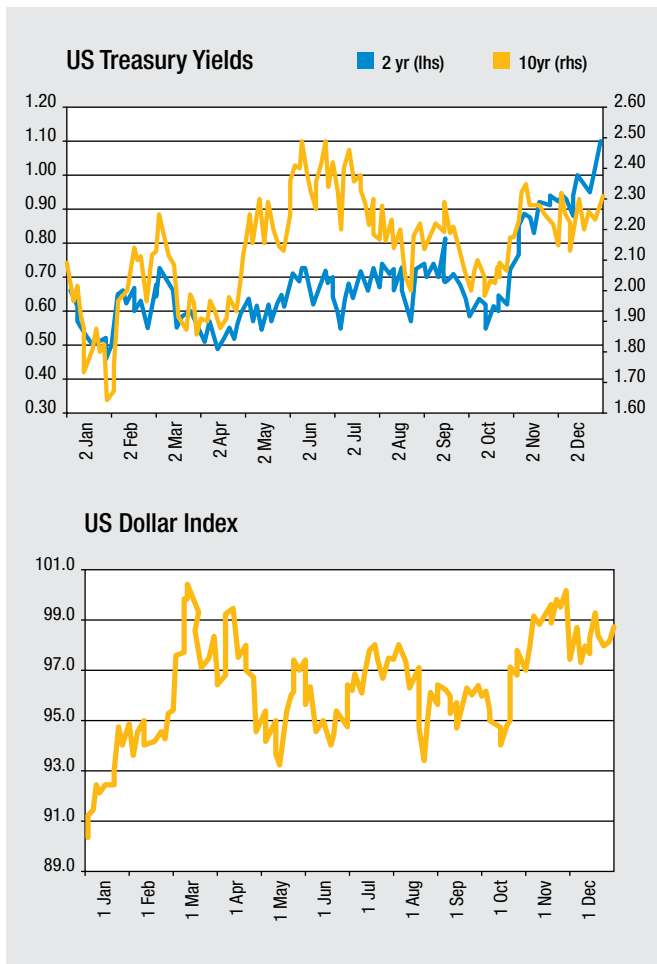
Oil prices continued to fall in 2015, driven mainly by a growing supply while demand remained sluggish. The increase in supply was in part due to the refusal by the Organisation of the Petroleum Exporting Countries (OPEC) to limit production for a second year in a row.



The devaluation of the Chinese yuan in August 2015 led investors to believe that China's economy was not as strong as previously thought, despite the explanation from the Chinese regulators that the move was so that the exchange rate would better reflect market forces. The devaluation prompted a sell off in higher risk assets, particularly equities.

The US Federal Reserve ('the Fed') was closely watched over the course of the year, with market observers noting its signals that it was ready to raise the Federal Funds Rate on growing optimism of its domestic economy.

In December the Fed finally raised its benchmark interest rate by a quarter percentage point to 0.50 percent. By sending the market signals over several months the Fed had prepared the way for the prospect of an increase. The result was a positive and reasonably steady reaction from the market.



## MONETARY POLICY IMPLEMENTATION

The Bank's open market operations, such as auctions of Central Bank Bills (CBBs), Treasury bills and Inscribed stock, are the main instruments of implementing monetary policy, after the release of the six-monthly Monetary Policy Statement and the monthly KFR. The Bank can also use its direct policy instrument, the Cash Reserve Requirement (CRR), for liquidity management.

Inflation was relatively stable throughout 2015, with 6.1 percent in March, 5.8 percent in June, 5.7 percent in September and 6.4 percent in December. This inflation level, which was in line with the Bank's forecast, was considered manageable. Accordingly the Bank maintained the KFR at 6.25 percent throughout the year. Commercial banks maintained their Indicator Lending Rates (ILRs) between 11.20 percent and 11.70 percent.

High levels of liquidity persisted in 2015, largely a result of the Government's expansionary fiscal policy, as well as redemption of CBBs. The Bank continued to issue CBBs, complemented by the Government's issuing of Treasury bills and Inscribed stock. Through the process of the commercial banks and financial institutions investing in CBBs and the public (including businesses, financial institutions and members of the general public) purchasing Treasury bills and Inscribed stock, money is withdrawn from the banking system, thereby diffusing liquidity.

The Cash Reserve Requirement (CRR) was maintained at 10.0 percent throughout the year.

The Minimum Liquid Asset Ratio (MLAR) remained at zero throughout 2015.

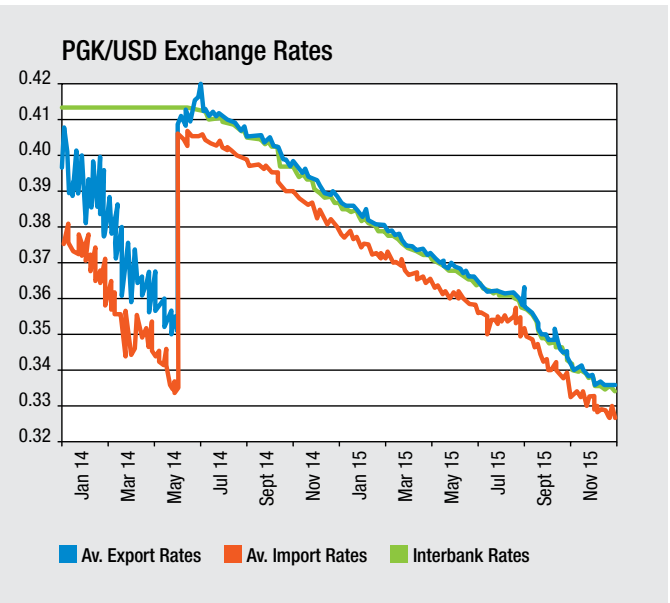
In contrast, the European Central Bank and the Bank of Japan continued their aggressive monetary stimulus efforts to revive their fragile economies. Over the year they injected huge amounts of liquidity into their respective economies under bond purchase programs that eventually led to negative yields. In turn currency markets through 2015 were very volatile, although the US dollar remained firm against other major currencies.

In response to these market developments, the Bank maintained a conservative approach to its investments throughout 2015. Cautious of increasing Government bond yields, the Bank maintained a neutral portfolio duration strategy over the year. Positive economic conditions in the US as well as the need to intervene in the domestic foreign exchange market resulted in the Bank opting to take a long US dollar currency position against other major currencies.

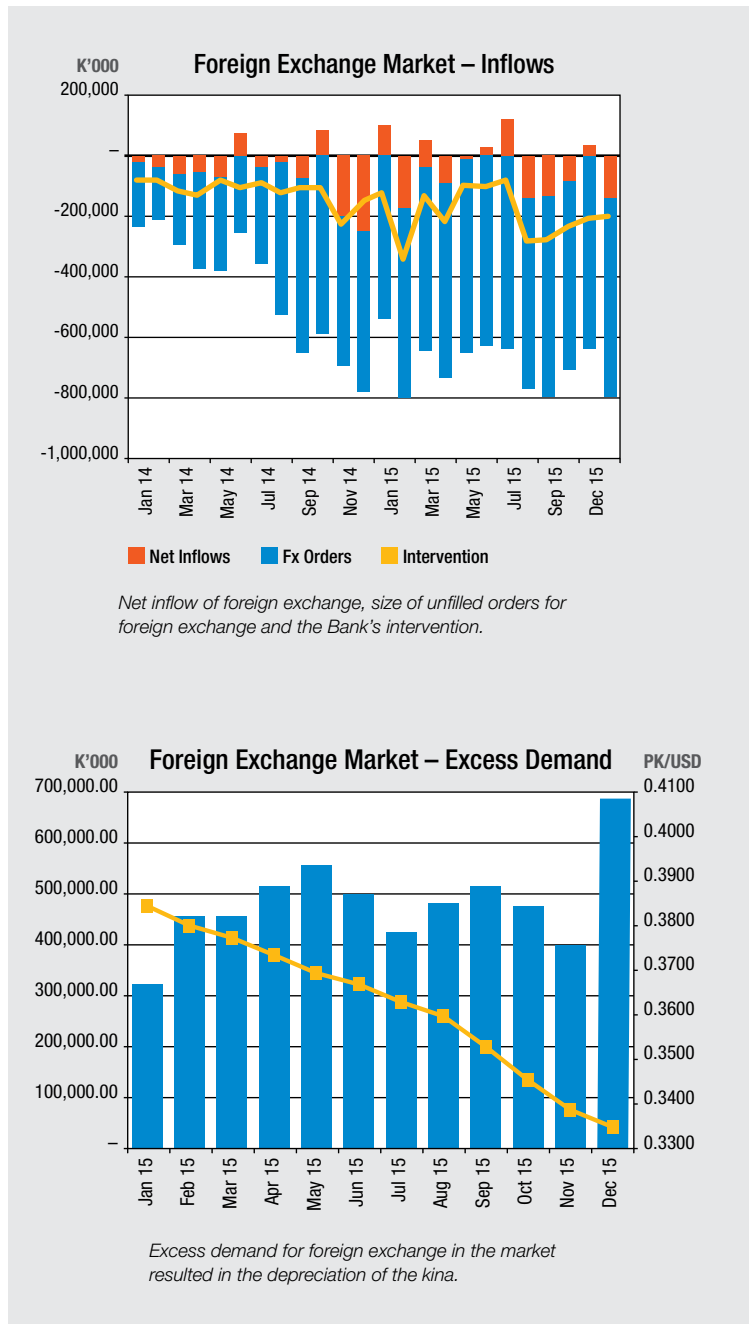
## FOREIGN EXCHANGE MANAGEMENT

Demand for foreign exchange continued to dominate trade in the interbank market throughout 2015. Increased Government spending was the main influence on demand, as well as a build-up of unfilled foreign exchange payments, which more than offset supply.

Low foreign exchange inflows from the PNG LNG project and other key export commodities, stemming from low global commodity prices, combined with unfavorable El Niño weather conditions, affected the supply of foreign currency. Consequently, turnover in the foreign exchange market declined and the kina depreciated by 14 percent against the US dollar to end the year at 0.3325 USD.



The imbalance in the supply of and demand for foreign exchange throughout 2015 resulted in a net outflow of K1,234.4 million during the year. There was a 5 percent decrease in foreign currency inflows in 2015, which more than offset a 1 percent decrease in outflows.



The decline in the inflow of foreign exchange was mainly due to 38 percent slump in Gas sector inflows, while outflows were mainly influenced by the availability of foreign exchange. Despite low commodity prices, Agricultural sector inflows were firm over the year.

## Major Sector Contributions to Foreign Exchange Flows

	2014 K'm	2015 K'm	Change
<i>Inflows</i>			
Mining	3,695.9	3,473.5	-6%
Finance & Business	2,435.4	2,216.9	-9%
Gas	1,419.0	877.2	-38%
Agriculture	1,813.3	1,859.0	3%
<b>Total Inflows</b>	<b>14,136.5</b>	<b>13,470.2</b>	<b>-5%</b>
<i>Outflows</i>			
Finance & Business	3,102.2	3,391.1	9%
Retail	3,210.3	2,442.0	-24%
Manufacturing	1,647.5	1,569.5	-5%
Petroleum	2,075.7	1,740.7	-16%
<b>Total Outflows</b>	<b>14,885.3</b>	<b>14,704.6</b>	<b>-1%</b>

## Kina Trading Margin

The Bank introduced the kina trading margin in 2014 to improve the price setting mechanism on exchange rates offered by Authorised Foreign Exchange Dealers (AFEDs) to their clients. The aim was to reduce margins charged by the commercial banks and to bring discipline back to the market.

In 2015 all AFEDs complied with the kina trading margin, keeping the margins for quoting foreign exchange deals within the specified 75 basis points limit above and below the interbank mid-rate throughout the year.

In December the Governor approved a revised version of the guidelines relating to the kina trading margin.

## Intervention

The Bank intervened regularly in the domestic foreign exchange market to allow a smooth depreciation in the kina exchange rate. In 2015 the Bank sold a total of US\$833.3 million in the domestic foreign exchange market.

## Exchange Rates

	End of Dec 2014	End of Dec 2015	YTD (%Change)
PGK/USD	0.3855	0.3325	-13.75%
PGK/AUD	0.4708	0.4552	-3.31%
PGK/EUR	0.3172	0.3043	-4.07%
PGK/GBP	0.2477	0.2243	-9.45%
PGK/JPY	46.17	40.04	-13.28%
PGK TWI	35.93	33.27	-7.41%



## Core Functions

### FOREIGN RESERVES MANAGEMENT

The Bank of Papua New Guinea is responsible for the management of PNG's gold, foreign exchange and other international reserves.

The main reasons for the Bank to hold foreign exchange reserves are to:

- support price stability
- service the State's foreign debt
- protect the domestic economy from external shocks

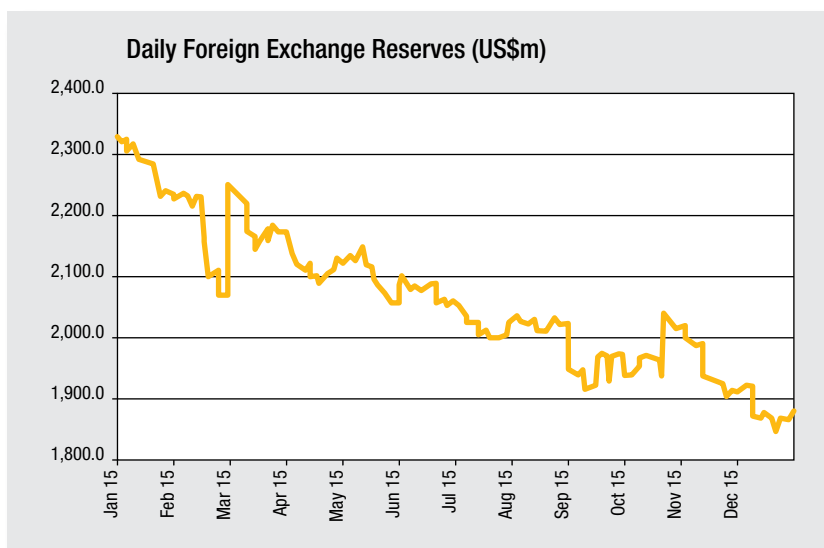
In terms of investing foreign exchange reserves, the Bank's primary objectives are to:

- preserve the capital value of the foreign exchange reserves
- maintain adequate liquidity
- manage credit risk conservatively
- earn an acceptable rate of return on the assets

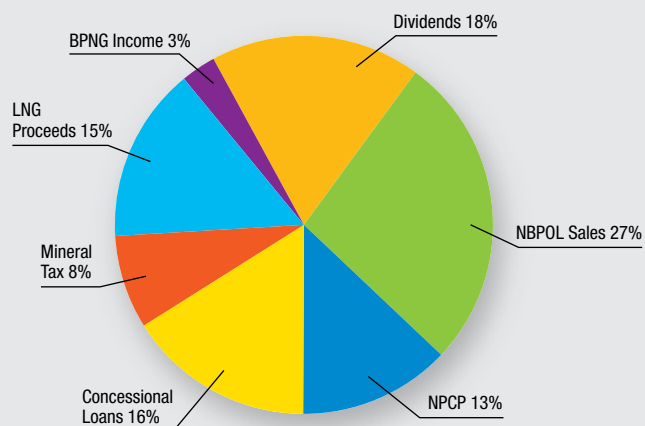
At the end of December 2015 the level of foreign reserves declined by US\$0.46 billion to US\$1.86 (K5.52) billion. The decline was mainly attributed to the Bank's intervention in the domestic foreign exchange market.

Inflows into the foreign exchange reserves in 2015 totaled US\$684.9 million, compared to outflows of US\$1,036.1 million. Inflows mainly comprised proceeds from the sale of New Britain Palm Oil Limited shares totaling US\$183.2 million, government dividends of US\$125.6 million and LNG proceeds totaling US\$102.3 million (royalties and development levy).

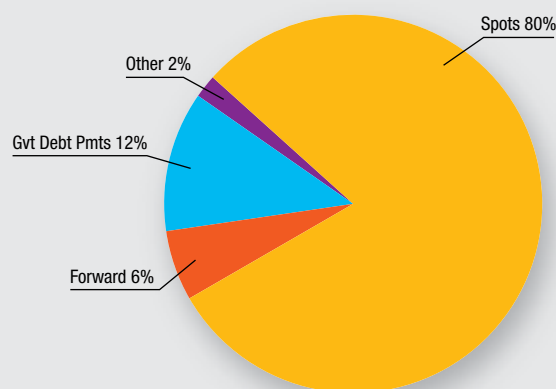
The outflows mainly comprised of the Bank's intervention in the domestic foreign exchange market of US\$833.3 million (Spot) and Government foreign debt payments of US\$123.1 million.



#### Inflows into Foreign Exchange Reserves 2015



#### Outflows from Foreign Exchange Reserves 2015



## Fund performance

### Inhouse funds management

The Bank's inhouse managed reserves generated portfolio returns of 0.97 percent over the year to December 2015, compared to 2.22 percent in 2014. The return was generated mainly from Australian dollar money market and bond investments.

During the year the Bank commenced implementing the Trade Order Management System (TOMS). Phase 1 involved uploading the Bank's inhouse investment portfolio into the TOMS trading platform. The benefits from this phase included:

- real time price calculations
- more interactive risk management tools
- better execution of trading strategies and trade capture
- improved reporting, and
- strengthening of internal investment processes.

### External funds management

The Bank's outsourced funds increased to a total value of US\$1,122.64 million, equivalent to an average return of 0.76 percent. This compares favourably to the Citi Group 1-3 year fully hedged World Government Bond Benchmark returns of 0.71 percent.

Source	2015	2014
In house funds management	0.97%	2.22%
External funds managers		
Pictet	0.72%	0.91%
Schroders	0.90%	1.34%
Deutsche Bank	0.61%	1.08%
Lombard	0.80%	1.19%
BlackRock	0.78%	1.00%
Average return	0.76%	1.10%
Benchmark Citi Group 1-3 year World Government Bond	0.71%	0.96%

### Composition of Foreign Exchange Reserves

The total foreign exchange reserve level as at 31 December 2015 stood at US\$1,865.6 million (PGK5,527.7 million). The table below shows the break-up of the reserves by mandate and changes in the levels during 2015.

Date	Foreign Exchange Reserves 2015											
	Inhouse Managed Reserves ('m)		Externally Managed Reserves ('m)		Gold		Total Invested Foreign Exchange Reserves ('m)		IBRD		Total Foreign Exchange Reserves ('m)	
	USD	PGK	USD	PGK	USD	PGK	USD	PGK	USD	PGK	USD	PGK
31 Dec 15	697.09	2,065.45	1,122.64	3,326.35	45.59	135.09	1,865.33	5,526.89	0.25	0.74	1,865.58	5,527.63
31 Dec 14	1,176.24	3,012.13	1,114.16	2,853.16	51.54	131.75	2,341.85	5,997.04	0.25	0.64	2,342.10	5,997.68
Change	-479.15	-946.68	8.48	473.19	-5.86	3.34	-476.52	-470.15	-	0.10	-476.52	-470.05
Change (%)	-40.74	-31.43	0.76	16.58	-11.38	2.54	-20.35	-7.84	-	15.74	-20.35	-7.84

The decline in the foreign exchange reserves during 2015 was mainly due to intervention in the domestic foreign exchange market and payments for overseas government debt.



### International Transactions Monitoring

#### Foreign Exchange Control Directives

With the aim of achieving a more orderly functioning of the foreign exchange market, the Bank issued foreign exchange control directives during 2015.

The key requirements set by the directives included:

- No new domestic or offshore foreign currency account may be opened without the prior approval of the Bank. The Bank will also audit existing onshore foreign currency accounts.
- Only licensed banks in Papua New Guinea (PNG) are allowed to conduct banking business by accepting deposits, providing loans and converting currency (kina and foreign currency). It has become evident that foreign banks are doing banking business in PNG through their kina accounts held with domestic banks which are also called Vostro accounts. Kina remittances for the receipt or payment of foreign currency must be done through Authorised Foreign Exchange Dealers. Direct kina deposits by PNG Residents into Vostro accounts of foreign banks are not permitted.
- All outward remittances (telegraphic transfers and drafts) must be in foreign currency and effected through an Authorised Foreign Exchange Dealer.
- A three months repatriation requirement will apply from the day of shipment of export, for those offshore foreign currency accounts held by Resident Exporters that were approved by BPNG. The balances in these accounts can be used only for payment of their foreign liabilities, and any surplus repatriated to PNG and deposited into their domestic foreign currency accounts. Alternatively, this foreign currency can be converted to kina, through the Authorised Foreign Exchange Dealers.

The Bank also revised the Foreign Exchange Manual (2007), the BOP Reporting Framework (2007) and the FE Guidelines (2007), to incorporate the new directives.

The Bank granted an exemption to the insurance industry to enable remittance of reinsurance premiums abroad in kina for re-insurance against claims from domestic policyholders.

#### Foreign Exchange Transactions Audit

In April 2015 the Bank commissioned an external audit into domestic foreign currency accounts, foreign banks' use of Vostro accounts and kina remittances abroad. The audit ended in August 2015.

The audit aimed to determine whether

- domestic foreign currency account holders were building large balances while there was a shortage in the foreign exchange market
- foreign banks were using Vostro accounts for unauthorised banking activities, such as accepting kina deposits and making kina withdrawals for other clients, and
- outward kina remittances were made without first being converted through an authorised foreign exchange dealer.

The audit confirmed the occurrence of these practices in the domestic foreign exchange market.

#### Foreign Currency Accounts

The Bank received 21 applications to open domestic and offshore foreign currency accounts, in line with the new directives. Fifteen applications were approved.

## Gold Export Licences

The Bank allows residents and non-residents to buy and sell gold freely within PNG. However, they must obtain a gold export licence from the Bank to sell gold outside the country. Subject to compliance with the conditions of the licence, the licence is renewable on application each year.

### Applications approved and renewed in 2015

- Gold Exports Limited
- Golden Valley Enterprises Limited
- Issacc Lete Lumbu Gold Buyers Ltd
- Italpreziosi South Pacific Limited
- Vertic Ltd
- Wanaka Gold Limited
- Aurum Export Ltd
- Bella Bon Appetit Ltd
- Deblu Limited
- Meekom Minerals Ltd
- Soi Gold Ltd
- Transpacific Metals Ltd
- Waria Gold Limited
- Precious Metals Mining and Refining Ltd

New applications approved	5
Applications requiring more information	2
Applications cancelled	1

## Domestic Lending in Foreign Currency

Lending to residents of PNG by Authorised Foreign Exchange Dealers in any foreign currency requires prior approval of the Bank.

Applications approved and renewed in 2015	5
Value of transactions	K273.4 million (US\$86.5 million)

## Contingent Guarantees in Favour of Non-Residents

Approval of the Bank is required to issue guarantees (or indemnities) for the benefit of non-residents.

Applications received in 2015	7
Applications approved	7

## Cash Taken out of PNG

Prior approval of the Bank is required to take cash and numismatic bank notes in excess of K20,000.00 out of the country.

Applications received and reviewed in 2015	25
Applications approved	25
Value of approved transactions	K2.2 million
Value of approved numismatic notes exported	K1.4 million



## Core Functions

### FINANCIAL SYSTEM

The financial system covers institutions authorised, regulated and supervised by the Bank of Papua New Guinea. In broader terms the nation's financial system also includes financial institutions regulated by other authorities.

The Bank conducts prudential supervision of the authorised licensed institutions to ensure stability of the financial system.

This is achieved through:

- setting licensing requirements
- promoting proper standards of conduct
- setting prudential standards and guidelines for sound and prudent business practices, and
- ensuring authorised institutions comply with the relevant legislation and prudential standards through effective supervisory activities.

### The Financial System

Type of institution	31 Dec 2015	31 Dec 2014
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	14	13
Savings & loan societies (SLSs)	22	22
Authorised superannuation funds (ASFs)	4	4
Licensed investment managers (LIMs)	5	3
Licensed fund administrators (LFAs)	3	3
Life insurance companies (LICs)	4	5
Life insurance brokers (LIBs)	4	4
Authorised money changers	8	8
Money remitter	1	1
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operator	1	1
<b>Total assets</b>	<b>K42.3 billion</b>	<b>K40.1 billion</b>
Banking industry	75.1%	75.5%
ASFs	24%	23.3%
LICs	0.9%	1.2%
<b>Total deposits</b>	<b>K24.3 billion</b>	<b>K21.9 billion</b>
Commercial banks	93.7%	93.6%
LFIs	3.4%	3.5%
SLSs	2.1%	2.1%
Micro-banks	0.7%	0.8%
<b>Total loans outstanding</b>	<b>K15.7 billion</b>	<b>K11.3 billion</b>

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## REGULATION AND SUPERVISION

### Licences and Approvals

Over the course of 2015 the Bank considered and made decisions on several applications regarding expansion, closure, relocation of operations and new licences.

During the year the Bank

- granted 1 licence
- assessed 2 applications for licences, and
- rejected 4 applications.

In April the Bank approved the application of Bank of South Pacific (BSP) to acquire the operations of Westpac Banking Corporation (Westpac) in Solomon Islands, Vanuatu, Cook Islands, Samoa and Tonga.

Kina Securities Limited applied for approval to acquire Maybank PNG Limited under Section 20 of the *Banks and Financial Institutions Act 2000*. The Bank approved the acquisition, which was completed in September 2015.

In November the Bank gave in principle approval to BSP for its subsidiary, BSP Finance Limited, to pursue a partnership agreement with RMA Financial Services, a regulated lease financial business in Cambodia.

### Prudential Standards

#### Banking

The Bank issued further drafts for the proposed prudential standards on Corporate Governance for industry consultation in November.

#### Superannuation and Life Insurance

During the year the Bank circulated the draft Risk Management Prudential Standard to the life insurance industry for comment.

### Legislative Issues

#### *Savings and Loan Society (Amendment) Act 1995*

In November Parliament repealed and replaced the Savings and Loan Society legislation to enable significant reform of the S&L industry.

#### *Proposed Review Committee*

The Bank approached the Department of Treasury in April 2015, proposing a committee to review regulation and supervision of the superannuation and life insurance industries and to ensure legislative changes are in the best interests of members and policyholders.

#### *Defence Force Retirement Benefit Fund (DFRBF) review*

In November 2015 Parliament passed an amendment to the *DFRBF Act*, which will come into effect in 2016.

### Supervisory Enforcement Actions

#### Reviews

As part of the Bank's supervisory role in strengthening the risk management systems and compliance capacities of the authorised institutions and licensed entities, 16 on-site prudential reviews or examinations were conducted in 2015.

The Bank conducted reviews on 3 banks, 3 licensed financial institutions, 7 savings & loan societies, 2 superannuation funds and 1 investment manager, which was visited twice.

#### *Supervisory College*

The Bank participated in 4 supervisory colleges in 2015, with ANZ Bank, BSP and Capital Insurance Group.

### Statutory Administration, Management and Liquidation Activities

The liquidation process for Workers Mutual Insurance (PNG) Limited (WMI) and Eastern Highlands Savings & Loan Society Limited continued in 2015.

## PAYMENT SYSTEM

### Key Developments in 2015

#### Direct Credits

Phase 3 of KATS, Direct Credits, was successfully launched in February 2015. The Direct Credits process starts with the customer sending a payment instruction to their bank, with the payee's account details and a payment reference meaningful to the payee. The funds are deducted from the customer's bank account and payment details are sent to KATS. The settlement between banks is completed in KATS, either in real time or during the next clearing session, depending on the payment type. Payment is sent to the payee's bank and the payee has access to the funds on the same day (or the next day if the payment is submitted after the last clearing session). This achievement places PNG's Payments System in the same league as other developed countries in electronic banking progress.

Information about the value and volume of payments transactions is available on the Bank's website [www.bankpng.gov.pg](http://www.bankpng.gov.pg)

#### KATS Review

The Bank conducted a comprehensive review of the KATS system. The review concluded that all phases of the project had been successfully implemented and the system had achieved its objectives. It also highlighted a positive business impact on the commercial banks' operation and identified future IT infrastructure requirements and system enhancements.

#### Banking Services System

The Bank launched its Banking Services System (BSS) in September 2014, to improve the Bank's internal banking and accounting processes. Work continued throughout 2015 to automate the banking services the Bank supplies to the National Government and other statutory authorities. During the year the Bank completed tests on the connectivity to BSS and Electronic Funds Transfer Files with the Department of Finance (DOF). The benefits from the BSS to date include the ability to view real time account balances online and make payments to Government Agencies efficiently, as well as better cash-flow management and reconciliation. The Bank also continued to work on integration with Customs and Internal Revenue Commission systems to facilitate electronic payments.



## NATIONAL CURRENCY MANAGEMENT

### Currency Banknotes and Coins

The Bank issues currency banknotes and coins, ensures an adequate supply of quality currency is in circulation, withdraws damaged banknotes from circulation and monitors the overall supply.

An important on-going activity is the Clean Banknote Policy Awareness program, which seeks to educate the general public on proper ways of handling banknotes, the different security features on banknotes, how to identify different characteristics of unfit notes and how to tell genuine banknotes from counterfeits.

During 2015 the Clean Note Awareness program involved public presentations conducted by Bank staff. The awareness sessions focused mainly on educating the public about the different security features on the banknotes, determining if a banknote is unfit and returning the unfit notes to the Bank. Bank staff also visited the commercial banks and conducted training for their cashiers on Clean Banknote Policy and practices.

### Re-opening of Cash Distribution Centres

During the year the Bank entered into an agency agreement with Bank South Pacific (BSP) to re-open cash distribution centres, previously housed in BSP premises in Lae, Kokopo and Mt Hagen, but closed down in 2011.

The cash distribution centre in Lae was re-opened and commenced operation in November.

### Release of Commemorative Banknotes

In May 2015 the Bank issued special K10 and K20 banknotes into circulation. The notes feature overprint designs, commemorating the XV Pacific Games in the case of the K10 note and the 40th Anniversary of Papua New Guinea Independence in the case of the K20 note.

The new notes retain their original design elements and security features of the existing banknotes except for their lengths, which have been slightly reduced as part of the banknote reform to differentiate the different values of the notes by size.

A new security feature, Optical Variable Image (OVI), has been added to the traditional pattern adjacent to the numeral, which changes colour from green to gold when the banknote is tilted.

### Commemorative Coins

#### *Pacific Games Commemorative Coins*

The Bank issued into circulation two new 50 toea coins, a standard coin and a coin with added colours, to commemorate the XV Pacific Games. The coins, which are the same size and shape as the non-commemorative 50 toea, feature the XV Pacific Games logo. The coloured coin features the Pacific Games colours – yellow, red, green, black and blue – surrounding the logo.

#### *50th Golden Jubilee of UPNG coins*

The University of Papua New Guinea, in collaboration with the Bank, marked the Golden Jubilee



of the University

(1965-2015), issuing two uncirculated commemorative coins, a K2 and a K5. The Hon. Malakai Tabar M.P., Minister for Higher Education, Research, Science and Technology, and Governor Bakani CMG officially launched the coins in October.

The K2 coin combines aluminium, zinc and bronze, is 38.74mm in diameter, weighs 20grams and has a gold finish. The K5 coin is 99.9 percent silver, is 40mm in diameter, weighs 31.1grams, and has a full-colour printed logo in a silver finish.



## Core Functions

### International Award for Best New Circulating Coin

The International Association of Currency Affairs (IACA) presented the Bank of Papua New Guinea with the Award of "Best New Circulating Coin or Coin Series" for the coloured 50 toea XV Pacific Games coin. The prestigious Award was announced during the annual IACA Coin Conference in Madrid, Spain in October 2015.



### Notes and Coins in Circulation

Notes Denomination	Value K'm 2015	Value K'm 2014	Value K'm 2013	Value K'm 2012
K2	52.7	49.9	46.3	45.8
K5	52.4	51.4	45.6	44.4
K10	72.6	69.0	65.5	66.6
K20	185.0	207.4	209.8	213.9
K50	407.2	445.6	433.6	417.0
K100	969.0	953.5	877.1	822.7
<b>Sub Total</b>	<b>1,738.9</b>	<b>1,776.8</b>	<b>1,677.9</b>	<b>1,610.1</b>
<b>Coins Denomination</b>				
K2	0.2	0.2	0.2	0.3
K1	24.3	23.2	21.3	19.9
50 Toea	6.8	6.5	6.4	6.5
20 Toea	20.1	20.1	19.3	18.6
10 Toea	20.1	19.4	18.8	18.0
05 Toea	6.4	6.2	6.1	5.9
<b>Sub Total</b>	<b>77.9</b>	<b>75.6</b>	<b>72.1</b>	<b>69.2</b>
<b>Total</b>	<b>1,816.8</b>	<b>1,852.4</b>	<b>1,750.0</b>	<b>1,679.3</b>

### Numismatic Sales

The Bank sells commemorative items to the public and currency collectors worldwide. Total sales were in excess of K1.3 million, a substantial increase over the K0.1 million sales achieved in 2014.

The most popular items were the 2015 XV Pacific Games uncut banknote sheets, 2012 gold coin sets, 1995 coin sets and the 2015 XV Pacific Games coin sets.

### New Notes and Coins issued in 2015

Notes Denomination	Value K'm 2015	Value K'm 2014	Value K'm 2013	Value K'm 2012
K2	21.7	23.7	21.1	21.3
K5	24.9	24.9	22.8	19.8
K10	34.5	33.5	31.0	28.0
K20	74.8	92.6	106.0	86.6
K50	142.5	145.7	215.0	114.0
K100	215.0	269.9	250.0	280.0
<b>Sub Total</b>	<b>513.4</b>	<b>590.3</b>	<b>645.8</b>	<b>549.7</b>
<b>Coins Denomination</b>				
K1	1.20	1.70	1.50	3.20
50 Toea	0.40	0.00	0.00	0.36
20 Toea	0.14	0.80	0.70	1.57
10 Toea	0.83	0.60	0.83	1.51
05 Toea	0.28	0.07	0.21	0.33
<b>Sub Total</b>	<b>2.85</b>	<b>3.17</b>	<b>3.24</b>	<b>6.97</b>
<b>Total</b>	<b>516.25</b>	<b>593.47</b>	<b>556.67</b>	<b>693.67</b>

### Destruction of Soiled Banknotes

Notes Denomination	VALUE OF SOILED NOTES DESTROYED			
	K'm 2015	K'm 2014	K'm 2013	K'm 2012
K2	16.9	23.4	23.6	19.8
K5	22.7	24.7	18.3	22.4
K10	31.7	46.0	30.9	43.1
K20	99.5	102.6	120.4	101.1
K50	152.5	144.1	198.1	171.9
K100	157.5	199.9	189.1	134.5
<b>Total</b>	<b>480.8</b>	<b>540.8</b>	<b>580.4</b>	<b>492.8</b>

## GOVERNMENT BANKING AND AGENCY SERVICES

### Government Banking

As part of its statutory function, the Bank provides banking services to the National Government.

The financial activities of the National Government are conducted by the Department of Finance through the Waigani Public Account, from which transfers of funds are initiated and executed to the various departmental drawing, trust, provincial government and statutory authorities accounts. The revenue collections by PNG Customs, Internal Revenue Commission (IRC) and other agencies are also banked at the Bank of Papua New Guinea.

In 2015 financial institutions and other organisations continued making tax payments to IRC accounts maintained at the Bank through KATS. Government and other statutory authorities' cheques were cleared through the Automated Clearing House (ACH), part of the KATS cheque truncation facility. The ACH and other improvements to cheque processing procedures demonstrated their effectiveness, with no major incident of fraud reported in Government drawing accounts during 2015.

The National Government maintained a total of 80 trust accounts with the Bank during 2015. The trust accounts balance as at 31 December 2015 was K362.2 million, compared with K227.7 million at the end of 2014. During the year, large transactions processed were for the XV Pacific Games, Tuition Fee Free Education and Autonomous Bougainville Government Grants.

### Commercial Banks

During 2015 Kina Securities Limited acquired Maybank (PNG) Limited and rebranded it as Kina Bank. BPNG assisted in the smooth transfer of ownership by providing advice to the new owners on operating procedures for their membership of the National Payments System.

### Temporary Advance Facility

The National Government operates a Temporary Advance Facility (TAF) with the Bank of Papua New Guinea to meet short-term cash flow mismatches during the year.

The limit under the TAF was increased in July from K112 million to K200 million.

During 2015 the Government sought financing under the TAF on 49 occasions.

### Government Agent Operations

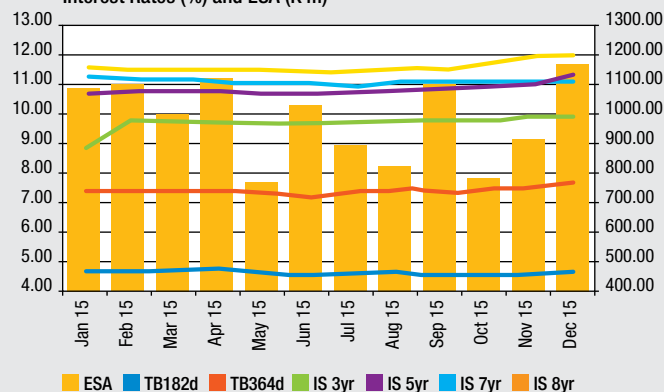
The Bank of Papua New Guinea is the agent for the Government as an authorised issuer, registrar and paying agent for Government securities.

### Treasury bills and Inscribed stock

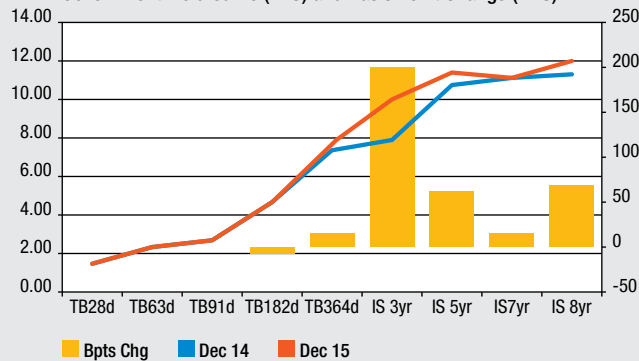
In 2015 the Government initially issued its Treasury bills in the 182 and 364 day terms. A lack of demand by investors in these terms resulted in the issuance of Treasury Bills in the 28, 63 and 91 day terms during the second half of 2015. Government Inscribed stock was issued in the 3, 5, 7 and 8 year terms.

Interest rates on Inscribed stock increased in 2015 while interest rates on Treasury bills were relatively flat. The increase in the Inscribed stock interest rates was mainly driven by the under-subscription at the auctions, mainly reflecting the market's preference for shorter dated investments. The largest increase in interest rates was seen in the 3 year inscribed stock, which increased by approximately 200 basis points over the year.

Treasury Bills and Inscribed Stock  
Interest Rates (%) and ESA (K'm)



Government Yield Curve (LHS) and Basis Point Change (RHS)





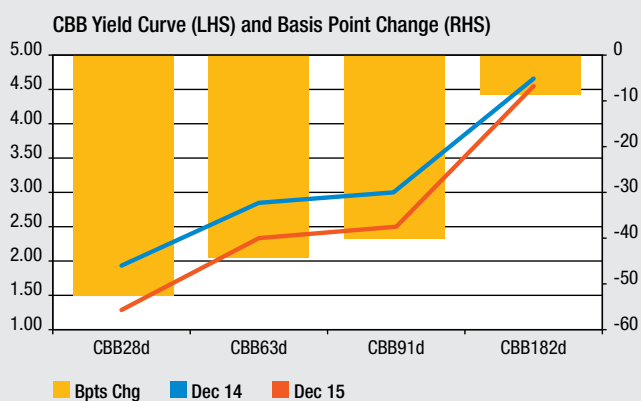
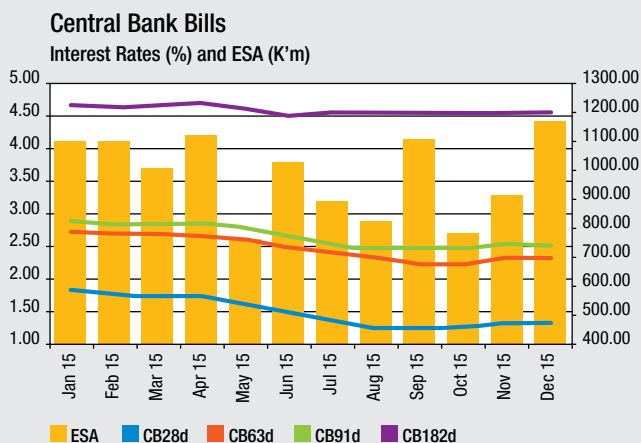
## Core Functions

### Central Bank Bills

In 2015 the CBB interest rate curve became steeper, as yields on the shorter dated bills decreased more than the longer maturities.

High liquidity in the banking system through the year did not lead to inflationary pressures within the economy. With the Government increasing issuance of Government securities, the Bank selectively matured CBBs. This strategy caused interest rates across the CBB yield curve to decline throughout the year.

The largest decrease was seen in the 28 day term, which declined by 61 basis points, followed by the 63 day by 52 basis points and the 91 day by 46 basis points, from the previous year.



### Tap Facility

The CBB Tap facility continued to operate in 2015, continuing the aim of increasing smaller investors' participation in Government securities and helping develop a savings culture.

During 2015 the CBB Tap was offered in maturities of 63 and 91 days. The 91 day term attracted strong demand. However, demand for Tap investments fell over the course of 2015 as interest rates declined.

The Bank recorded a net maturity of K7.8 million in CBBs through the Tap facility for the year.

### Repurchase Agreement (Repo)

The Repo market, operating under the unsecured arrangement, was used only during the last quarter of 2015, when one commercial bank experienced tight liquidity. With that exception, throughout the year commercial banks had sufficient funds in their exchange settlement accounts, which enabled them to use the interbank market to lend and borrow from each other.

The Bank completed a review of the proposed Repo Agreement Under a Secured Arrangement during the year, for implementation in 2016.

### Slack Arrangement

The Slack Arrangement was first introduced in 2014 with a proposed finish date of March 2015 as a temporary measure to address the sharp increase in the interest rates of domestic Government securities. The Arrangement enabled the Bank to manage liquidity, by allowing the Bank to take up the under-subscription of Treasury bills and Inscribed stock at auctions and on-sell them to potential investors as CBBs outside the normal auction timetable.

In July 2015 the Arrangement was reintroduced. The Bank purchased a total of K956.9 million Treasury Bills by the end of the year. The Bank on-sold the same amount in the CBB market, to prevent an increase in liquidity.

## Government debt

At the end of 2015 total borrowing by the Government from the public amounted to K13,942 million, an increase of K2,114 million from the end of 2014. Total Government debt issued in 2015 comprised K8,880 million in Treasury bills and K1,496 million in Inscribed stock.

### Inscribed Stock

Issued in 2015	K1,496 million
Maturities in 2015	K491 million
Net issuance	K1,005 million
Total holdings 31 December 2015	K7,212 million
Balance as at 31 December 2014	K6,207 million
Increase in balance	K1,005 million
BPNG IS portfolio holdings Dec 2015	K1,531 million
BPNG IS portfolio holdings Dec 2014	K1,013 million
Increase in total holding	K518 million
BPNG Tbill portfolio holdings Dec 2015	K955 million
BPNG Tbill portfolio holdings Dec 2014	K1,731 million
Decrease in holding	K776 million

### Treasury Bills

Outstanding at 31 Dec 2014	K5,621 million
Issued in 2015	K8,880 million
Slack issued in 2015	K957 million
Maturities in 2015	K6,991 million
Slack maturities in 2015	K1,736 million
Outstanding at 31 Dec 2015	K6,729 million

### Central Bank Bills

Outstanding at 31 Dec 2014	K2,287 million
Issued in 2015	K20,901 million
Slack issued in 2015	K796 million
Maturities in 2015	K21,770 million
Slack maturities in 2015	K663 million
Outstanding at 31 Dec 2015	K1,551 million

### Central Bank Bill Tap Facility

Available for sale 2015	K200 million
Balance at 31 Dec 2014	K29 million
Issued in 2015	K106 million
Maturities in 2015	K113 million
Outstanding at 31 Dec 2015	K22 million

## PAYMENT SYSTEMS SUPPORT

The Bank has statutory responsibility for the National Payment System (NPS), which is part of the core financial infrastructure that underpins the PNG economy.

In 2015 the Bank implemented initiatives to strengthen the operation of the NPS, including:

- Creating internal structures to monitor and oversee the NPS
- Developing prudential standards for the NPS
- Enhancing monitoring and controlling the Temporary Advance Facility
- Improving cheque matching and clearance services
- Streamlining processes relating to currency circulation and
- Monitoring payments relating to Anti-Money Laundering and Proceeds of Crimes.

# Secondary Functions

## ECONOMIC ADVICE TO GOVERNMENT

The Bank provides the National Government with economic advice to help optimise fiscal and economic policy.

As well, when issues of concern to the Bank arise, the Bank has a specific statutory responsibility to advise the Government.

The advice is provided by briefings by the Governor, presentations by the Governor and his representatives at various official forums, as well as by means of the Governor's six monthly Monetary Policy Statements. In addition, the Bank's staff provides economic information at technical meetings attended by officers from the Department of Treasury and other Government departments.

## INCREASING ECONOMIC KNOWLEDGE

Research activities are key to the Bank's ability to increase economic knowledge. A number of ongoing information gathering and analysis tasks are essential in aiding policy analysis and making forecasts for policy decisions.

### Research Papers

The Bank released two working papers in 2015:

- Demand for Money in PNG, and
- Estimating an Aggregate Import Demand Function for PNG.

The papers were launched in November at the National Research Institute.

### Business Liaison and Employment Surveys

The Bank surveys 380 companies in the private sector, across different industries and regions, on an ongoing basis.

Business Liaison Survey: 94 companies are surveyed quarterly while the other 286 companies are surveyed annually.

Employment Survey: all 380 companies are surveyed every quarter.

The analysis of the survey results is used to

- Inform the public about economic developments and trends through the Quarterly Economic Bulletin
- Provide inputs into the design and formulation of monetary policy
- Estimate and forecast growth in gross domestic product (GDP)

- Provide information to the private sector on employment trends and sales data by industry.

The Bank also conducts its monthly Retail Price Index (RPI) by collecting prices of items that fall within the National Statistical Office CPI basket from major retail companies in Port Moresby.

In 2015 the Bank developed a tool to forecast short term inflation, which was operated in parallel with the Bank's existing inflation forecasting model.

## Strategic Research Activities

### Expansion of Monetary and Financial Data Coverage

Recommendations of the International Monetary Fund (IMF) technical assistance (TA) mission undertaken in 2013 for the Monetary and Financial Statistics project continued to be worked on in 2015. This covered areas of data quality and coverage. A major achievement during the year was the inclusion of data from the general insurance industry, enabling full coverage of the whole PNG financial system.

### Review of the Kina Facility Rate

Building on findings of a review in 2014 that high liquidity levels are the primary cause of weak transmission of monetary policy, in 2015 the Bank conducted research into the signalling rate, the KFR, and its relevance for signalling the stance of monetary policy.

This review identified factors causing failure of the transmission pricing and suggested measures that could be adopted to strengthen and improve the transmission mechanism. These included considering increases in the cash reserve requirements, transferring Government deposits at commercial banks to the Bank of Papua New Guinea and refining the Repo arrangements with commercial banks.

The review will continue as a business improvement program within the Bank's Strategic Plan.

### Balance of Payments System

The Bank made progress on a number of recommendations arising from the IMF Technical Assistance (TA) mission in 2014. These included improving the Balance of Payments compilation through coverage, reliability, data sourcing and frequency and completing several tasks towards contributing to the International Investment Survey.

The IMF conducted a follow up TA mission in July to review progress.

The Bank achieved better access to key information during 2015, including broadening trade data gathering with a further improvement in accessing PNG Customs' Automated System for Customs Data (ASYCUDA). As well, ongoing communication with the commercial banks led to improved reporting on domestic foreign currency account balances.

In December representatives from the Bank attended the closing workshop of the External Sector Statistics (ESS) project. The three-year project, coordinated by the IMF and funded by the Japanese Government, aimed to enhance the quality of the major ESS including balance of payments, international investment position and external debt as well as to improve the capacity of the Bank of PNG as the compilation agency. The workshop was conducted to assess the progress achieved, identify the challenges encountered and plan future action.

## FACILITATING FINANCIAL SERVICES DEVELOPMENT AND INCLUSION

As well as carrying out its three core functions, the Bank of Papua New Guinea actively supports and contributes to the Nation's economic growth.

### Financial Inclusion and Financial Literacy

During 2015 the Bank continued its involvement in fostering financial inclusion and financial literacy, on the basis that achieving these objectives will assist Papua New Guinea to attain sustainable economic growth.

The Bank's commitment to financial inclusion is embedded in the Strategic Plan, in its alignment with the objectives and targets of the Maya Declaration, is reflected in the Bank's membership of the global network Alliance for Financial Inclusion (AFI) and in its leadership role with the Centre of Excellence for Financial Inclusion (CEFI), of which Governor Bakani CMG is the Chairman.

### Centre of Excellence for Financial inclusion

CEFI is the peak organisation responsible for coordinating all financial inclusion activities in PNG, including the implementation of the National Financial Inclusion and Financial Literacy Strategy 2014-2015 ("NFIFL Strategy").

During the year CEFI continued overseeing the implementation of the NFIFL Strategy, through conducting and participating in information sharing sessions for NFIFL stakeholders and a number of strategy workshops. CEFI representatives attended workshops in Kavieng, Kokopo, Port Moresby and Sydney, Australia and took part in Pacific Microfinance Week in Honiara, Solomon Islands.

In 2015 CEFI's sources of funding included:

- Microfinance Expansion Project (MEP) budget allocation of US\$379,000
- US\$200,000 grant from Pacific Financial Inclusion Programme (PFIP)
- K750,000 allocation from PNG Government.

### Microfinance Expansion Project (MEP)

The Bank of Papua New Guinea is the MEP's Executing Agency, with responsibility for providing support and oversight of the Project's implementation.

The MEP's overarching goal is to reduce poverty by providing financial services to financially literate clients and capable businesses. To achieve this, the Project's focus during 2015 included activities to:

- strengthen the capacity of the microfinance industry to provide financial services to a broader cross-section of the community (Industry Capacity)
- strengthen the capacity of its clients and potential clients to use these services through financial education and business development training (Financial Education)
- regulate and supervise microfinance institutions (MFIs) and savings and loan societies (SLS) through the Bank of PNG (Industry Supervision)
- increase lending to micro and small enterprises to increase rural income (Products).

## Secondary Functions

During the year MEP received technical assistance from international microfinance specialist organisations, including Indian-based firms MicroSave and Basix and the German firm, AFC Consultants International.

In April the mid-term evaluation of the MEP was conducted, with participation from the Asian Development Bank (ADB), the Australian Government and the PNG Department of Planning and Monitoring.

The Review's findings were positive, resulting in the extension of MEP for a further year and recommendations to expand various activities, including training and awareness building, to reach more potential microfinance participants.

2015 was a very successful year for the MEP. A number of important milestones were achieved, including:

### **Industry Capacity**

The measure of industry sustainability improved by 8 percent.

Memoranda of understanding (MOUs) were signed with 10 microfinance institutions to become PFIs.

4 women's groups in the Highlands received rapid institutional assessment to gauge their readiness for admission as PFIs.

The average lending portfolio quality of the microfinance industry improved. By the end of the year the average portfolio at risk level was 16%.

Growth in loan business was encouraged and supported by the Risk Share Facility (RSF). RSF agreements were signed with MiBank Limited, PNG Microfinance Limited and People's Microbank, after conducting due diligence during the year. Loans amounting to K1,964,402 to 164 clients financed by the 3 institutions, including K568,256 loaned to women were covered by the RSF.

PFI staff received extensive industry training by MEP through a study program provided by IBBM and on the job training provided by business mentors. Women accounted for 49 percent of the training participants.

### **Financial Education (FE)**

During the year MEP partnered with four local institutions (Reformation Ministries and Churches Network, Abumangre Micro Credit Scheme, K1 Association and Layman's Professional Servicers) to roll out FE training throughout PNG. 58,492 people were reached, including 26,701 women.

With technical assistance from MEP, Bank South Pacific conducted training for 20,953 people during the year.

By the end of the year financial education training had reached over 100,000 people, with women representing 48 percent of the total. FE training participants operated 31,831 bank accounts.

4 graduation ceremonies for financial education participants were staged in 2015, in Mt Hagan and Mul Baiyer District, Western Highlands Province, Tsak Valley, Enga Province and Kokopo, East New Britain Province.

6 FE modules were developed during 2015: Savings, Budgeting, Bank Services, Mobile Money, Debt Management and Financial Negotiation.

Business Development Service (BDS) training commenced in October. 7 partnership agreements were signed and 21 trainers attended trainer training. By the end of the year 217 people had participated in the BDS training program.

### **Industry Supervision**

Microfinance industry standards were implemented, including performance ratios, reporting requirements to promote transparency and client protection principles.

Additional support was provided to Alekano Savings and Loan Society to overcome liquidity and delinquency issues. The Bank of PNG withdrew MEP support of Sepik Savings and Loan Society.

As part of MEP activities, a considerable number of manuals, explanatory papers, toolkits, guidelines and information pieces were produced during 2015.

### **Products**

45,670 customers opened new bank accounts with partner financial institutions.

The total lending portfolio grew by K26.8 million.

3 new products were developed during the year.

27 new financial products have now been developed as a result of the MEP; 9 have been rolled out and are commercially available, 12 are undergoing testing and the balance are in development phase. 9 products have been designed specifically for women.

Partner Financial Institutions (PFIs) MiBank, People's Microbank and Kada Poroman Microfinance Limited introduced new service delivery channels using ATMs.

### National Survey on Financial Capability

In December 2015 the Bank and the World Bank released the findings of the PNG Financial Inclusion and Financial Capability Survey (NSFC). The NSFC Survey was a joint undertaking of the Bank of PNG, the World Bank and the PNG Institute of National Affairs, with the full support of the local governments at all levels in Morobe and Madang Provinces and technical support from the National Statistical Office (NSO).

The Survey investigated decision-making on money management, financial planning habits, use of information and formal financial services focusing on gender, location, income levels, livelihood and age groups.

The Survey Report found that around 80 percent of the respondents interviewed owned no formal financial products such as a bank account or loan.

According to the Survey, women are significantly less involved in all aspects of household financial management, and are significantly more likely to be financially excluded compared to men. The report calls for greater investment in financial literacy programs targeted specifically to women.

The Survey further found that most rural communities had no readily accessible financial services and many rural villagers were forced to travel significant distances to access a bank branch or ATM.

The Survey findings will be used to help develop a national financial capability baseline understanding for PNG, to support the nation's development of financial inclusion, financial education and literacy and consumer protection programs.

### Young Minds Savings Campaign

The Young Minds Savings Campaign encourages 6 to 25 year olds to learn financial responsibility by opening savings accounts and embracing a savings habit.

In April 2015 the Young Minds Savings Campaign team, including BPNG staff and representatives from 4 partner financial institutions, visited 10 schools in Kavieng, New Ireland Province, bringing the savings message to around 10,000 students.

In June, another 10,000 students had the opportunity to learn about savings when the team, including BPNG staff and 7 partner financial institutions, visited 10 schools in Madang Province.

BPNG staff and 2 partner financial institutions visited 8 schools in Esa'ala, Milne Bay Province in August, reaching around 8,000 students at primary and high schools.



*Students at Okiufa Primary School, Goroka, Eastern Highlands Province attend the Young Minds Campaign visit.*

In September the Campaign travelled to Kundiawa, Simbu Province and Goroka, Eastern Highlands Province. In Kundiawa the team, the Bank and 3 financial institutions, visited 10 schools, addressing around 10,000 students. In Goroka the Bank and 4 partners presented the Campaign message to around 10,000 students from 10 schools.

In October the Young Minds Savings Team, including the Bank and 7 financial institutions, visited 10 schools, another 10,000 students, in Lae, Morobe Province.

### Financial Inclusion Expos

Over 5,500 people visited the Financial Inclusion Mini Expo in Madang Province in June 2015. The Bank hosted the Expo and 15 financial institutions participated.

### FINANCIAL INTELLIGENCE MONITORING

#### Anti-Money Laundering and Counter Terrorist Financing (AML/CTF)

PNG is a member of the Asia-Pacific Group on Money Laundering (APG), the regional body mandated to assist countries in the region to strengthen their anti-money laundering and counter terrorist financing regimes. As a Member of APG, PNG is also required to meet the Financial Action Taskforce (FATF) standards.

PNG's AML/CTF activities are coordinated at the national level through a committee co-chaired by the Bank and the Department of Justice and Attorney General (DJAG). The committee's tasks include putting in place an effective legal framework and working towards complying with international requirements and standards to meet the FATF's International Co-operation Review Group (ICRG) procedures, with the aim of PNG being removed from ICRG's 'grey list'.

In July 2015 Parliament passed the AML/CTF legislation, which had been drafted with technical assistance from the Anti-Money Laundering Assistance Team (AMLAT) within the Australian Attorney-General's Department. The laws are now operational to combat money laundering and terrorist financing in PNG.

The *Anti-Money Laundering and Counter-Terrorist Financing Act 2015* (AML/CTF Act) imposes ongoing obligations on financial institutions and other commercial cash handling operations, including the requirement to report:

- cash or bearer bond transactions for K20,000 or more
- international electronic funds transfers of K20,000 or more and
- any financial transaction considered suspicious.

During the year the Bank established the Financial Analysis and Supervision Unit (FASU) to implement AML/CTF reform. As part of this role, FASU is responsible for analysis of reports and financial intelligence supplied by PNG's various money-handling agencies, formerly a task of the Royal Papua New Guinea Constabulary.

FASU's achievements over the course of 2015 included:

- Conducted industry forums on the AML/CTF policy and regulatory frameworks for all regulated financial institutions, in collaboration with DJAG and AMLAT, with technical assistance from the Australian Transaction Reports and Analysis Centre (AUSTRAC).
- Developed reporting formats for financial institutions and other organisations subject to the AML/CTF requirements.
- Developed supervision strategies and drafted standard operating procedures for on- and off-site compliance supervision, with assistance from AUSTRAC.
- Developed and implemented a control mechanism to flag potential AML/CTF transactions through KATS.
- Participated in training activities and workshops conducted by AUSTRAC and a proceeds of crime workshop conducted by the Office of the Public Prosecutor and the Australian AGD.
- Produced material to support awareness building activities and education programs, including fact sheets, information pamphlets and posters, with the assistance of DJAG and AML Solutions International.

### SOVEREIGN WEALTH FUND SECRETARIAT

#### Sovereign Wealth Fund (SWF)

In February 2015 Parliament passed the first and second readings of a new draft Bill on Organic Law on the SWF. In August 2015 Parliament passed the Bill which became the Organic Law (OL) on SWF of PNG.

The new OL repealed and replaced the former OL, which had been enacted by Parliament in February 2012. The passage of the new OL paved the way for the Government to proceed and develop the subordinate legislation and put in place the necessary administrative structures, including establishing the SWF Board and the Administrative Secretariat, bringing the SWF into full operation.

## STRATEGIC AND OPERATIONAL MANAGEMENT

The Bank's Strategic Plan 2012-2015 was concluded at the end of the year.

More than 80 percent of identified strategic actions were completed over the course of the Plan. The remaining 20 percent include a number of continuing strategic programs and business improvement projects, which were incorporated into the Bank's Strategic Plan 2016-2020.

### Strategic Plan 2016-2020

Over the course of 2015 the Bank developed the Strategic Plan for the next five years, building and expanding on the Strategic Plan 2012-2016.

The consultative process involved input from people across the Bank, from Board level to each functional group. Feedback from external reports also provided key information, such as provided by the Centre of Excellence for Financial Inclusion (CEFI), World Bank and Department of Treasury.

A formal workshop facilitated by an external consultant established the framework and priorities of the Strategic Plan 2016-2020.

The resulting draft Plan was submitted for quality assurance by an independent external consultant.

### Strategic Projects

Strategic projects and programs are based on the Bank's functional responsibilities: Monetary Policy, Financial System Stability, Payments System and Supporting Economic Growth, which align with its four key objectives. The Strategic Plan also deals with Internal Effectiveness and Efficiency, including support areas such as governance, management, information and communications technology and other communications and infrastructure, which enable the Bank to operate effectively in meeting its core mandates.

The Bank progressed a number of strategic projects and programs as part of achieving the Strategic Plan 2012-2015.

## Monetary Policy

### *Secondary market for Government securities development*

One of the Bank's strategic goals is to help develop a secondary market for Government securities. Having effective trading, bookkeeping and monitoring systems in place is essential to achieving this goal.

In November the Bank started a project to upgrade the Registry and Money Market System (RMS) to a web-based system, which will include new functions such as a Repurchase Agreement facility and a secondary market trading facility for Bank stock.

During the year the Bank also commenced implementing the Trade Order Management System (TOMS). Phase 1 involved uploading the Bank's inhouse investment portfolio into the TOMS trading platform. The benefits from this phase included:

- real time price calculations
- more interactive risk management tools
- better execution of trading strategies and trade capture
- improved reporting, and
- strengthening of internal investment processes.

## Payments System

### *National Payment System enhancements*

PNG's national payment system, including the Kina Automated Transfer System (KATS) and the Banking Services System (BSS), continued to be developed during 2015.

During the year the Bank launched Direct Credits, the third and final phase of the Kina Automated Transfer System (KATS), along with further improvements to the Banking Services System (BSS). (see page 28)

With the implementation of Direct Credits during the year, PNG's national payments system supports Real Time Gross Settlement (RTGS), faster cheque clearing (cheque truncation) and electronic funds transfer, placing the nation's payment system in the same league as other developed countries.

Phase 2 of the BSS project was launched in September, to improve the Bank's internal banking and accounting processes and to automate banking services provided to the National Government and other statutory authorities.



## Institutional Support

### *Lae Currency Distribution Facility*

The Bank is committed to developing more effective ways to issue and distribute currency around the country. As part of this strategy the Bank is establishing a currency distribution facility in Lae, Morobe Province.

The 'early works' phase of the Facility's construction phase started in November 2015.

### *Re-alignment of Bank's Accounts*

The Bank commenced this project in September 2014, aiming to align the Bank's chart of accounts with its organisational structure and allow for future additions and restructures. Over the course of 2015 the project was substantially completed.



*Governor Bakani CMG 'hands-on', participated in the ground-breaking ceremony of the Lae Currency Distribution Facility.*



*Artist's impression of the Lae Currency Distribution Facility.*

### **Supporting Economic Growth**

During 2015 the Bank continued progress on a number of initiatives aimed towards supporting macro-economic growth in PNG.

These included financial inclusion and financial literacy activities (see page 35) and continued expansion of the microfinance sector (see page 35).

### **Financial Intelligence Monitoring**

The Bank established the Financial Analysis and Supervision Unit (FASU) to deal with money laundering and terrorism financing issues. (see page 38)

### **Institutional Support**

#### *Establishment of Data Centre*

With the implementation of KATS and BSS and the Bank's continuing focus on automating more of its business functions, the need for a purpose-designed and built data centre became a priority.

During 2015 the Bank commissioned a comprehensive market survey to evaluate the Bank's options for the location of a dedicated data centre. The survey results supported the construction of the centre within the Bank's head office building. By the end of 2015 the design phase of the proposed data centre was completed.

#### *Business Continuity*

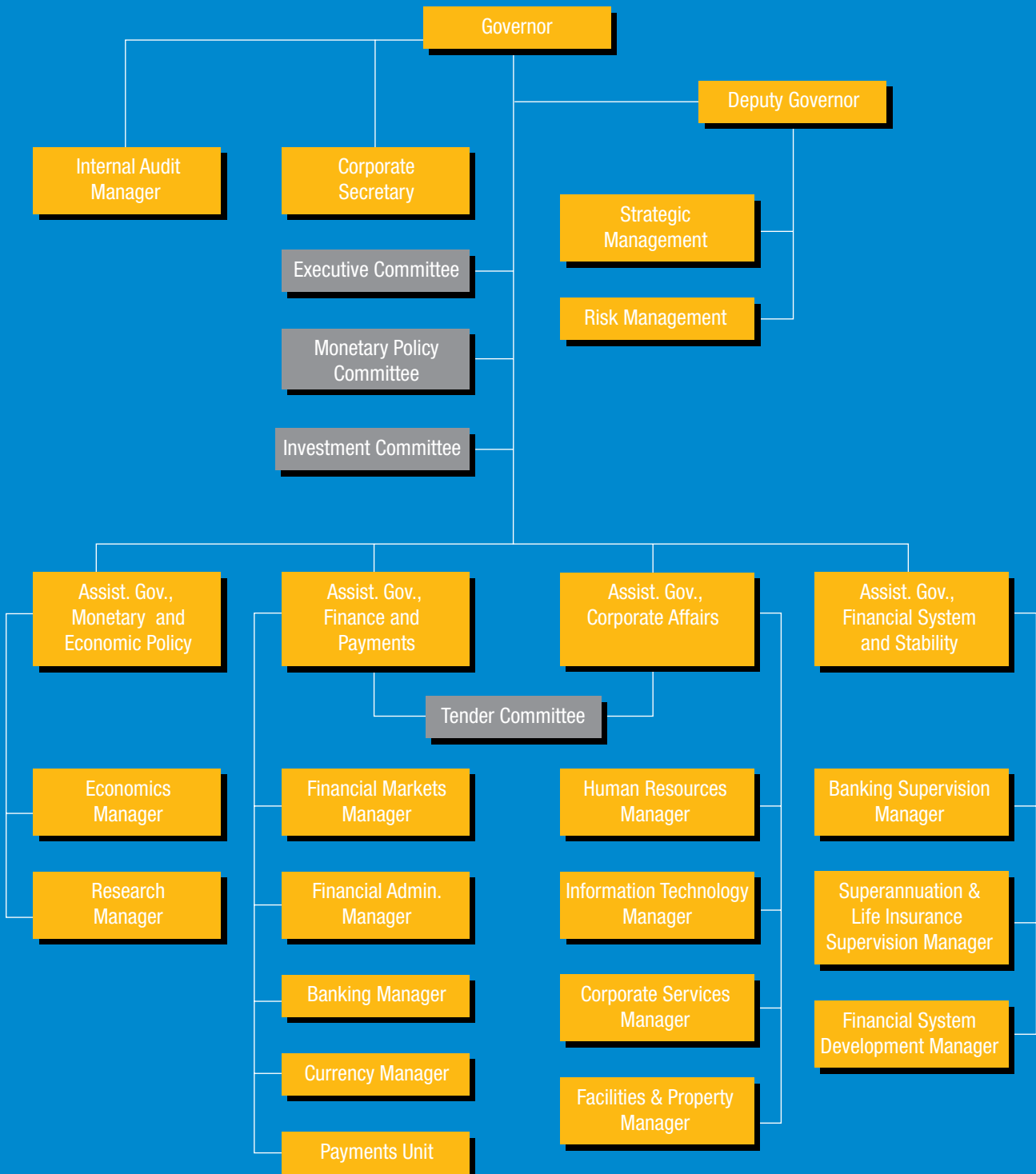
The work to develop the Bank's business recovery and continuity processes and procedures, including data recovery, continued through 2015. During the year the Bank established a secure offsite facility to house staff involved in business continuity activities.

#### *Data Warehouse and Business Intelligence Reporting project*

During the year the banking processes component of the Data Warehouse project was completed. When rolled out to industry, this solution will enable supervised Licensed Financial Institutions to report to the Bank online.

## HUMAN RESOURCE MANAGEMENT

### Organisation Chart as at 31 December 2015



## Staff Numbers as at 31 December 2015

Staff Category	2015	2014	2013
General staff members	315	310	293
Management	58	48	48
Executive	6	6	6
Total employees	379	364	347

The Bank continued its focus on recruiting and retaining appropriately skilled and qualified staff to meet the strategic goal of maintaining and retaining a high level of staff skills in line with the changing work environment.

Over the course of 2015 the number of staff increased to 379 employees, an increase from 364 employees in the previous year.

### Projects

Over the course of the year the Bank undertook a number of significant human resource projects, including recommendations for appropriate staffing arrangements for restructured functional areas, job evaluations and reviews of position descriptions, a review of the Bank's human resource policy and an update of the Employee Handbook.

### Recruitment

During 2015 the Bank was engaged in recruiting appropriate staff for the Financial System Stability Group, Finance and Payments Group, Corporate Services Group and for the Microfinance Expansion Project.

### Staff Capacity Development

Over the course of the year the Bank sponsored or supported capacity development for Bank employees through a range of activities, including:

- formal education towards recognised qualifications, both locally and overseas, from certificate through to post-graduate levels
- informal training, including workshops, seminars and conferences
- the introduction of an induction program to orient new recruits to the functions of the Bank
- the Bank's structured Graduate Development Program.

In addition the Bank encourages staff to hold memberships and seek professional qualifications and participate in ongoing education from relevant industry associations, including CPA PNG and the PNG Institute of Directors.



<b>Senior Officers</b>	
<b>Governor</b>	<b>Loi M. Bakani CMG</b>
Deputy Governor	Vacant
Adviser to Governor	Benny Popoitai MBE
<b>Secretariat</b>	
Corporate Secretary	Tau Vini
<b>Internal Audit</b>	
Manager	Benek Beriso
<b>Projects</b>	
Manager	Nathan Maire
<b>Risk Management</b>	
Manager	Ron Sikar
<b>Financial Analysis and Supervision Unit</b>	
Manager	Wilson Onea
<b>Monetary &amp; Economic Policy Group</b>	
Assistant Governor	Dr Gae Kauzi
<b>Economics</b>	
Manager	Sali David
Manager, Monetary Policy Unit	Wilson Jonathan
Manager, Balance of Payments	Thomas Jiki
Manager, Library	Maryanne Kani
Manager, Internal Transactions Monitoring Unit	Elim Kiang
<b>Research</b>	
Manager	Jeffrey Yabom
Manager, Economic Analysis Unit	Jacob Marambini (Acting)
Manager, Projects Unit	Boniface Aipi
<b>Finance &amp; Payments Group</b>	
Assistant Governor	Joe Teria
<b>Financial Markets</b>	
Manager	Simon Gaius
Manager, Foreign Reserves	Rowan Rupa
Manager, Money Markets	Winnie Linken
Manager, Registry	Marie Martin
Manager, Middle Office	Ambrose Papis

<b>Senior Officers</b> <i>(continued)</i>	
<b>Financial Administration</b>	
Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Oliver Kludapalo
Manager, Settlements	Soms Yankey
<b>Banking</b>	
Manager	Jason Tirime
Manager, Customer Services Unit	So'on Drewei
Manager, Clearing Accounts	Aiva Aku
Manager, Government Accounts	Vacant
<b>Currency</b>	
Manager	David Lakatani
Manager, Control Unit	John Yenas
Manager, Processing Unit	Edward Kisakau
<b>Payments</b>	
Manager, Payments System Unit	Gaona Gwaibo
Manager, Payments Oversight & Compliance Unit	Alfred Napun
<b>Corporate Affairs Group</b>	
Assistant Governor	Elizabeth Genia
<b>Human Resources</b>	
Manager	Naomi Kedeia
Manager, Strategy Planning & Development Unit	Patrick Kwiwa
Manager, Administration Support Unit	Gaudi Kauna (Acting)
Manager, Client Support Unit	Vagi Gareitz
HR Projects	Mairi Matthew
<b>Information Technology</b>	
Chief Information Officer	Naime Kilamanu
Manager, Corporate Systems Unit	Brian Semoso
Manager, Operations Unit	Manea Joseph

<b>Senior Officers</b> <i>(continued)</i>	
<b>Corporate Services</b>	
Manager	Jerome Peniasi
<b>Facilities &amp; Property</b>	
Manager	Bruce Kitchen
<b>General Services</b>	
Manager	William Tiki
<b>Publication &amp; Communication</b>	
Manager	Jon Kombeng
<b>Security</b>	
Manager	Slim Ropusina
<b>Financial System &amp; Stability Group</b>	
Assistant Governor	Ellison Pidik
<b>Banking Supervision</b>	
Manager	Sabina Deklin
Manager, Banks & Financial Institutions Unit	Boas Irima
Manager, Savings & Loan Societies Unit	Nickson Kunjil
<b>Superannuation &amp; Life Insurance Supervision</b>	
Manager	Elizabeth Gima
Manager, Superannuation Unit	Tom Milamala
Manager, Life Insurance Unit	Peter Samuel
Manager, Employer Contributions Enforcement Unit	Nonza Makip
<b>Financial System Development</b>	
Manager	George Awap
Manager, Macro-Prudential Supervision Unit	Maria Kanari
Manager, Financial System Policy Unit	Tanu Irau
Manager, Licensing and Compliance Unit	Walio Gamini

## Institutional Support

### INFORMATION AND COMMUNICATION TECHNOLOGY SERVICES

Following on from initiatives started in 2014, over the course of 2015 the Bank continued to strengthen its technology capability to enable and support its core functions and strategic initiatives.

Significant systems developments and enhancements achieved during the year included:

- Implemented KATS phase 3 - Direct Credits
- Completed the banking supervision solution component of the Data Warehouse project
- Established the Anti-Money Laundering (AML) module in KATS
- Assisted with the installation of the AML and Countering Financing Terrorism (CFT) database
- Investigated the options for a purpose-built data centre for the Bank
- Recommended constructing the proposed data centre in the Bank's head office and completed design documents for the centre.

### COMMUNICATION SERVICES

The Bank is committed to providing timely and useful information to its wide range of audiences. To this end, the Bank produces a number of publications, available through printed publications and the Bank's website, including policy statements, media releases and public announcements. As well, the Bank participates in a number of public events, such as regional shows and cultural events, to provide face to face communication and financial education.

The Bank is also a leader in using technology to reduce paper-based communications. For example, delegates attending conferences hosted by the Bank are provided with electronic devices such as tablet computers.

### INFRASTRUCTURE SERVICES AND SYSTEMS

The Bank owns various physical assets and provides services to support its operation, including office accommodation, staff housing, transport, security and purchasing. These assets and services are professionally planned, delivered and managed.

## BPNG IN THE COMMUNITY

The Bank of PNG supports a number of national, cultural, educational, sporting and health-related activities, in line with its leadership position in the PNG business sector and broader community.

In addition to ongoing support to charities, the Bank has supported the Sir Buri Kidu Heart Foundation for many years. During 2015 the Bank made significant contributions to 5 organisations for specific works. They included:

#### University of Papua New Guinea

The Bank's sponsorship contributed to the University's role in building effective leadership of Papua New Guinea, promoting good governance and promoting capacity building for the nation.

#### Hope Worldwide PNG

The Bank's support helped Hope to renovate two children's clinics at Nine Mile and Konedobu in Port Moresby. The longer term benefits will be better health and well-being for the children housed at Hope centres.

#### PNG Paralympic Committee

The Bank's sponsorship went to supporting the Asian Open Powerlifting Championship to help provide an opportunity for PNG competitors to get exposure and experience at an international level in their preparation to represent PNG at a future Paralympics.

#### PNG Association of Administrative Professionals

The Bank's sponsorship helped stage the Association's conference, which focused on a positive approach to professionalism in the workplace.

#### Port Moresby General Hospital (Children's Ward)

The Bank's generous donation was earmarked by the hospital to purchase a range of medical equipment for sick and injured children.



# Bank of Papua New Guinea

## FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2015

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# Statement of Profit or Loss and Other Comprehensive Income

For the year ended  
31 December 2015

	Notes	2015 K'000	2014 K'000
<b>Revenue from foreign currency investments</b>			
Interest revenue	2	92,572	103,369
Realised gain/(loss) on financial assets		(26,224)	25,658
Foreign exchange gains and commissions		9,442	12,377
<b>Total revenue from foreign currency investments</b>		<b>75,790</b>	<b>141,404</b>
<b>Expenses on foreign currency investments</b>			
Interest expense on liabilities with IMF		(261)	(452)
Custodian and investment management fees		(5,772)	(4,422)
<b>Total expenses from foreign currency investments</b>		<b>(6,033)</b>	<b>(4,874)</b>
<b>Net foreign currency income</b>		<b>69,757</b>	<b>136,530</b>
<b>Revenue from domestic investments</b>			
Interest revenue	3	234,606	114,103
Other income	4	11,575	14,887
<b>Total revenue from domestic investments</b>		<b>246,181</b>	<b>128,990</b>
<b>Expense on domestic liabilities</b>			
Interest expense	5	(53,615)	(62,077)
<b>Total expenses on domestic liabilities</b>		<b>(53,615)</b>	<b>(62,077)</b>
<b>Net domestic income</b>		<b>192,566</b>	<b>66,913</b>
<b>Total net operating income</b>		<b>262,323</b>	<b>203,443</b>
<b>Operating expenses</b>			
General and administration expenses	6	(122,828)	(113,784)
<b>Profit excluding unrealised income</b>		<b>139,495</b>	<b>89,659</b>
<b>Other unrealised income and (expense)</b>			
Fair value and foreign exchange revaluation gain on foreign currency investments		515,629	139,614
Fair value revaluation gain/(loss) on domestic investments		20,791	(97,385)
<b>Profit for the year</b>		<b>675,915</b>	<b>131,888</b>
<b>Other comprehensive income</b>			
<b>Items that may be subsequently reclassified to profit and loss</b>			
Gain/(loss) on gold asset revaluation		4,822	7,617
<b>Other comprehensive income/(loss) for the year</b>		<b>4,822</b>	<b>7,617</b>
<b>Total comprehensive income for the year</b>		<b>680,737</b>	<b>139,505</b>

The financial statements are to be read in conjunction with the notes on pages 52 to 78.

# Statement of Financial Position

For the year ended  
31 December 2015

	Notes	2015 K'000	2014 K'000
<b>Assets</b>			
<b>Foreign currency financial assets</b>			
Cash and cash equivalents	8	455,935	745,812
Financial assets at fair value	9	4,890,468	5,038,553
Assets held with IMF and other financial organisations	7	38,630	35,098
Accrued interest		23,126	26,080
<b>Total foreign currency financial assets</b>		<b>5,408,159</b>	<b>5,845,543</b>
<b>Local currency financial assets</b>			
Government of Papua New Guinea securities	10	2,220,380	2,413,811
Loans and advances	11	184,516	10,076
Accrued interest and other receivables		59,039	39,345
<b>Total local currency financial assets</b>		<b>2,463,935</b>	<b>2,463,232</b>
<b>Total Financial Assets</b>		<b>7,872,094</b>	<b>8,308,775</b>
<b>Non-financial assets</b>			
Gold		134,639	129,817
Property, plant & equipment	13	136,170	117,475
Investment properties	14	38,740	38,740
Other non-financial assets	12	50,917	52,790
<b>Total non-financial assets</b>		<b>360,466</b>	<b>338,822</b>
<b>Total Assets</b>		<b>8,232,560</b>	<b>8,647,597</b>
<b>Liabilities</b>			
<b>Foreign currency financial liabilities</b>			
Liabilities to IMF	7	529,260	472,985
Other financial liabilities	19	1,233	2,074
<b>Total foreign currency financial liabilities</b>		<b>530,493</b>	<b>475,059</b>
<b>Local currency financial liabilities</b>			
Deposits from banks and third parties	15	3,211,773	3,432,690
Deposits from Government and Government entities	16	871,407	1,064,491
Debt securities issued	17	1,566,893	2,306,685
Accrued interest payable on debt securities		2,881	5,031
Currency in circulation	18	1,883,089	1,850,629
Other financial liabilities	19	111,531	51,517
<b>Total local currency financial liabilities</b>		<b>7,647,574</b>	<b>8,711,043</b>
<b>Total financial liabilities</b>		<b>8,178,067</b>	<b>9,186,102</b>
<b>Non-financial liabilities</b>			
Provisions for employee entitlements	20	19,108	16,847
<b>Total non-financial liabilities</b>		<b>19,108</b>	<b>16,847</b>
<b>Total Liabilities</b>		<b>8,197,175</b>	<b>9,202,949</b>

## Statement of Financial Position

	Notes	2015 K'000	2014 K'000
<b>Equity</b>			
Capital	21	145,540	145,540
Gold revaluation reserve	21	113,992	109,170
Property revaluation reserve	21	93,452	93,452
Unrealised loss reserve	21	(558,013)	(1,082,678)
Retained earnings	21	240,414	179,164
<b>Total Equity</b>		<b>35,385</b>	<b>(555,352)</b>
<b>Total Liabilities and Equity</b>		<b>8,232,560</b>	<b>8,647,597</b>

The financial statements are to be read in conjunction with the notes on pages 52 to 78.

## Statement of Changes in Equity

For the year ended  
31 December 2015

In Kina (K'000)	Property Revaluation Reserve	Unrealised Profit/(loss) Reserve	Gold Reserve	Capital	Retained earnings	Total
<b>Balance at 1 January 2014</b>	<b>98,680</b>	<b>(1,124,907)</b>	<b>101,553</b>	<b>145,540</b>	<b>186,277</b>	<b>(592,857)</b>
Profit for the year	-	42,229	-	-	89,659	131,888
Other comprehensive income/(loss) for the year	-	-	7,617	-	-	7,617
Transfers to equity	(5,228)	-	-	-	5,228	-
Dividend declared and paid	-	-	-	-	(102,000)	(102,000)
<b>Balance at 31 December 2014</b>	<b>93,452</b>	<b>(1,082,678)</b>	<b>109,170</b>	<b>145,540</b>	<b>179,164</b>	<b>(555,352)</b>
Profit for the year	-	536,420	-	-	139,495	675,915
Other comprehensive income/(loss) for the year	-	-	4,822	-	-	4,822
Net transfers from loss reserve to retained earnings on realised sale of securities	-	(11,755)	-	-	11,755	-
Dividend declared and unpaid	-	-	-	-	(90,000)	(90,000)
<b>Balance at 31 December 2015</b>	<b>93,452</b>	<b>(558,013)</b>	<b>113,992</b>	<b>145,540</b>	<b>240,414</b>	<b>35,385</b>

The realised profit for the year is K139.5million. The unrealised loss reserve and net asset balance at 31 December 2015 are K558 million and K35.3 million, respectively. The *Central Banking Act 2000* states that no distribution will be made where, in the opinion of the Bank of Papua New Guinea, the assets of the Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital.

The financial statements are to be read in conjunction with the notes on pages 52 to 78.

# Statement of Cash Flows

For the year ended  
31 December 2015

	Notes	2015 K'000	2014 K'000
<b>Cash Flows from Operating Activities</b>			
Interest received on foreign investments		95,526	120,360
Interest received on domestic investments		214,912	90,165
Fees, commissions and other income received		21,017	14,887
Interest paid on IMF liabilities		(261)	(452)
Interest paid on domestic liabilities		(55,765)	(65,695)
Payments to employees		(41,879)	(45,045)
Payments to suppliers		(53,383)	(55,506)
Fees and commissions paid		(5,772)	(4,422)
Net proceeds from foreign investments		641,489	1,139,144
Net payment for Government securities		214,222	(1,571,211)
Net loans issued to staff		(174,440)	(125)
<b>Net Cash Flow provided by / (used in) Operating Activities</b>		<b>855,666</b>	<b>(377,900)</b>
<b>Cash Flows from Investing Activities</b>			
Purchase of property, plant and equipment		(25,038)	(11,344)
Proceeds from sale of property, plant and equipment		577	183
<b>Net Cash Flow used in Investing Activities</b>		<b>(24,461)</b>	<b>(11,161)</b>
<b>Cash Flows from Financing Activities</b>			
Net movement of currency in circulation		32,460	100,603
Net movement in debt securities issued		(739,792)	(883,651)
Distributions to the Government		-	(102,000)
Net movement in deposits from Government		(193,084)	84,319
Net movement in deposits from banks		(220,917)	1,281,506
Net movement in IMF liabilities		251	2,762
<b>Net Cash Flow (used in) / provided by Financing Activities</b>		<b>(1,121,082)</b>	<b>483,539</b>
<b>Net (Decrease)/Increase in Cash and Cash Equivalents</b>		<b>(289,877)</b>	<b>94,478</b>
Cash and cash equivalent at 1 January		745,812	651,334
<b>Cash and Cash Equivalent at 31 December</b>	<b>8</b>	<b>455,935</b>	<b>745,812</b>

The financial statements are to be read in conjunction with the notes on pages 52 to 78.

## **Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Bank of Papua New Guinea (the 'Bank') is domiciled in Papua New Guinea and is the country's central bank and regulator of monetary policy, the financial sector and payments system.

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

### **(a) Basis of preparation**

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and in accordance with the *Central Banking Act 2000* (the "Act"). In the event of any conflict between the requirements of the Act and the Accounting Standards, the Bank is required to comply with the Act.

All amounts are expressed in kina rounded to the nearest thousand unless otherwise stated. Fair value accounting is used for all the Bank's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for land and buildings. In all other cases, a historical cost basis of accounting is used. Revenues and expenses are brought to account on an accrual basis.

### **Going concern**

The Bank was exposed to significant valuation losses in its foreign currency assets as a result of appreciation of the PNG kina against other major currencies in previous years. As a result, the Bank has an unrealised loss reserve of PGK 558M (2014: 1,082.7M).

Although in a net asset position of PGK 35.3M at 31 December 2015 (2014: net liabilities of PGK 555.4M), a relatively small (less than 1%) foreign exchange or fair value movement in the Bank's assets would result in the Bank returning to a net liability position. Accordingly, despite improvement during the year, there is a material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern and therefore it may not be able to realise its assets and discharge its liabilities in the normal course of business.

Section 50(2) of the Act provides that where the Bank incurs a loss due to a change in the value of assets or liabilities, the Minister shall cause to be paid to the Bank such amount out of the Consolidated Revenue account as is necessary to avoid the loss.

Subsection 50(4) of that Act further provides that the Minister may create and issue to the Central Bank non-interest bearing non-negotiable notes for an amount not exceeding any payment made by the Minister to the Central Bank out of the Consolidated Revenue account in accordance with Subsections (1) and (2) of the Act.

The above provisions of the Act effectively require the Government to provide financial support to the Bank and under the powers of the Act the Minister issued a Promissory Note on the 10th December 2014. Under the terms of the Promissory note the Independent State of Papua New Guinea promises to pay, on the demand of the Bank, PGK 1.12 billion without interest. This note is valid for as long as the Bank has a negative valuation reserve in its audited financial statements. On this basis, the Governor, Deputy Governor and the Board of Directors of the Bank believe that the preparation of the financial statements of the Bank on a going concern basis is appropriate.

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**(b) Functional and presentation currency**

Transactions in foreign currency are translated to kina being the functional and presentation currency of the Bank at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to kina at the foreign exchange rate prevailing at reporting date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income.

**(c) Use of judgements and estimates**

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Bank's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

**(i) Assumptions and estimation uncertainties**

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 December 2015 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

- (a) Note 23 (iv) – determination of the fair value of financial instruments with significant unobservable inputs;
- (b) Note 14 – fair value of investment properties.

**(ii) Accounting estimates**

Fair value of financial instruments that are not traded in an active market (for example over the counter derivatives or PNG Government inscribed stock) is determined using valuation techniques. The Bank uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period. Derivative transactions are entered into on behalf of the Bank by the external fund managers and similar valuation techniques are used in valuing these derivatives.

These financial statements are not considered to contain any significant accounting estimates, as the most significant balance sheet items can be valued with reference to market rates, and revenue and expense recognition criteria are clearly defined.

**(d) Revised standard, amendments to existing standards and interpretations adopted by the Bank**

(i) The following are amendments to IFRSs that are mandatorily effective for the 2015 financial year:

Effective for	New standards or amendments	Summary of the requirements	Impact on financials
Periods beginning 1 July 2014	<i>Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)</i>	The amendments to IAS 19 clarify the accounting treatment for contributions from employees or third parties to a defined benefit plan. The amendment requires retrospective application.	The impact on the Bank's financial statements as a result of the application of the amendment is immaterial. The Governor and the Deputy Governor are the Bank's only offers who contributed to a defined benefit pension fund.
	<i>Annual Improvements to IFRSs 2010-2012 Cycle</i>	The annual improvements include amendments to a number of IFRSs: <ul style="list-style-type: none"> <li>• IFRS 2 Share-based Payment</li> <li>• IFRS 3 Business Combinations</li> <li>• IFRS 8 Operating Segments</li> <li>• IFRS 13 Fair Value Measurement</li> <li>• IAS 16 Property Plant and Equipment and IAS 38 Intangible Assets</li> <li>• IAS 24 Related Party Disclosures</li> </ul>	The impact on the Bank's financial statements as a result of the application of the annual improvements is immaterial. The amendments to the standards are not applicable to the circumstances of the Bank.
	<i>Annual Improvements to IFRSs 2011-2013 Cycle</i>	The annual improvements include amendments to a number of IFRSs: <ul style="list-style-type: none"> <li>• IFRS 3 Business Combinations</li> <li>• IFRS 13 Fair Value Measurement</li> <li>• IAS 40 Investment Property</li> </ul>	The impact on the Bank's financial statements as a result of the application of the annual improvements is immaterial. The amendments to the standards are not applicable to the circumstances of the Bank.



- (ii) Below is a list of new and revised IFRSs that are not yet mandatorily effective (but allow early application) for the year ending 31 December 2015. The Bank has not applied the following new or amended standards in preparing these financial statements, however is assessing whether they will have a material or significant effect at the time of mandatory application:

Effective for	New standards or amendments	Summary of the requirements	Possible impact on financials
Periods beginning 1 July 2018	<i>IFRS 9 Financial Instruments</i>	The new standard contains revised requirements for the classification, measurement and de-recognition of financial assets and liabilities. It will replace correspond requirements currently in IFRS 39.	The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 9.
	<i>IFRS 15 Revenue from Contracts with Customers</i>	IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted	The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 9.

- (iii) The following new or amended standards are not yet effective, but are available for early adoption:

Effective for	New standards or amendments
Periods beginning 1 January 2016	Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)
	Annual Improvements to IFRSs 2012-2014 Cycle – various standards
	Disclosure Initiative (Amendments to IAS 1)

#### (e) Financial assets and liabilities

##### Definition of financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The Bank's financial instruments are its domestic government securities, foreign government securities, Central Bank Bills issued, bank deposits, cash and cash equivalents, deposit liabilities and currency in circulation.

The Bank accounts for its financial instruments in accordance with IAS 39 – Financial Instruments: Recognition and Measurement and reports these instruments under IFRS 7 –Financial Instruments: Disclosures and IFRS 13 – Fair Value Measurement



**(i) Domestic Government securities**

The Bank holds Inscribed stocks and Treasury bills with fixed coupon rates issued by the Government. Domestic Government securities are classified under IAS 139 as a 'fair value through profit or loss'. In accordance with this standard, the securities are accounted for on a fair value basis using the discounted present value model, with realised and unrealised gains and losses taken to profit. Interest earned on the securities is accrued over the term of the security and included as revenue in the statement of comprehensive income. Interest is received biannually at the coupon rate and the principal is received at maturity.

**(e) Financial assets and liabilities (continued)**

**(ii) Foreign exchange holdings**

Foreign exchange holdings are invested mainly in securities (issued by the Governments of Australia, the United Kingdom, United States of America, Germany, France and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). These instruments are classified as 'financial assets held for trading' in accordance with IAS 39. Accordingly, these assets are measured at their fair value. External fund managers engaged by the Bank also enter into forward exchange contracts to hedge the returns of portfolios under their management to the US Dollar. No PNG kina forward contracts are entered into.

**(iii) Foreign exchange translation**

Assets and liabilities denominated in foreign currency are converted to kina equivalents at the prevailing exchange rate on balance date in accordance with IAS 21 – The Effects of Changes in Foreign Exchange Rates. Realised and unrealised gains or losses on foreign currency are taken to profit or loss, but only realised gains are available for distribution.

**(iv) Foreign government securities**

Foreign government securities include coupon and discounted securities. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal is received at maturity. Interest earned on discount securities is the difference between the purchase cost and the face value of the security; this is accrued over the term the securities are held. The face value is received at maturity. Foreign securities are classified under IAS 39 as 'at fair value through profit or loss', as they are available to be traded in managing the portfolio of foreign exchange reserves. In accordance with this standard, these securities are valued at market bid prices on balance date. Realised and unrealised gains or losses are taken to profit; only realised gains and losses are available for distribution in accordance with the *Central Banking Act 2000*. Interest earned on securities is accrued as revenue in the Statement of Profit or Loss and Other Comprehensive Income.

**(v) Foreign deposits**

The Bank holds its foreign currency reserves in deposits with highly-rated international banks. Deposits are classified as 'cash and cash equivalents' under IAS 7 and recorded at their face value. Foreign deposits are revalued at period end using the applicable foreign exchange bid rate. Any gains or losses due to changes in the foreign exchange rates between periods are taken to profit.

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**(vi) Foreign currency forward contracts**

External fund managers engaged to manage part of the Bank's investment portfolio enter into forward foreign exchange contracts to hedge the return of portfolios under their management to the US Dollar. Gains/(losses) on this portfolio are treated as unrealised by the Bank as they remain as part of the overall portfolio under the management of external fund managers. These forward contracts are accounted for on a fair value basis, with all changes in fair value being reflected in the statement of comprehensive income in accordance with IAS 39. The fair values are determined with reference to prevailing exchange rates at balance date.

**(vii) Deposit liabilities**

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilities under IAS 39. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of the deposits and paid periodically or at maturity. Interest accrued but not yet paid and the deposit liabilities are included in Note 15.

**(viii) Central Bank Bills on issue**

Since 2006, the Bank has issued Central Bank Bills as part of its money market operations. These are classified as financial liabilities. The Bills issued have maturities ranging from 28 days to 181 days and are recorded at their amortised cost using the effective interest method. Interest is paid at maturity.

**(ix) Loans and Advances**

Loans and advances are non-derivative financial assets with fixed or determinable repayment terms that are not quoted in an active market. Loans are receivables and 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 rate method.

**(x) Assets and Liabilities with the International Monetary Fund (IMF)**

As Papua New Guinea is an IMF member nation, special drawing rights (SDR) are periodically allocated. The Bank recognises the allocation as an asset. The IMF assets and liabilities are denominated in SDR which are based on the weighted average of four main trading currencies. These are translated to PGK using the SDR market rate at balance date. These assets and liabilities are accounted for on a fair value basis, with changes to the fair value being taken to the statement of comprehensive income in accordance with IAS39.

**(xi) Currency in Circulation**

Currency issued by the Bank represents a claim on the Bank in favour of the holder. It is recorded at face value in the Statement of Financial Position.

**(f) Determination of fair value**

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

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from the exchange, dealer, broker, pricing service or regulatory agencies, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

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 (for example, foreign exchange rates, volatilities and counterparty spreads) existing at the dates of the statement of financial position.

For more complex instruments, the Bank uses internally developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value unlisted debt securities and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions.

### (g) Property, plant and equipment

Formal valuations of all the Bank's properties are conducted on a triennial basis. The properties are valued by local independent valuers. The most recent independent valuation of the properties was conducted during the year and the valuations reflected in the financial statements at 31 December 2013. In accordance with IAS 16 – Property, Plant and Equipment, properties are valued at fair value, which reflects observable prices and are based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Valuation gains and losses are transferred to the Property Revaluation Reserve. Management has assessed the fair value of all property and equipment as at year end and consider them to be appropriate.

Annual depreciation is based on fair values less their estimated residual values using the straight-line method over their estimated useful lives, and is recognised in the profit or loss. The range of useful lives used for each class of assets is:

	Years
Residential Properties	20 – 30
Office Buildings	50
Computer Equipment	5
Vehicles	4
Equipment	5
Intangible – Computer Software License	13

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

### (h) Computer Software

Computer software that is internally developed or purchased is accounted for in accordance with IAS 38 – Intangible Assets. Intangibles are recognised at cost less accumulated amortisation and impairment adjustments (if any), details of which are included in Note 13.

Amortisation of computer software is calculated on a straight line basis using the estimate useful life of the relevant asset with is usually a period of between three to five years. The useful life of core banking software may be up to 13 years, reflecting the period over which the future economic benefits are expected to be realised from this asset.

### (i) Gold

Gold reserves placed on deposit with a financial institution are valued at the kina equivalent of the prevailing exchange rate at balance date. On this basis, the underlying transaction means that the Bank holds a gold asset, which is separately disclosed as gold. Unrealised gains and losses on gold are transferred to other comprehensive income.

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**(j) Investment properties**

Investment property is initially measured at cost and subsequently at fair value, with any change therein recognised in profit or loss within other income.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

**(k) Investment property rental income**

Rental income from investment property is recognised in other income from domestic investments on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

**(l) De-recognition**

A financial asset is de-recognised when the Bank loses control over the contractual rights that comprise the asset. This will occur when the rights are realised, expired or surrendered. A financial liability shall be de-recognised when it is extinguished.

**(m) Offsetting financial instruments**

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

**(n) Inventory – Notes & Coins**

The cost of the printing of notes and minting of coins are initially capitalised until such time as they are issued into circulation, at which point the related cost is expensed. The weighted average cost method is used to calculate the number of pieces issued into circulation. All other expenditures of a non-capital nature are expensed when incurred.

**(o) Cash and cash equivalents**

Cash and cash equivalents comprise balances with a maturity of less than three months from the date of acquisition, including cash on hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

**(p) Other receivables**

Other receivables are stated at amortised cost.

**(q) Employee benefits**

**(i) Pension Fund**

The Governor and Deputy Governor contribute to the Bank's defined benefit pension fund and all other employees contribute to an approved external superannuation fund. Interest is paid on the Bank's pension fund balance half yearly based on the average interest rate of Nasfund and Nambawan Superannuation Fund.

Contributions to the Bank's pension fund and external superannuation fund are recognised as an expense in the Bank's statement of comprehensive income. The value of the Bank's pension fund defined benefit obligations and the fair value of the Bank's pension fund assets are determined with sufficient regularity to ensure that the amounts recognised in the Bank's financial statements do not differ materially from the amounts that would be determined at the balance date.

### (ii) Provision For Leave Entitlement

The Bank maintains provisions for accrued annual leave in accordance with IAS 19 - Employees Benefits, calculated on salaries expected to prevail when leave is anticipated to be taken. The Bank also maintains provisions for long service leave. The provision of employee benefits for long service leave represent the present value of the estimated future cash outflows to be made resulting from employees' service provided to balance date. The provision is calculated using expected future increases in wages and salary rates including related on-costs and expected settlement dates based on staff turnover history and is discounted using the rates attaching to PNG Government bonds at balance date which most closely match the terms of maturity of the related liabilities.

### (r) Other liabilities

Other liabilities are initially recognised at their fair value and subsequently recognised at amortised cost.

### (s) Reserves

The Bank maintains the following reserves. Their purpose and method of operation is to be as follows:

#### (i) Bank of Papua New Guinea Reserve Fund

The Bank of Papua New Guinea Reserve Fund was created under the *Central Banking Act 2000* Section 42, and represents reserves set aside as determined to meet contingencies which arise in the course of the Central Bank's operations in carrying out its functions. No reserves have been put aside in the financial year.

#### (ii) Property Revaluation Reserve

The property revaluation reserve reflects the impact of changes in the fair value of property.

#### (iii) Unrealised Profits Reserve

Unrealised gains and losses on foreign exchange balances and domestic securities are recognised in the unrealised loss reserve until such gains and losses are realised whereby they are recognised in profit and loss from ordinary activities. Such gains and losses are not available for distribution.

#### (iv) Distributable Profit Reserve

The distributable profit reserve reflects closing distributable profit which may be distributed to the Government of Papua New Guinea after ensuring that the current financial position of the Bank meets the requirements under the *Central Banking Act 2000* Section 49(3). No reserves have been put aside in the financial year.

#### (v) Gold Revaluation Reserve

Unrealised gains and losses arising from revaluation are recognised in the Gold Revaluation Reserve at end of the accounting period. Realised gains and losses are recognised in profit and loss from ordinary activities.

### (t) Determination of distributable profit

Profits of the Bank are determined and dealt with in accordance with Sections 49 and 50 of the *Central Banking Act 2000* as follows:

- (i) Section 50 (1) states that net profit arising from revaluation and foreign currency movements shall not be available to be distributed to the Government or paid into the Consolidated Revenue account. Accordingly such unrealised profits are transferred to the Unrealised Profits Reserve.
- (ii) The Board of the Bank is required to determine the net profit of the Bank and then consult with the Minister for Treasury to determine the amount of profit that is to be placed to the credit of the Bank's reserves.

- (iii) The balance of net profit after any transfer in (a) and (b) is paid to the Consolidated Revenue account, in accordance with Sections 49(2)(a) and 50(1) of the Act.
- (iv) The amount shall not be paid into the Consolidated Revenue account under the above sections where, in the opinion of the Central Bank, the assets of the Central Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital.
- (v) The unrealised profit reserve of the Bank represents gains or loss arising from the revaluation of gold, properties and other financial assets of the Bank. These gains and losses are separately classified under the respective reserves in the statement of changes in equity.

**(u) Tax Exemption**

Bank of Papua New Guinea is exempt from income tax under section 87 of the *Central Banking Act 2000*.

**(v) Comparatives**

Comparative financial information has been reclassified to conform to current year presentation where necessary.

**(w) Rounding**

Financial information has been rounded to the nearest thousand kina.

	2015 K'000	2014 K'000
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**Note 2: INTEREST REVENUE – FOREIGN CURRENCY OPERATIONS**

Foreign securities and bank deposits

92,572	103,369
<b>92,572</b>	<b>103,369</b>

Interest income on foreign investments includes interest earned on foreign bonds, Treasury bills, nostro accounts and other foreign investments. Income of K51.1 million (2014: K40.5 million) is in relation to investments managed by external fund managers and the remainder of K41.5 million (2014: K62.9 million) relates to investments managed by the Bank. Coupon rates during the year varied between 0.003% and 5.5% (2014: 0.1% and 6.3%) and yields varied between (4.1)% and 5.2% (2014: (0.48)% and 5%).

**Note 3: INTEREST INCOME – DOMESTIC OPERATIONS**

Inscribed stock and other Government securities

234,606	114,103
<b>234,606</b>	<b>114,103</b>

Interest income on Government Inscribed stock amounted to K136.6 million (2014: K92.5 million) during the year with the remainder of K116.1 million earned from Government Treasury bills (2014: K21.6 million). During the year coupon rates on Inscribed stock varied between 7.7% and 15% (2014: 6% and 14%, while yields on Treasury bills varied between 1.4% and 7.4% (2014: 4.5% and 7.42%).

## Notes to the Financial Statements

	2015 K'000	2014 K'000
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### Note 4: OTHER INCOME – DOMESTIC OPERATIONS

Licensing and other fees	6,966	11,750
Numismatic currency	1,396	91
Property rent	2,636	2,246
Other	577	800
	<b>11,575</b>	<b>14,887</b>

### Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

Central Bank Bills issued	53,275	62,077
Other deposits held	340	-
	<b>53,615</b>	<b>62,077</b>

Interest on securities issued varied between 1.3% and 3.5% during the year (2014: 1.83% and 4.55%)

### Note 6: GENERAL AND ADMINISTRATION EXPENSES

Staff costs	44,140	46,807
Premises and equipment	23,320	18,525
Other expenses	11,946	11,054
Amortisation of notes and coins production expenses	11,540	10,982
Travel	7,013	6,178
Depreciation of property, plant and equipment	6,289	5,966
Legal & consultancy fees	8,973	5,944
Staff training and development	3,596	3,034
Provisioning of staff and other loans	2,918	2,705
Audit fee	1,406	1,172
Board & meeting expenses	1,174	952
Currency distribution expenses	513	465
	<b>122,828</b>	<b>113,784</b>

### Note 7: IMF AND OTHER FINANCIAL ORGANISATION RELATED ASSETS & LIABILITIES

#### Assets

IMF SDR holdings and deposits and other organisations	38,630	35,098
	<b>38,630</b>	<b>35,098</b>

#### Liabilities

IMF number 1 and 2 loan accounts	5,931	1,557
SDR allocation	523,329	471,428
	<b>529,260</b>	<b>472,985</b>

Papua New Guinea has been a member of the IMF since 1975. The Bank of Papua New Guinea acts as the fiscal agent for the IMF on behalf of the Government. As fiscal agent, the Bank of Papua New Guinea is authorised to carry out all operations and transactions with the Fund.

	2015 K'000	2014 K'000
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Special Drawing Rights (SDR) are allocated by the IMF to members on the basis of members' quota at the time of the SDR allocation. The Bank of Papua New Guinea pays interest on its SDR allocations and earns interest on its holdings of SDR.

#### Note 8: CASH & CASH EQUIVALENTS

Foreign currency holdings – nostro accounts

455,935	745,812
<b>455,935</b>	<b>745,812</b>

The nostro accounts represent the Bank's foreign currency holdings with corresponding foreign banks.

#### Note 9: FINANCIAL ASSETS AT FAIR VALUE

Foreign investments

4,888,598

5,015,656

Derivative assets

1,870

22,897

**4,890,468**

**5,038,553**

Foreign investments include K3.3 billion (2014: K2.84 billion) of investments managed by external fund managers. The remainder of K1.5 billion (2014: K2.2 billion) is managed directly by the Bank. The investments comprise foreign bank debt securities, sovereign debt securities and derivative currency contracts.

#### Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

Inscribed stock

1,486,597

945,545

Treasury bills

733,783

1,468,266

**2,220,380**

**2,413,811**

#### Note 11: LOANS AND ADVANCES

Loans to PNG commercial banks

174,825

-

Agricultural export commodity support loans

1,386

1,386

Loans and advances to staff (including housing loans)

13,928

11,395

Allowance for doubtful loans

(5,623)

(2,705)

**184,516**

**10,076**

As at 31 December there were two loans issued to PNG commercial banks. The first was a loan of PGK 74.9M incurring an interest charge of 2.34% p.a. and with a term to maturity of 22 days. The second was a loan of PGK 99.8M incurring an interest charge of 2.34% p.a. and with a term to maturity of 31 days.

#### Note 12: OTHER NON FINANCIAL ASSETS

Inventory notes and coins

47,586

49,671

Commemorative notes & coins and other receivables

1,358

1,859

Other non-financial assets

1,973

1,260

**50,917**

**52,790**



## Notes to the Financial Statements

In Kina (K'000)	Land and Buildings	Equipment	Motor Vehicles	Computer Equipment	Computer Software	Total
<b>Note 13: PROPERTY PLANT &amp; EQUIPMENT</b>						
<b>Year ended</b>						
<b>31 December 2014</b>						
Cost or fair value	92,133	6,369	2,681	6,711	27,014	134,908
Accumulated Depreciation	(3,917)	(3,305)	(1,208)	(5,259)	(3,745)	(17,434)
<b>Net Book Amount</b>	<b>88,216</b>	<b>3,064</b>	<b>1,473</b>	<b>1,452</b>	<b>23,269</b>	<b>117,474</b>
<b>Year ended</b>						
<b>31 December 2015</b>						
Opening net book amount	88,216	3,064	1,473	1,452	23,269	117,474
Additions	10,970	275	515	1,774	11,504	25,038
Disposals	-	-	(577)	-	-	(577)
Write back depreciation	-	-	525	-	-	525
Depreciation charges	(4,014)	(229)	(665)	(585)	(797)	(6,290)
<b>Closing Book Amount</b>	<b>95,172</b>	<b>3,110</b>	<b>1,271</b>	<b>2,641</b>	<b>33,976</b>	<b>136,170</b>
<b>Year ended</b>						
<b>31 December 2015</b>						
Cost or fair value	103,103	6,644	2,619	8,485	38,518	159,367
Accumulated Depreciation	(7,931)	(3,534)	(1,348)	(5,844)	(4,542)	(23,197)
<b>Net Book Amount</b>	<b>95,172</b>	<b>3,110</b>	<b>1,271</b>	<b>2,641</b>	<b>33,976</b>	<b>136,170</b>

The Bank's increase in property, plant and equipment during the year pertains primarily to land and buildings and computer software additions.

The increase in land and buildings assets is driven mainly by the development of the Lae Currency Distribution Centre, which had its ground breaking in November 2015.

Additions to computer software during the year pertain primarily to capitalised cost incurred in relation to Phase 3 of the Kina Automated Transfer System (KATS), the Data Warehouse project, OPICS upgrade and Oracle Financial Exadata project, which was undertaken in order to enhance functionality of BSS. KATS and BSS allow commercial banks to process electronic payments/transfers against their exchange settlement accounts (ESA) in real time. KATS also allows the commercial banks to view their respective ESA and cash reserve requirement balances in real time to facilitate reconciliation.

	2015 K'000	2014 K'000
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#### Note 14: INVESTMENT PROPERTIES

Balance at 1 January	38,740	-
Acquisitions	-	-
Reclassification from property, plant and equipment	-	38,740
Change in fair value	-	-
Balance at 31 December	<b>38,740</b>	<b>38,740</b>

Investment property comprises two commercial properties that are leased to third parties. The fair values of investment properties were determined by external, independent property valuers, having appropriate recognised professional qualifications and recent experience in location and category being valued. The independent valuers provide the fair value of the Bank's investment property every 3 years and the last valuations were performed in 2013. The fair value measurements for all of the investment properties have been categorised as level 3 fair value measurements. Rental income from investment properties is K2.6million (2014: K2.8million).

#### Note 15: DEPOSITS FROM BANKS & THIRD PARTIES

Banks		
Exchange settlement accounts	1,182,360	1,515,141
Cash reserve requirement	2,023,079	1,910,136
Other Deposits	6,334	7,413
	<b>3,211,773</b>	<b>3,432,690</b>

#### Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES

Deposits from Government and Government entities	871,407	1,064,491
	<b>871,407</b>	<b>1,064,491</b>

#### Note 17: SECURITIES ISSUED

Central Bank Bills issued	1,566,893	2,306,685
	<b>1,566,893</b>	<b>2,306,685</b>

Securities issued are debt securities issued by the Bank of Papua New Guinea for terms of twenty eight days, three or six months. These bills are used to manage liquidity in the money and open market operations in the domestic financial markets.

#### Note 18: CURRENCY IN CIRCULATION

Currency in circulation	1,883,089	1,850,629
	<b>1,883,089</b>	<b>1,850,629</b>

Currency in circulation represents currency issued having a claim on the Bank of Papua New Guinea. The liability for currency in circulation is recorded at its fair value in the statement of financial position.

	2015 K'000	2014 K'000
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## Note 19: OTHER FINANCIAL LIABILITIES

### Foreign Currency

Foreign currency deposits

1,233	2,074
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<b>1,233</b>	<b>2,074</b>
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### Local Currency

Expense creditors

21,531	51,557
--------	--------

Distributions payable

90,000	-
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Other liabilities

-	(40)
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<b>111,531</b>	<b>51,517</b>
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Expense creditors include cheques or warrants issued by the Bank but not yet presented for clearance and subsequent encashment by Government departments, investors and suppliers.

## Note 20: PROVISIONS FOR EMPLOYEE ENTITLEMENTS

Provision for gratuity leave

2,026	1,828
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Provision for annual leave

13,754	11,882
--------	--------

Provision for long service leave

3,328	3,137
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<b>19,108</b>	<b>16,847</b>
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Reconciliation of leave provisions

Balance at 1 January

16,847	15,085
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Net charged to statement of comprehensive income

2,261	1,762
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Balance at 31 December

<b>19,108</b>	<b>16,847</b>
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## Note 21: SHARE CAPITAL

At 31 December 2015, the authorised and subscribed capital of the Bank was K145.5 million (2014: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

### Capital

At the beginning of the year

145,540	145,540
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At the end of the year

<b>145,540</b>	<b>145,540</b>
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### Other Reserves

Gold revaluation reserve

13,992	109,170
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Property revaluation reserve

93,452	93,452
--------	--------

Unrealised loss reserve

(558,013)	(1,082,678)
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Retained earnings

240,414	179,164
---------	---------

Total other reserves

(110,155)	(700,892)
-----------	-----------

Total owner's equity

<b>35,385</b>	<b>(555,352)</b>
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## Note 22: SEGMENT REPORTING

The Bank's primary function as a Central Bank is the implementation of monetary policy in one geographical area, Papua New Guinea.

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## Note 23: RISK MANAGEMENT

### Note 23(i): Financial Risk Management

International Financial Reporting Standard (IFRS) 7 – Financial Instruments: Disclosures – requires disclosure of information relating to financial instruments, their significance, performance, accounting policy, terms and conditions, fair values and the Bank’s policies for controlling risks and exposures relating to the financial instruments.

A financial instrument is defined as any contract that gives rise to both a financial asset of one enterprise and financial liability or equity instrument of another entity. The identifiable financial instruments for Bank of Papua New Guinea are its domestic government securities, its foreign government securities, loans and advances, bank deposits, central bank bills, currency in circulation and deposit liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction. Bank of Papua New Guinea’s recognised instruments are carried at amortised cost or current market value.

The Bank is involved in policy-oriented activities. Therefore, the Bank’s risk management framework differs from the risk management framework for most other financial institutions. The main financial risks to which the Bank is exposed include commodity price risk, credit risk, foreign exchange risk, liquidity risk and interest rate risk. In the management of foreign reserves, minimising liquidity risk is the prime consideration in order to ensure the availability of currency as required. Like most central banks, the nature of the Bank’s operations creates exposure to a range of operational and reputational risks.

Bank management seeks to ensure that strong and effective risk management and control systems are in place for assessing, monitoring and managing risk exposure. Experienced staff conduct the Bank’s local currency, foreign currency reserves management, and foreign exchange dealing operations in accordance with a clearly defined risk management framework, including delegated authority limits as set by the Governor.

The Bank is subject to an annual audit by an external auditor. Auditing arrangements are overseen by an Audit & Governance Committee of the Board to monitor the financial reporting and audit functions within the Bank and the Committee reviews the internal audit functions as well. The Committee reports to the Board of Directors on its activities.

The overall risk management framework is designed to strongly encourage the sound and prudent management of the Bank’s risk. The Bank seeks to ensure the risk management framework is consistent with financial market best practice. The risks tables in this note are based on the Bank’s portfolio as reported in its statement of financial position.

### Note 23(ii): Credit Risk

#### (a) Credit Risk Management

Credit risk is the potential for financial loss arising from a counterparty defaulting on its obligation to repay principal, make interest payments due on an asset or settle a transaction.

The Bank manages credit risk by employing the following strategies;

Selection of a counterparty is made based on their respective credit rating. Investment decisions are based on the credit rating of the particular issuer, the issue size, country limits and counterparty limits in place to control exposures.

Foreign currency placements are made in approved currencies with Government, Government guaranteed or other approved counterparties. Geographical exposures are controlled by country limits. Limits are updated periodically where necessary based on the latest market information. Credit risk in the Bank’s portfolio is monitored, reviewed and analysed regularly.

## (b) Concentration of Credit Exposure

The Bank's end-of-year concentrations of credit exposure by industry type were as follows:

	2015 K'000	2014 K'000
Foreign Governments, Banks & Financial Organisations		
Nostro accounts	455,935	745,812
Gold	-	129,817
Foreign investments (note 9)	4,890,468	5,038,553
Assets held with IMF and other financial organisations	38,630	35,098
Accrued interest receivable	23,126	26,080
Papua New Guinea Government		
Government of Papua New Guinea securities (note 10)	2,220,380	2,413,811
Accrued interest receivable	59,039	39,345
PNG commercial banks (note 11)	174,825	-
Bank staff and employees (note 11)	13,928	11,395
Other Government Institutions (note 11)	1,386	1,386
	<b>7,877,717</b>	<b>8,441,297</b>

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the statement of financial position. 16% (2014: 22%) of the total assets have a credit rating of A+ or above in short term investments and 43% (2014: 32%) of long term investments have a credit of A+ or above. Gold was in term deposits in 2014.



**(c) Credit Exposure by Credit Rating**

The following table represents the Bank's financial assets based on Standard and Poor's and Moody's credit ratings of the issuer. Under Standard and Poor's ratings, AAA is the highest quality rating possible and indicated the entity has an extremely strong capacity to pay interest and principal, AA is a high grade rating, indicating a very strong capacity, and A is an upper medium grade, indicating a strong capacity; BBB is the lowest investment grade rating, indicating a medium capacity to pay interest and principal. Non-rated ('NR') indicates the entity has not been rated by Standard and Poor's and Moody's.

Investment in Financial Assets	2015 K'000	% 2015 Financial Assets	2014 K'000	% 2014 Financial Assets
<b>Short term foreign investments</b>				
AAA	584,895	9	-	-
AA+	119,639	2	-	-
AA	339,524	5	-	-
AA-	27,266	-	-	-
A+	79,362	1	1,667,400	22
A	101,532	1	447,227	6
A-	14,154	-	14,223	-
BBB	2,332	-	-	-
BBB-	25,472	-	-	-
NR	111,883	2	41,400	-
	<b>1,406,059</b>	<b>20</b>	<b>2,170,250</b>	<b>29</b>
<b>Long term foreign investments</b>				
AAA	1,144,923	16	873,888	12
AA+	1,123,622	16	151,732	2
AA	376,026	5	1,108,975	15
AA-	190,164	3	151,264	2
A+	242,744	3	46,942	1
A	57,007	1	195,001	3
A-	8,400	-	-	-
BBB+	7,859	-	340,501	5
BBB	142,779	2	-	-
BBB-	190,885	3	-	-
	<b>3,484,409</b>	<b>49</b>	<b>2,868,303</b>	<b>38</b>
<b>Total foreign investments</b>	<b>4,890,468</b>	<b>69</b>	<b>5,038,553</b>	<b>67</b>
<b>Short term domestic investments</b>				
B	733,783	10	1,468,267	20
	<b>733,783</b>	<b>10</b>	<b>1,468,267</b>	<b>20</b>
<b>Long term domestic investments</b>				
B+	1,486,597	21	945,544	13
	<b>1,486,597</b>	<b>21</b>	<b>945,544</b>	<b>13</b>
<b>Total domestic investments</b>	<b>2,220,380</b>	<b>31</b>	<b>2,413,811</b>	<b>33</b>
<b>Total investments</b>	<b>7,110,848</b>	<b>100</b>	<b>7,452,364</b>	<b>100</b>

## Notes to the Financial Statements

### Note 23(iii): Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate and currency products, 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, credit spreads and foreign exchange rates.

#### (a) Foreign Exchange Risk

Currency risk (foreign exchange rate risk) is a form of risk that arises from the change in price of one currency against another, which directly affects the value of foreign exchange reserves as well as investments. At the Bank, foreign exchange reserve management and investment functions are guided by an Investment Committee. The decision of the Investment Committee and dealing practices approved by the Investment Committee serve as operational guidelines for the Bank's reserve management and investments. The guidelines are directed towards managing different types of risks, while earning a reasonable return. There is an approved benchmark for investment in terms of currency composition, portfolio duration and proportion of different assets within the Bank. Dealers/portfolio managers endeavour to comply with this benchmark through rebalancing the investment portfolio following benchmarking daily / weekly as approved by the Investment Committee. The currency of denomination of Gold assets is USD.

As at 31 December 2015 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

As at 31 December 2015	CURRENCY OF DENOMINATION							Total K'000
	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	
<b>Foreign Currency Assets:</b>								
Foreign currency	111,889	222,990	46,951	48,849	22,004	-	3,252	455,935
Gold holdings	134,639	-	-	-	-	-	-	134,639
Investments	2,153,707	896,827	1,084,166	244,955	414,896	-	94,047	4,888,598
Derivative assets	1,870	-	-	-	-	-	-	1,870
Assets held with IMF	-	-	-	-	-	38,630	-	38,630
Accrued interest	7,197	7,165	6,220	1,551	484	-	509	23,126
	<b>2,409,302</b>	<b>1,126,982</b>	<b>1,137,337</b>	<b>295,355</b>	<b>437,384</b>	<b>38,630</b>	<b>97,808</b>	<b>5,542,798</b>
<b>Foreign Currency Liabilities:</b>								
Liabilities with IMF	-	-	-	-	-	529,260	-	529,260
Foreign currency liabilities	1,233	-	-	-	-	-	-	1,233
	1,233	-	-	-	-	529,260	-	530,493
<b>Net Foreign Currency Exposure</b>	<b>2,408,069</b>	<b>1,126,982</b>	<b>1,137,337</b>	<b>295,355</b>	<b>437,384</b>	<b>(490,630)</b>	<b>97,808</b>	<b>5,012,035</b>

As at 31 December 2014	CURRENCY OF DENOMINATION							Total K'000
	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	
<b>Foreign Currency Assets:</b>								
Foreign currency	194,125	123,008	218,383	104,298	103,005	-	2,993	745,812
Gold holdings	129,817	-	-	-	-	-	-	129,817
Investments	2,914,038	767,551	991,476	192,317	150,274	-	-	5,015,656
Derivative assets	22,897	-	-	-	-	-	-	22,897
Assets held with IMF	-	-	-	-	-	35,098	-	35,098
Accrued interest	861	3,222	6,278	2,402	222	-	13,095	26,080
	<b>3,261,738</b>	<b>893,781</b>	<b>1,216,137</b>	<b>299,017</b>	<b>253,501</b>	<b>35,098</b>	<b>16,088</b>	<b>5,975,360</b>
<b>Foreign Currency Liabilities:</b>								
Liabilities with IMF	-	-	-	-	-	472,985	-	472,985
Foreign currency liabilities	2,074	-	-	-	-	-	-	2,074
	2,074	-	-	-	-	472,985	-	475,059
<b>Net Foreign Currency Exposure</b>	<b>3,259,664</b>	<b>893,781</b>	<b>1,216,137</b>	<b>299,017</b>	<b>253,501</b>	<b>(437,887)</b>	<b>16,088</b>	<b>5,500,301</b>

The functional currency of all operations is kina.

#### (b) Interest rate risk

Interest rate risk is the risk that the fair value or cash flows of financial instruments will fluctuate because of movements in market interest rates. The Bank is exposed to considerable interest rate risk because most of its assets are financial assets, such as domestic and foreign securities, which have a fixed income stream. The price of such securities increases when market interest rates decline, while the price of a security due to the associated income stream is fixed for a longer period.

The Bank manages interest rate risk by investing in securities with different maturity dates to mitigate against any adverse fluctuation in interest rates.

#### (c) Liquidity Risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities in its operations. The ultimate source of liquidity is kina and the Bank has the authority to create liquidity by issuing unlimited amounts of kina.

Liquidity risk is also associated with financial assets to the extent that the Bank may have to sell a financial asset at less than its fair value. The Bank manages this risk by holding a diversified portfolio of highly liquid domestic and foreign assets. The Bank's assets held for managing liquidity risk comprise cash and bank balances with other Central Banks and Government bonds and other securities that are readily acceptable in repurchase agreements with other Central Banks.



## Notes to the Financial Statements

The table below summarises the maturity profile of the Bank's financial liabilities based on the contractual repayment date determined on the basis of the remaining period at the balance sheet date to the contractual maturity date.

As at 31 December 2015	MATURITY PROFILE							Weighted average effective rate %
	Balance Total K'000	On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specific maturity K'000	
<b>Assets</b>								
<b>Foreign Currency</b>								
<b>Financial Assets:</b>								
Cash and cash equivalents	455,935	-	455,935	-	-	-	-	0.34%
Financial Assets at fair value	4,890,468	80,193	826,088	533,943	3,056,518	393,726	-	1.89%
Assets held with IMF	38,630	-	-	-	-	-	38,630	0.03%
Accrued interest	23,126	-	14,901	8,088	137	-	-	na
	<b>5,408,159</b>	<b>80,193</b>	<b>1,296,924</b>	<b>542,031</b>	<b>3,056,655</b>	<b>393,726</b>	<b>38,630</b>	
<b>Local Currency</b>								
<b>Financial Assets:</b>								
Government of Papua New Guinea Securities	2,220,380	-	465,865	321,947	306,656	1,125,912	-	10.56%
Loans and advances	184,516	-	174,825	-	-	9,691	-	0.07%
Accrued interest	59,039	-	37,856	21,183	-	-	-	na
	<b>2,463,935</b>	<b>-</b>	<b>678,546</b>	<b>343,130</b>	<b>306,656</b>	<b>1,135,603</b>	<b>-</b>	
<b>Non-financial assets:</b>								
Gold	134,639	-	-	-	-	-	134,639	0.23%
Property plant and equipment	136,170	-	-	-	-	-	136,170	na
Investment properties	38,740	-	-	-	-	-	38,740	na
Other non-financial assets	50,917	-	-	-	-	-	50,917	na
	<b>360,466</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>360,466</b>	
<b>Total Assets</b>	<b>8,232,560</b>	<b>80,193</b>	<b>1,975,470</b>	<b>885,161</b>	<b>3,363,311</b>	<b>1,529,329</b>	<b>399,096</b>	
<b>Liabilities</b>								
<b>Foreign Currency</b>								
<b>Financial Liabilities:</b>								
Liabilities with IMF	529,260	-	-	-	-	-	529,260	0.05%
Other financial liabilities	1,233	-	1,233	-	-	-	-	na
	<b>530,493</b>	<b>-</b>	<b>1,233</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>529,260</b>	
<b>Local Currency</b>								
<b>Financial Liabilities:</b>								
Deposits from bank and third parties	3,211,773	3,211,773	-	-	-	-	-	0.01%
Deposits from Government	871,407	871,407	-	-	-	-	-	0.01%
Securities issued	1,566,893	-	1,566,893	-	-	-	-	3.42%
Accrued interest payable	2,881	-	2,881	-	-	-	-	na
Currency in Circulation	1,883,089	1,883,089	-	-	-	-	-	na
Other financial liabilities	111,531	-	111,531	-	-	-	-	na
	<b>7,647,574</b>	<b>5,966,269</b>	<b>1,681,305</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	
<b>Total Liabilities</b>	<b>8,178,067</b>	<b>5,966,269</b>	<b>1,682,538</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>529,260</b>	

As at 31 December 2014	MATURITY PROFILE							Weighted average effective rate %
	Balance Total K'000	On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specific maturity K'000	
<b>Assets</b>								
<b>Foreign Currency</b>								
<b>Financial Assets:</b>								
Cash and cash equivalents	745,812	-	745,812	-	-	-	-	0.21%
Financial Assets at fair value	5,038,553	-	1,408,083	466,264	2,852,920	311,286	-	2.05%
Assets held with IMF	35,098	-	-	-	-	-	35,098	0.02%
Accrued interest	26,080	-	16,375	9,705	-	-	-	na
	<b>5,845,543</b>	<b>-</b>	<b>2,170,270</b>	<b>475,969</b>	<b>2,852,920</b>	<b>311,286</b>	<b>35,098</b>	
<b>Local Currency</b>								
<b>Financial Assets:</b>								
Government of Papua New Guinea Securities	2,413,811	-	86,465	1,376,767	151,534	799,045	-	4.72%
Loans and advances	10,076	-	-	-	-	10,076	-	0.01%
Accrued interest	39,345	-	9,442	29,903	-	-	-	na
	<b>2,463,232</b>	<b>-</b>	<b>95,907</b>	<b>1,406,670</b>	<b>151,534</b>	<b>809,121</b>	<b>-</b>	
<b>Non-financial assets:</b>								
Gold	129,817	-	-	-	-	-	129,817	0.22%
Property plant and equipment	117,474	-	-	-	-	-	117,474	na
Investment properties	38,740	-	-	-	-	-	38,740	na
Other non-financial assets	52,791	-	-	-	-	-	52,791	na
	<b>338,822</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>338,822</b>	
<b>Total Assets</b>	<b>8,647,597</b>	<b>-</b>	<b>2,266,177</b>	<b>1,882,639</b>	<b>3,004,454</b>	<b>1,120,407</b>	<b>373,920</b>	
<b>Liabilities</b>								
<b>Foreign Currency</b>								
<b>Financial Liabilities:</b>								
Liabilities with IMF	472,985	-	-	-	-	-	472,985	0.09%
Other financial liabilities	2,074	-	2,074	-	-	-	-	na
	<b>475,059</b>	<b>-</b>	<b>2,074</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>472,985</b>	
<b>Local Currency</b>								
<b>Financial Liabilities:</b>								
Deposits from bank and third parties	3,432,690	3,432,690	-	-	-	-	na	
Deposits from Government	1,064,491	1,064,491	-	-	-	-	na	
Securities issued	2,306,685	-	2,298,862	7,823	-	-	-	2.69%
Accrued interest payable	5,031	-	4,973	58	-	-	-	na
Currency in circulation	1,850,629	1,850,629	-	-	-	-	-	na
Other financial liabilities	51,517	-	51,517	-	-	-	-	na
	<b>8,711,043</b>	<b>6,347,810</b>	<b>2,355,352</b>	<b>7,881</b>	<b>-</b>	<b>-</b>	<b>-</b>	
<b>Total Liabilities</b>	<b>9,186,102</b>	<b>6,347,810</b>	<b>2,357,426</b>	<b>7,881</b>	<b>-</b>	<b>-</b>	<b>472,985</b>	

## Note 23(iv): Fair Value

Fair value represents the amount at which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. Fair value has been based on management assumptions according to the portfolio of the asset and liability base. IFRS requires that the fair value of the financial assets and liabilities be disclosed according to their classification under IAS 39. The following table summarises the financial assets and liabilities in accordance with IAS 39 classifications.

	2015 K'000	2014 K'000
<b>Financial Assets</b>		
Cash and cash equivalents	455,935	745,812
At fair value through profit/(loss)	7,188,218	7,526,202
Loans & receivables	266,681	75,501
Assets accounted for under other standards	321,726	300,082
	<b>8,232,560</b>	<b>8,647,597</b>
<b>Financial Liabilities</b>		
At fair value through profit/(loss)	530,493	475,059
At amortised cost	7,647,574	8,711,043
Provisions	19,108	16,847
	<b>8,197,175</b>	<b>9,202,949</b>

Fair values are estimated to be the same as their carrying values in the statement of financial position.

## FAIR VALUE HIERARCHY

IFRS 7 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 Bank'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). This level includes over the counter derivative contracts. The sources of input parameters are Bloomberg or Reuters.
- 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.

The table below shows the Bank's assets and liabilities in their applicable fair value level. Investments managed by external fund managers include foreign government bonds and other debt instruments for which quoted prices are available as well as derivatives which are valued with reference to observable market data. Accordingly, these are classified under level 1 and 2 respectively.

In Kina (K'000)	Level 1	Level 2	Level 3	Total
<b>31 December 2015</b>				
Financial assets held at fair value through profit or loss				
– Domestic Government securities - Inscribed stock and Treasury bills	-	-	2,220,380	2,220,380
– Foreign government and semi-government bonds	1,474,848	-	-	1,474,848
– Money market instruments	-	102,600	-	102,600
– Derivatives managed by external fund managers	-	1,870	-	1,870
– Investments in bonds and other instruments managed by external fund managers	3,311,150	-	-	3,311,150
– Assets held with IMF	38,630	-	-	38,630
– Investment property	-	-	38,740	38,740
<b>Total assets at fair value through profit or loss</b>	<b>4,824,628</b>	<b>104,470</b>	<b>2,259,120</b>	<b>7,188,218</b>
Non financial assets at fair value				
– Gold	134,639	-	-	134,639
– Property plant and equipment	-	-	136,170	136,170
<b>Total assets at fair value</b>	<b>4,959,267</b>	<b>104,470</b>	<b>2,395,290</b>	<b>7,459,027</b>
Financial liabilities held at fair value through profit & loss				
– Derivatives	-	1,233	-	1,233
– Liabilities with IMF	529,260	-	-	529,260
<b>Total liabilities at fair value through profit or loss</b>	<b>529,260</b>	<b>1,233</b>	<b>-</b>	<b>530,493</b>
<b>31 December 2014</b>				
Financial assets held at fair value through profit or loss				
– Domestic Government securities - Inscribed stock and Treasury bills	-	-	2,413,811	2,413,811
– Foreign government and semi-government bonds	2,041,250	-	-	2,041,250
– Money market instruments	-	519,268	-	519,268
– Derivatives managed by external fund managers	-	22,897	-	22,897
– Investments in bonds and other instruments managed by external fund managers	2,455,138	-	-	2,455,138
– Assets held with IMF	35,098	-	-	35,098
– Investment property	-	-	38,740	38,740
<b>Total assets at fair value through profit or loss</b>	<b>4,531,486</b>	<b>542,165</b>	<b>2,452,551</b>	<b>7,526,202</b>
Non financial assets at fair value				
– Gold	129,817	-	-	129,817
– Property plant and equipment	-	-	117,475	117,475
<b>Total assets at fair value</b>	<b>4,661,303</b>	<b>542,165</b>	<b>2,570,026</b>	<b>7,773,494</b>
Financial liabilities held at fair value through profit & loss				
– Derivatives	-	2,074	-	2,074
– Liabilities with IMF	472,985	-	-	472,985
<b>Total liabilities at fair value through profit or loss</b>	<b>472,985</b>	<b>2,074</b>	<b>-</b>	<b>475,059</b>

## Notes to the Financial Statements

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2015:

	Level 3 K'000
<b>Opening balance</b>	2,413,811
Investment net of maturities	(214,222)
Fair value revaluation gains/(losses) on level 3 instruments	20,791
<b>Closing balance</b>	<b>2,220,380</b>
Total gains and losses for the period included in the profit or loss for level 3 assets held at the end of the reporting period.	<b>20,791</b>

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2014:

	Level 3 K'000
<b>Opening balance</b>	939,984
Investment net of maturities	1,571,212
Fair value revaluation gains/(losses) on level 3 instruments	(97,385)
<b>Closing balance</b>	<b>2,413,811</b>
Total gains and losses for the period included in the profit or loss for level 3 assets held at the end of the reporting period.	(97,385)

	Valuation Technique	Unobservable Input	Range of Inputs		Fair value movement due to change in unobservable Input:	
			2015	2014	Increase	Decrease
Domestic Government securities – Inscribed stock and Treasury bills	Discounted cash flows present value method	Current market yield	7.7% to 15%	6% to 14%	Decrease	Increase
Investment property	Income capitalisation	Capitalisation rate	10% to 12%	10% to 12%	Decrease	Increase

#### Note 23(v): Sensitivity Analysis

The sensitivity of the Bank's profit and equity to a movement of +/- 10 percent in the value of the kina as at 31 December 2015 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2015 K'000	2014 K'000
Changes in profit/equity due to a 10 percent appreciation in the value of the kina	(520,873)	(567,847)
Changes in profit/equity due to a 10 percent depreciation in the value of the kina	637,184	694,035

The figures below show the effect on the Bank's profit and equity of a movement of +/- 1 percentage point in interest rates, given the level, composition and modified duration of the Bank's interest bearing assets and liabilities.

	2015 K'000	2014 K'000
Changes in profit/equity due to a 10 percent appreciation in the value of the kina	71,029	51,647
Changes in profit/equity due to a 10 percent depreciation in the value of the kina	(71,029)	(51,647)

#### Note 24: EVENTS AFTER THE BALANCE DATE

Subsequent to the balance date, no events have occurred which require adjustments to, or disclosures in, the financial statements.

#### Note 25: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2015 (2014: nil) and there are no transactions or events that will have material impact on the financial report during the preparation of this report.

The Bank is a party to a number of litigations, the outcome of which are currently uncertain. The directors, Governor and the Deputy Governor in consultation with the Bank's legal advisors consider that these litigations are not expected to result in material loss to the Bank.

#### Note 26: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

## Note 27: REMUNERATION OF MEMBERS OF THE BOARD AND KEY MANAGEMENT PERSONNEL

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. This group comprises 29 in total (2014: 25), including the Governor, Deputy Governor Regulation, 4 Assistant Governors, 8 non-executive Board members and 15 senior staff. The Salaries and Remuneration Committee (SRC) and Salaries, Conditions & Monitoring Committee (SCMC) determine the terms and conditions on which the Governor and Deputy Governor hold office in accordance with the *Central Banking Act 2000*. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

### Key Management Personnel Remuneration

	2015 K'000	2014 K'000
Short term benefits	8,580	7,691
Post employment benefits	963	862
Other long term benefits	3,413	3,017
	<b>12,956</b>	<b>11,570</b>

Short term benefits include cash salary and in the case of staff, annual leave and motor vehicle, housing benefits and superannuation which can be accessed prior to retirement. Post employment benefits include superannuation benefit payments which can be accessed on retirement. Other long term benefits include long service leave. The components of benefits are reported on an accruals basis.

As at 31 December 2015, the loans owed by the key management personnel to the Bank were K1,956,483 (2014: K1,800,652)

## Note 28: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,406,250 (2014: K1,171,775). This represents the total statutory audit fee paid to the Auditor General's Office and other auditors in relation to external fund manager operations. These transactions are performed at arm's length.

## Note 29: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

The Bank of Papua New Guinea acts as the banker to the Government and its various Government departments and controlled enterprises. The Government of Papua New Guinea is restricted under the *Central Banking Act 2000* in actively participating in Bank's decision and policy formulations. All related party transactions are carried out with reference to market rates. Transactions entered into include:

- Acting as the fiscal agent, banker and financial advisor to the Government, the Bank is the depository of the Government and or its agents or institutions providing banking services to Government and Government departments and corporations.
- Acting as the agent of the Government or its agencies and institutions, providing guarantees, participating in loans to Government departments and corporations.
- As the agent of the Government managing public debt and foreign reserves.

# Declaration by Management

## **DECLARATION BY MANAGEMENT**

In my opinion the foregoing Statement of Profit or Loss and other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows including the Notes to and forming part thereof, have been drawn up so as to give a true and fair view of the matters to which they relate for the year ended 31 December 2015.

For and on behalf of the Bank of Papua New Guinea,



**Loi M Bakani CMG**  
Governor

*30 June 2016*



# Report of the Auditor-General



Phone: (+675) 3012200 Fax: (+675) 325 2872



Email: [agof@bop.gov.pg](mailto:agof@bop.gov.pg) Website: [www.ago.gov.pg](http://www.ago.gov.pg)

*Our Reference: 30-13-1*

**The Honourable Patrick Pruitch, MP**  
Minister for Treasury  
*Office of the Minister*  
PO Box 542  
WAIGANI, NCD

## INDEPENDENT AUDITOR'S REPORT ON THE BANK OF PAPUA NEW GUINEA FOR THE YEAR ENDED 31 DECEMBER 2015

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2015** as set out on pages 2 to 27 which comprise the Statement of Financial Position as at 31 December, 2015, the Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and a Summary of significant accounting policies and other explanatory notes.

### **Responsibility of the Board, the Governor and the Deputy Governor for the Financial Statements**

The Bank's management is responsible for the preparation and fair presentation of these financial statements in accordance with *International Financial Reporting Standards*, other generally accepted accounting practice in Papua New Guinea and other statutory requirements including the *Papua New Guinea Central Banking Act, 2000*. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

### **Responsibility of the Auditor-General**

I have conducted an independent audit in order to express an opinion to you. My audit has been planned and performed in accordance with *International Standards on Auditing* as promulgated by the International Federation of Accountants to obtain reasonable assurance whether the financial statements are free of material misstatement. The audit involved performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.

The nature of an audit is influenced by factors such as the use of professional judgement, including the assessments of the risks of material misstatements of the financial statements, whether due to fraud or error. I have considered the risks, based on those assessments, on the internal controls relevant to the preparation and fair presentation of the financial statements in designing audit procedures considered appropriate in the circumstances.

Procedures were performed to assess whether, in all material respects, the financial statements present fairly, in accordance with Section 45 of the *Papua New Guinea Central Banking Act 2000* and *International Financial Reporting Standards*, a true and fair view which is consistent with my understanding of the Bank's financial position and its performance.

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for this report.

#### **AUDIT OPINION**

In my opinion:

- (a) the financial statements of Bank of Papua New Guinea is in accordance with the *Papua New Guinea Central Banking Act 2000* including:
  - (i) give a true and fair view of the financial position of the Bank as at 31 December 2015 and of its financial performance and its cash flows for the year then ended; and
  - (ii) complying with *International Financial Reporting Standards*; and
- (b) proper accounting records have been kept by the Bank as far as it appears from my examination of those records; and
- (c) I have obtained all the information and explanation that were required.

  
**PHILIP NAUGA**  
*Auditor-General*

30 June, 2016

# Notes

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