AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

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Our Reference: 30-13-4

INDEPENDENT AUDIT REPORT ON THE ACCOUNTS OF *BANK OF PAPUA NEW GUINEA* FOR THE YEAR ENDED 31 DECEMBER 2019

OPINION

I have audited the financial statements of **Bank of Papua New Guinea,** which comprise the Statement of Financial Position as at **31 December 2019**, Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes In Equity, Statement of Cash Flows and Summary of Significant Accounting Policies and Other Explanatory Notes;

In my opinion:

(a) the financial statements of Bank of Papua New Guinea for the year ended 31 December 2019:

(i) give a true and fair view of the financial position and of its financial performance and cash flows for the year then ended; and

(ii) comply with the *International Financial Reporting Standards*, *Papua New Guinea Central Banking Act 2000* and other generally accepted accounting practice in Papua New Guinea; 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.

BASIS FOR OPINION

I conducted my audit in accordance with *International Standards on Auditing* and the *Audit Act, 1989 (as amended)*. My responsibilities under those standards are further described in the Auditor-General's responsibilities for the audit of the financial statements section of my report.

I am independent of the Bank of Papua New Guina in accordance with the ethical requirements that are relevant to my audit of the financial statements in Papua New Guinea, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of the Board, the Governor and the Deputy Governor of the Bank for the Financial Statements

The Bank's Management is responsible for the preparation and fair presentation of the financial statements in accordance with the *International Financial Reporting Standards* and *Papua New Guinea Central Banking Act 2000* and for such internal control as the Management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, Management is also responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Independent State of Papua New Guinea either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

Auditor-General's Responsibilities for the Audit of the Financial Statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *International Standards on Auditing* will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial statements.

As part of an audit in accordance with the *International Standards on Auditing*, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control;

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management;

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

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

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

GORDON KEGA MBA, CPA
Acting Auditor-General

30 June 2020

Bank of Papua New Guinea

Statutory Financial Statements
For the year ended 31 December 2019

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Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December 2019
Bank of Papua New Guinea

	Note	2019 K'000	2018 K'000
Revenue from foreign currency investments			
Interest revenue	2	112,983	94,854
Realised gain/(loss) on financial assets		23,631	(34,896)
Foreign exchange gains and commissions		36,637	27,347
Total revenue from foreign currency investments		**173,251**	**87,305**
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(5,204)	(2,533)
Custodian and investment management fees		(6,740)	(6,604)
Total expenses from foreign currency investments		**(11,944)**	**(9,137)**
Net foreign currency income		**161,307**	**78,168**
Revenue from domestic operations			
Interest revenue	3	275,715	308,354
Other income	4	18,317	9,968
Total revenue from domestic operations		**294,032**	**318,322**
Expense on domestic liabilities			
Interest expense	5	(67,214)	(48,245)
Total expenses on domestic liabilities		**(67,214)**	**(48,245)**
Net domestic income		**226,818**	**270,077**
Total net operating income		**388,125**	**348,245**
Operating expenses			
General and administration expenses	6	(231,615)	(161,055)
Profit excluding unrealised income		**156,510**	**187,190**
Other unrealised income			
Fair value and foreign exchange revaluation gain on foreign currency investments		154,078	150,044
Fair value revaluation gain on domestic investments		82,780	5,273
Profit for the year		**393,368**	**342,507**
Other comprehensive income			
Items that may be subsequently reclassified to profit or loss			
Gain on gold asset revaluation		36,304	5,050
Items that will not be subsequently reclassified to profit or loss			
Gain on property valuation		11,794	24,760
Other comprehensive income for the year		**48,098**	**29,810**
Total comprehensive income for the year		**441,466**	**372,317**

The financial statements are to be read in conjunction with the notes on pages 6 to 36.

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Statement of Financial Position as at 31 December 2019
Bank of Papua New Guinea

Assets	Note	2019 K'000	2018 K'000
Cash and cash equivalents	8	1,804,862	1,640,037
Financial assets at fair value through profit or loss	9	5,775,555	5,564,449
Assets held with IMF and other financial organisations at fair value through profit or loss	7	30,209	37,187
Accrued interest		19,714	19,462
Total foreign currency financial assets		**7,630,340**	**7,261,135**
Government of Papua New Guinea securities	10	2,408,970	2,660,968
Loans and advances	11	126,093	149,025
Accrued interest and other receivables		58,947	63,434
Total local currency financial assets		**2,594,010**	**2,873,427**
Total Financial Assets		**10,224,350**	**10,134,562**
Non-financial assets			
Gold		218,020	181,716
Property and equipment	13	448,424	361,831
Investment properties	14	39,170	41,460
Other assets	12	68,707	70,678
Total non-financial assets		**774,321**	**655,685**
Total Assets		**10,998,671**	**10,790,247**
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF at fair value through profit or loss	7	597,335	593,735
Other financial liabilities	19	1,794	13,644
Total foreign currency financial liabilities		**599,129**	**607,379**
Local currency financial liabilities			
Deposits from banks and third parties	15	3,625,837	3,116,735
Deposits from Government and Government entities	16	1,351,160	1,505,423
Debt securities issued	17	1,775,731	2,402,654
Accrued interest payable on debt securities		2,381	1,751
Currency in circulation	18	2,298,574	2,151,993
Other financial liabilities	19	51,731	37,487
Total local currency financial liabilities		**9,105,414**	**9,216,043**
Total financial liabilities		**9,704,543**	**9,823,422**
Non-financial liabilities			
Provisions for employee entitlements	20	33,798	27,961
Total non-financial liabilities		**33,798**	**27,961**
Total Liabilities		**9,738,341**	**9,851,383**
Equity			
Capital	22	145,540	145,540
Gold revaluation reserve	22	197,412	161,108
Property revaluation reserve	22	95,028	83,234
Unrealised gain/(loss) reserve	22	299,888	63,030
Building reserve	22	73,800	73,800
General reserve	22	30,000	-
Retained earnings	22	418,662	412,152
Total Equity		**1,260,330**	**938,864**
Total Liabilities and Equity		**10,998,671**	**10,790,247**

The financial statements are to be read in conjunction with the notes on pages 6 to 36.

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Statement of Changes in Equity for the year ended 31 December 2019
Bank of Papua New Guinea

	Capital	Gold Revaluation Reserve	Property Revaluation Reserve	Unrealised gain/(loss) Reserve	Building Reserve	General Reserve	Retained Earnings	Total
	K'000	K'000	K'000	K'000	K'000	K'000	K'000	K'000
Balance at 1 January 2018	**145,540**	**156,058**	**58,474**	**(92,287)**	-	-	**398,762**	**666,54**
Profit for the year	-	-	-	155,317	-	-	187,190	**342,50**
Net transfers from unrealised profit/(loss) reserve to retained earnings	-	-	-	-	-	-	-	
Other comprehensive income	-	5,050	-	-	-	-	-	**5,05**
Net transfers from retain earnings to building reserve	-	-	-	-	73,800	-	(73,800)	
Revaluation of PPE	-	-	24,760	-	-	-	-	**24,76**
Dividend declared and paid	-	-	-	-	-	-	(100,000)	**(100,000**
Balance at 31 December 2018	**145,540**	**161,108**	**83,234**	**63,030**	**73,800**	-	**412,152**	**938,86**
Profit for the year	-	-	-	236,858	-	-	156,510	**393,36**
Net transfers from unrealised profit/(loss) reserve to retained earnings	-	-	-	-	-	-	-	
Other comprehensive income	-	36,304	-	-	-	-	-	**36,30**
Net transfers from retain earnings to building reserve	-	-	-	-	-	30,000	(30,000)	
Revaluation of PPE	-	-	11,794	-	-	-	-	**11,79**
Dividend declared and paid	-	-	-	-	-	-	(120,000)	**(120,000**
Balance at 31 December 2019	**145,540**	**197,412**	**95,028**	**299,888**	**73,800**	**30,000**	**418,662**	**1,260,33**

The realised profit for the year is K156.5 million. The unrealised gain/(loss) reserve and net asset balance at 31 December 2019 are K299.8 million and K1.26 billion, respectively. The Central Bank Act 2000 states that no distribution will be made where, in the opinion of the Central Bank, 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 6 to 36.

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Statement of Cash Flows for the year ended 31 December 2019
Bank of Papua New Guinea

	Note	2019 K'000	2018 K'000
Cash Flows from Operating Activities			
Interest received on foreign investments		112,731	94,250
Interest received on domestic investments		280,203	316,205
Fees, commissions and other income received		54,954	37,315
Interest paid on IMF liabilities		(1,604)	-
Interest paid on domestic liabilities		(66,584)	(48,171)
Payments to employees		(89,946)	(71,427)
Payments to suppliers		(113,797)	(94,578)
Fees and commissions paid		(6,740)	(6,604)
Net proceeds from sale of foreign investments		(26,419)	(920,968)
Net payment for Government Securities		337,068	584,259
Net loans repaid / (issued)		22,933	(11,078)
Net Cash Flow (used in) / provided by Operating Activities		**502,799**	**(120,797)**
Cash Flows from Investing Activities			
Purchase of property and equipment		(47,468)	(29,493)
Payments for construction costs on capital projects		(45,047)	(71,499)
Proceeds from sale of property and equipment		44	38
Net Cash Flow used in Investing Activities		**(92,471)**	**(100,954)**
Cash Flows from Financing Activities			
Net movement of currency in circulation		146,580	78,246
Net movement in debt securities issued		(626,923)	312,915
Distributions to the government		(120,000)	(100,000)
Net movement in deposits from government		(154,263)	1,045,164
Net movement in deposits from banks		509,103	(181,790)
Net Cash Flow provided / (used in) by Financing Activities		**(245,503)**	**1,154,535**
Net Increase in Cash and Cash Equivalents		**164,825**	**932,784**
Cash and cash equivalents at 1 January		1,640,037	707,253
Cash and Cash Equivalents at 31 December	**8**	**1,804,862**	**1,640,037**

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The financial statements are to be read in conjunction with the notes on pages 6 to 36.

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. The application of these policies are consistent with the review and approval from the bank's board as at 30th June 2020.

(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 (CBA) 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 financial statements continue to be prepared on a going concern basis. The Bank recorded a net asset position of K1.26 billion at 31 December 2019 (2018: net asset of K938.9 million). This steady improvement in the Bank's net asset position over the last four years is mainly driven by continued depreciation of the Kina which is giving rise to the value of foreign assets.

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 Fund 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 Fund 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.

(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 profit or loss and other 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 2019 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

(a) Note 24 (iv) – determination of the fair value of financial instruments with significant unobservable inputs; and
(b) Note 14 – fair value of investment properties.

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(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) Standards issued but not yet adopted

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2019 and earlier application is permitted; however, the Bank has not early adopted them in preparing financial statements. The following amended standards are not expected to have a significant impact on the Bank's financial statements.

– Amendments to References to Conceptual Framework in IFRS Standards.
– Definition of a Business (Amendments to IFRS 3).
– IFRS 17 Insurance Contracts.

(e)* New standards Implemented and Adoption of IFRS 16 *Leases

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers which replaces all existing revenue requirements and related interpretations and is effective for annual periods beginning on 1 January 2018. The Bank also adopted IFRS 9 as of 1 January 2018. In accordance with the transition provisions of IFRS 9, comparative figures have not been restated.

No other material transition adjustments were identified by the transition to IFRS 15.

IFRS 16 *Leases*

This standard is effective for the Bank's annual reporting period beginning on 1 January 2019. IFRS 16 requires a lessee to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Under the standard, the Bank will reflect in the Statement of Financial Position the right-of-use assets and lease liabilities in respect of the lease agreements. The impact on the Statement of Financial Position and the Statement of Comprehensive Income is being assessed by the Bank.

The Bank applied IFRS 16 using the modified retrospective approach, under which the cumulative effect of initial application is recognised in retained earnings at 1 January 2019. Accordingly, the comparative information presented for 2018 is not restated to this effect – i.e. it is presented, as previously reported, under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed below. Additionally, the disclosure requirements in IFRS 16 have not generally applied to comparative information.

(i) The Bank as lessee

The Bank assesses whether a contract is or contains a lease, at inception of the contract. The Bank recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less or residential leases) and leases of low value assets (such as tablets and personal computers, small items of office furniture and telephones). For these leases, the Bank recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the Bank uses its Kina Facility Rate.

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Lease payments included in the measurement of the lease liability comprise:
- Fixed lease payments (including in-substance fixed payments), less any lease incentives receivable;
- Variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- The amount expected to be payable by the lessee under residual value guarantees;
- The exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- Payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is included under 'Other financial liabilities' in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The Bank remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:
- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using the current Kina Facility Rate.
- The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The Bank did not make any such adjustments during the periods presented.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Whenever the Bank incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognised and measured under IAS 37. To the extent that the costs relate to a right-of-use asset, the costs are included in the related right-of-use asset, unless those costs are incurred to produce inventories.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the Bank expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are included in the 'property and equipment' line in the statements of financial position.

The Bank applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in note 21.

Variable rents that do not depend on an index or rate are not included in the measurement the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line "other expenses" in profit or loss.

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(ii) Impact on transition

On transition to IFRS 16, the Bank recognised additional lease liabilities, recognising the difference in retained earnings. The impact on transition is summarised below:

	1 January 2019
Right of use assets presented in property and equipment	K15,200,428
Lease liabilities	K15,200,428
Retained earnings	Nil

When measuring lease liabilities for leases that were classified as operating leases, the Bank discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted-average rate applied is 6.25%.

	1 January 2019 K'000
Operating lease commitments at 31 December 2018 as disclosed under IAS 17 in the Bank's financial statements	17,168
Discounted using the incremental borrowing rate at 1 January 2019	15,140
Recognition exemption for leases of low-value assets	-
Recognition exemption for short-term leases	4,799
Lease liabilities recognised at 1 January 2019	15,200

(iii) The Bank as lessor

The Bank enters into lease agreements as a lessor with respect to its investment properties.
Leases for which the Bank is a lessor are classified as finance or operating leases. Whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee, the contract is classified as a finance lease. All other leases are classified as operating leases.

When the Bank is an intermediate lessor, it accounts for the head lease and the sub-lease as two separate contracts. The sub-lease is classified as a finance or operating lease by reference to the right-of-use asset arising from the head lease.

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

Amounts due from lessees under finance leases are recognised as receivables at the amount of the Bank's net investment in the leases.

(f) Financial Instruments

Classification and measurement of financial instruments

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 IFRS 9 and reports these instruments under IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement*.

(i) Recognition and initial measurement

Financial instruments are initially recognised when an entity becomes a party to the contractual provisions of the instrument, and are classified into various categories depending upon the type of instrument, which then determines the subsequent measurement of the instrument.

(ii) Classification and subsequent measurement of financial assets

The Bank classifies financial assets into one of the following measurement categories:
- Amortised cost;
- Fair value through other comprehensive income (FVTOCI); or
- Fair value through profit or loss (FVTPL).

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Financial Instruments (continued)

The classification of debt instruments is determined based on:
a) the business model under which the asset is held; and
b) the contractual cash flow characteristics of the instrument.

Business model assessment
Business model assessment involves determining how financial assets are managed in order to generate cash flows. The business model for debt instruments is to hold assets and collect contractual cash flows. Any sales of the asset are incidental to the objective of the model. The contractual cash flow characteristics assessment involves assessing the contractual features of an instrument to determine if they give rise to cash flows that are consistent with a basic lending arrangement. Contractual cash flows are consistent with a basic lending arrangement if they represent cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI). Principal is defined as the fair value of the instrument at initial recognition. Principal may change over the life of the instrument due to repayments or amortisation of premium/discount. Interest is defined as the consideration for the time value of money and the credit risk associated with the principal amount outstanding and for other basic lending risks and costs, and a profit margin. If the Bank identifies any contractual features that could significantly modify the cash flows of the instrument such that they are no longer consistent with a basic lending arrangement, the related financial asset is classified and measured at FVTPL.

Solely payments of principle and interest (SPPI) criteria
The SPPI test requires that the contractual terms of the financial asset (as a whole) give rise to cash flows that are solely payments of principal and interest on the principal amounts outstanding i.e. cash flows that are consistent with a basic lending arrangement.

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:
• contingent events that would change the amount and timing of cash flows;
• leverage features;
• prepayment and extension terms;
• terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
• features that modify consideration of the time value of money — e.g. periodical reset of interest rates.

Financial assets measured at amortised cost – financial assets are measured at amortised cost if they are held within a business model whose objective is to hold for collection of contractual cash, flows where those cash flows represent solely payments of principal and interest. After initial measurement, financial assets in this category are carried at amortised cost. Interest income on these instruments is recognised as interest income using the effective interest rate method.

Financial assets measured at FVTPL – financial assets are measured at FVTPL if assets:
i) are held for trading purposes;
ii) are held as part of a portfolio managed on a fair value basis; or
iii) whose cash flows do not represent payments that are solely payments of principal and interest.

Financial assets measured at FVTOCI – financial assets are measured at FVTOCI if the financial assets are held within a business model that is achieved by both collecting contractual cash flows and selling, which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest. These comprise primarily marketable securities. They are recognised at the trade date when the Bank enters into contractual arrangements to purchase and are derecognised when they are sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains or losses) are recognised in other

Financial Instruments (continued)

comprehensive income until the assets are sold. Upon disposal, the cumulative gains and losses in the comprehensive income are recognised in the income statement as 'gains and losses from financial instruments'. Financial assets measured at FVOCI are included in the impairment calculations and the impairment is recognised in profit or loss.

(iii) Classification of financial liabilities

The Bank classifies all financial liabilities as subsequently measured at amortised cost except for liabilities with IMF. Interest on financial liabilities is calculated using the effective interest rate method, is recognised as interest expense. Financial liabilities measured at fair value through profit or loss – the Bank designates financial liabilities to eliminate, or significantly reduce, inconsistencies that would otherwise arise from measuring assets and liabilities on different bases. The relevant assets and liabilities (including derivatives) are managed together and internal reporting is evaluated on a fair value basis.

(iv) Reclassifications of financial assets

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing the financial assets.

(v) Impairment of financial assets carried at amortised cost

The Bank applies a three-stage approach to measure allowance for credit losses, using an expected credit loss approach as required under IFRS 9.

Expected credit loss impairment model
The Bank's allowance for credit losses calculations are outputs of models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. The expected credit loss impairment model reflects the present value of all cash shortfalls related to default events either (i) over the following twelve months or (ii) over the expected life of a financial instrument depending on credit deterioration from inception. The allowance for credit losses reflects an unbiased, probability-weighted outcome which considers multiple scenarios based on reasonable and supportable forecasts.
This impairment model measures credit loss allowances using a three-stage approach based on the extent of credit deterioration since origination:

• **Stage 1** – 12-month ECL applies to all financial assets that have not experienced a significant increase in credit risk (SICR) since origination and are not credit impaired. The ECL will be computed using a 12-month probability of default that represents the probability of default occurring over the next 12 months. For those assets with a remaining maturity of less than 12 months, a PD is used that corresponds to remaining maturity.

• **Stage 2** – When a financial asset experiences a SICR subsequent to origination but is not credit impaired, it is considered to be in Stage 2. This requires the computation of ECL based on lifetime probability of default that represents the probability of default occurring over the remaining estimated life of the financial asset. Credit loss allowances are higher in this stage because of an increase in risk and the impact of a longer time horizon being considered compared to 12 months in Stage 1. When determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information and analysis based on the Bank's historical experience, expert credit assessment and forward-looking information.

• **Stage 3** – Financial assets that have an objective evidence of impairment will be included in this stage. Similar to Stage 2, the allowance for credit losses will continue to capture the lifetime expected credit losses. Under IFRS 9, the Bank will consider a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held).

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Financial Instruments (continued)

Measurement of expected credit loss
The probability of default (PD), exposure at default (EAD), and loss given default (LGD) inputs used to estimate expected credit losses are modelled based on macroeconomic variables that are most closely related with credit losses in the relevant portfolio. Details of key statistical parameters/inputs are as follows:
• PD – The probability of default is an estimate of the likelihood of default over a given time horizon.

A default may only happen at a certain time over the remaining estimated life, if the facility has not been previously derecognised and is still in the portfolio.
• EAD – The exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

• LGD – The loss given default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Company would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

Forward-looking information
The Bank formulates a base case view of the future direction of relevant economic variables and a representative range of other possible forecast scenarios and consideration of a variety of external actual and forecast information. This process involves developing four different economic scenarios, which represent a range of scenarios linked to housing and interest rate variables. The Bank has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments, choosing scenarios that specifically test the resilience of the Bank to financial stress.

ECL calculation
Expected credit losses are calculated by identifying scenarios in which a loan or receivable defaults, estimating the cash shortfall that would be incurred and then multiplying that loss by the probability of the default happening. When an ECL is identified, the carrying amount of the asset would be reduced and the amount of ECL is recognised in the income statement.

(vi) Derecognition of financial instruments

Derecognition of financial assets
A financial asset is derecognised when the contractual rights to the cash flows from the asset has expired; or the Bank transfers the contractual rights to receive the cash flows from the financial asset; or has assumed an obligation to pay those cash flows to an independent third-party; or the Bank has transferred substantially all the risks and rewards of ownership of that asset to an independent third-party. Management determines whether substantially all the risk and rewards of ownership have been transferred by quantitatively comparing the variability in cash flows before and after the transfer. If the variability in cash flows remains significantly similar subsequent to the transfer, the Bank has retained substantially all of the risks and rewards of ownership.

Where substantially all the risks and rewards of ownership of the financial asset are neither retained nor transferred, the Bank derecognises the transferred asset only if it has lost control over that asset. Control over the asset is represented by the practical ability to sell the transferred asset. If the Bank retains control over the asset, it will continue to recognise the asset to the extent of its continuing involvement. At times such continuing involvement may be in the form of investment in senior or subordinated tranches of notes issued by non-consolidated structured entities.

On derecognition of a financial asset, the difference between the carrying amount and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in the profit or loss.

Financial Instruments (continued)

Derecognition of financial liabilities
A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. If an existing financial liability is replaced by another from the same counterparty on substantially different terms, or the terms of the existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability at fair value.

The difference in the respective carrying amount of the existing liability and the new liability is recognised as a gain/loss in the profit or loss.

(vii) Modification of financial instruments

Modification of financial assets
If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original assets are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value plus any eligible transaction costs.

If the modification of a financial asset measured at amortised cost or FVTOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss.

Modification of financial liabilities
The Bank derecognises a financial liability when its terms are modified and cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and the consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

(viii) Domestic Government securities

The Bank holds inscribed stocks with fixed coupon rates issued by the Government. Interest is received biannually at the coupon rate and the principal is received at maturity. The Inscribed Stock securities are managed by the Bank on a fair value basis, and are held to implement monetary policy and may be sold or lent, typically for short terms, under repurchase agreements, thus they are designated as FVTPL under IFRS 9. 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. The Bank also holds treasury bills purchased at a discount. The securities are held to collect contractual cash flows hence are measured at amortised cost.

Interest earned on the securities is accrued over the term of the security and included as revenue in the statement of profit or loss and other comprehensive income.

(ix) 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). They are available to be traded in managing the portfolio of foreign exchange reserves. In accordance with IFRS 9, these assets are measured as 'fair value through profit or loss'. 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.

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Financial Instruments (continued)

(x) 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.

(xi) 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. They are available to be traded in managing the portfolio of foreign exchange reserves and are managed by the Bank on a fair value basis, thus they are measured as FVTPL under IFRS 9. 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.

(xii) 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.

(xiii) Foreign currency forward contracts

External fund managers engaged to manage part of the Bank's investment portfolio enter into over the counter 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 and recorded in a separate equity reserve as such gains and losses are not available for distribution. These forward contracts are accounted for on a fair value basis, with all changes in fair value being reflected in the statement of profit or loss and other comprehensive income in accordance with IFRS 9. The fair values are determined with reference to prevailing exchange rates at balance date.

(xiv) Repurchase agreements

A repurchase agreement involves the sale of securities with an undertaking to repurchase them on an agreed future date at an agreed price. In a reverse repurchase agreement, securities are initially bought and this transaction is reversed at an agreed price on an agreed future date. Reverse repurchase agreements provide the Bank's counterparties with cash for the term of the agreement and the Bank treats it as a cash receivable. Securities purchased and contracted for sale under reverse repurchase agreements are classified under IFRS 9 as 'held to collect' and measured at amortised cost. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue. Repurchase agreements result in cash being paid to the Bank and are treated as a liability, reflecting the obligation to repay cash.

(xv) Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are financial liabilities classified and measured at amortised cost under IFRS 9. Deposit balances are shown at their amortised cost. 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.

(xvi) 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.

The Bank is also issuing Central Bank bond with maturities ranging from 2 to 10 years and are also recorded at their amortised cost using the effective interest method. Interest is paid semi-annually.

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Financial Instruments (continued)

(xvii) 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 under IFRS 9. Loans and advances owing from previous staff are treated as financial assets measured at amortised cost and will be assessed for impairment based on an expected credit loss model in accordance with IFRS 9; however, loans and advances to current staff represent a prepaid employee benefit (a non-financial asset).

(xviii) 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. Under voluntary arrangements with the IMF, the Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies. These assets and liabilities are managed by the Bank on a fair value basis and are measured as FVTPL in accordance with IFRS 9.

(xix) 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.

(xx) Revenue

Interest income
Interest income is recognised as it accrues in the Statement of Profit or Loss and Other Comprehensive Income using the effective interest rate ("EIR") method in line with requirements of IFRS 9.

Foreign exchange gains and commissions
Foreign exchange gains and commissions include gains and losses on trading in foreign currency and profit or loss impact of conversion to functional currency of foreign currency denominated assets and liabilities.

Realised gains/(loss) on financial assets
Gains and losses realised from the sale of foreign financial instruments are reflected in the Statement of Profit or Loss and Other Comprehensive Income at the time of transaction.

Other income
Rental income is brought to account as the performance obligations are satisfied over time. All rents are payable on a monthly basis. All other income sources are generally brought to account as the performance obligations are satisfied at a point in time, with the exception of license and application fees which are brought to account over time.

(g) 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.

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Financial Instruments (continued)

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.

(h) Property 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 2019. In accordance with IAS 16 – Property 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. Reflecting their specialised nature, the Bank's head office at ToRobert Haus and the Lae currency distribution facility are valued at depreciated replacement cost. 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. Property Revaluations are done and accounted for at the end of the year applying the elimination method to any accumulated depreciation.

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.

(i) 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 which 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.

(j) 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.

(k) 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 unrealised income: Fair value revaluation gain on domestic investment.

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.
Any gain or loss on disposal of investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in profit or loss

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(l) 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.

(m) De-recognition

A financial asset is derecognised when the rights to receive cash flows from the financial asset have expired. The Bank also derecognises the financial asset if it has both transferred the financial asset and the transfer qualifies for derecognition under IFRS 9. A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

(n) 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.

(o) 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.

(p) 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.

(q) Other receivables

Other receivables are stated at amortised cost.

(r) 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 profit or loss and other 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.

(s) Other liabilities

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

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(t) 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 Central Banking Act 2000 Section 42, allows the bank to create reserve funds for meeting contingencies which arise in the course of operations in carrying out its functions. The bank currently has a General Reserve and Building Reserve fund.

(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).

(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.

(u) 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 Fund. 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) in accordance with Sections 49(2)(a) and 50(1) of the Act is paid to the Consolidated Revenue Fund.

(iv) The amount shall not be paid into the Consolidated Revenue Fund 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.

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(v) Tax Exemption

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

(w) Comparatives

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

(x) Rounding

Financial information has been rounded to the nearest thousand Kina.

Note 2: INTEREST REVENUE – FOREIGN CURRENCY INVESTMENTS

	2019 K'000	2018 K'000
Foreign securities and bank deposits	112,983	94,854
	112,983	**94,854**

Interest income on foreign investments includes interest earned on foreign bonds, treasury bills, nostro accounts and other foreign investments. Income of K63.8 million (2018: K56.5 million) is in relation to investments managed by external fund managers and the remainder of K49.2 million (2018: K38.4 million) relates to investments managed by the Bank. Coupon rates during the year varied between 0.0% and 1.8% (2018: 0.0% and 8.0%) and yields varied between 0% and 1.5% (2018: 0% and 4%). Interest is recognised on an effective interest rate basis

Note 3: INTEREST REVENUE – DOMESTIC OPERATIONS

	2019 K'000	2018 K'000
Inscribed stock and other Government securities	267,465	293,423
Temporary advances to Government	4,245	3,975
Overnight lending to Commercial Banks	4,005	10,956
	275,715	**308,354**

Interest income earned on government inscribed stock amounted to K238.2 million (2018: K227.5 million) while K28.9 million was earned from government treasury bills (2018: K65.8 million). During the year coupon rates on inscribed stock varied between 8% and 14% (2018: 9% and 12.5%) while yields on treasury bills varied between 4.7% and 8.1% (2018: 2.4% and 8.1%). Interest is recognised on an effective interest rate basis

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

	2019 K'000	2018 K'000
Licensing and other fees	12,675	4,757
Numismatic currency	246	86
Property rent	4,673	4,405
Other	723	720
	18,317	**9,968**

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2019 K'000	2018 K'000
Central Bank bills issued	66,041	47,999
Other deposit held	291	246
Lease interest expense	882	-
	67,214	**48,245**

Interest on securities issued varied between 1.4% and 11.98% during the year (2018: 1.4% and 2.4%) Interest is recognised on an effective interest rate basis

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Note 6: GENERAL AND ADMINISTRATION EXPENSES

	2019 K'000	2018 K'000
Staff costs	87,602	75,445
Premises and equipment	56,642	49,446
Property impairment/(Reversal of impairment)	-	(38,644)
Other expenses	18,008	13,658
Depreciation of property and equipment	22,040	13,430
Travel	13,125	11,557
Amortisation of notes and coins production expenses	15,122	16,270
Legal & consultancy fees	6,873	9,933
Staff training and development	6,475	6,083
Board & meeting expenses	1,873	1,294
Currency distribution expenses	1,947	1,153
Audit fee	1,908	1,430
	231,615	**161,055**

Note 7: IMF AND OTHER FINANCIAL ORGANIZATION RELATED ASSETS & LIABILITIES

	2019 K'000	2018 K'000
Assets – mandatorily measured at FVTPL		
IMF SDR holdings and deposits and other organisations	30,209	37,187
	30,209	**37,187**
Liabilities – designated as FVTPL		
IMF number 1 and 2 loan accounts	5,939	5,939
SDR allocation	591,396	587,796
	597,335	**593,735**

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.

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

	2019 K'000	2018 K'000
Foreign currency holdings - Nostro accounts	1,804,862	1,640,037
	1,804,862	**1,640,037**

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

Note 9: FINANCIAL ASSETS AT FAIR VALUE

	2019 K'000	2018 K'000
Foreign investments – mandatorily measured at FVTPL	5,793,790	5,420,914
Derivative assets – mandatorily measured at FVTPL	(18,235)	143,535
	5,775,555	**5,564,449**

Foreign investments include K4.1 billion (2018: K3.7billion) of investments managed by external fund managers. The remainder of K1.7 billion (2018: K1.7 billion) is managed directly by the Bank. The investments comprise of foreign bank debt securities, sovereign debt securities and over the counter derivative currency contracts.

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Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

	2019 K'000	2018 K'000
Inscribed stock – measured at FVTPL	2,113,222	2,067,450
Treasury bills – measured at Amortised Cost	295,748	593,518
	2,408,970	**2,660,968**

Note 11: LOANS AND ADVANCES

	2019 K'000	2018 K'000
Loans to PNG commercial banks	-	25,000
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	3,940	3,328
Allowance for doubtful loans	(4,714)	(4,714)
Temporary advances facility to PNG government	125,481	124,025
	126,093	**149,025**

The Temporary Advance Facility is governed by the provisions of the Central Banking Act 2000. The interest rate charged is the 6 monthly treasury bills rate, approximately 4.7% p.a. The facility limit is PGK 200m.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained based on the Bank's credit evaluation of the counterparty. Collateral may include:

- A floating charge over all assets and undertaking of an entity;
- Specific or inter-locking guarantees;
- Specific charge over defined assets of the counterpart and
- Loan agreements including affirmative and negative covenants.

The loans and advances are measured at amortised cost. The related expected credit loss allowances are immaterial. Accordingly, detailed disclosure regarding expected credit loss impairment has not been made.

Note 12: OTHER ASSETS

	2019 K'000	2018 K'000
Inventory notes and coins	27,354	38,118
Commemorative notes & coins and other receivables	(298)	(112)
Prepaid employee benefits	35,333	27,152
Other non-financial assets	6,318	5,520
	68,707	**70,678**

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Note 13: PROPERTY AND EQUIPMENT

	Land and Buildings at fair value K'000	Equipment K'000	Motor Vehicles K'000	Computer Equipment K'000	Computer Software K'000	ROU Asset K'000	Capital Work-In-progress K'000	Total K'000
At 31 December 2018								
Cost or fair value	155,486	25,376	4,439	14,414	42,641	-	173,853	416,209
Accumulated Depreciation	(24,739)	(7,950)	(1,668)	(7,893)	(12,128)	-	-	(54,378)
Net Book Amount	**130,747**	**17,426**	**2,771**	**6,521**	**30,513**	**-**	**173,853**	**361,831**
Year ended 31 December 2019								
Opening net book amount	130,747	17,426	2,771	6,521	30,513	15,200	173,853	377,031
Additions	18,168	13,022	1,362	2,311	117	1,655	45,047	81,682
Reclass/Transfers	136,195	-	-	-	-	-	(136,195)	-
Revaluation	11,794	-	-	-	-	-	-	11,794
Disposals	-	-	(44)	-	-	-	-	(44)
Depreciation charges	(8,529)	(1,417)	(993)	(2,681)	(4,051)	(4,368)	-	(22,039)
Closing Book Amount	**288,375**	**29,031**	**3,096**	**6,151**	**26,579**	**12,487**	**82,705**	**448,424**
At 31 December 2019								
Cost or fair value	288,375	38,397	5,801	16,725	42,758	16,855	82,705	491,616
Accumulated Depreciation	-	(9,366)	(2,705)	(10,574)	(16,179)	(4,368)	-	(43,192)
Net Book Amount	**288,375**	**29,031**	**3,096**	**6,151**	**26,579**	**12,487**	**82,705**	**448,424**

The Bank's increase in property and equipment during the year pertain primarily to land and buildings and capital work in-progress additions.

The increase in land and buildings and capital work in-progress assets are driven mainly by the development of the Lae Currency Processing Facility (CPF) and improvements to ToRobert Haus.

Land and buildings carried at fair value
The fair values of land and building carried at fair value 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 properties on a triennial basis. The most recent valuation was done in 2019.

The carrying amount of land and buildings had they been recognised under the cost model are Land K8.5 million (2018: K3.2 million) and Buildings K227 million (2018: K69 million).

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Note 14: INVESTMENT PROPERTIES

	2019 K'000	2018 K'000
Balance at 1 January	41,460	41,460
Acquisitions	-	-
Reclassification from property and equipment	-	-
Change in fair value	(2,290)	-
Balance at 31 December	**39,170**	**41,460**

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. The most recent valuation was done in 2019. 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 K4.7 million (2018: K4.3 million).

Note 15: DEPOSITS FROM BANKS & THIRD PARTIES

	2019 K'000	2018 K'000
Banks		
Exchange settlement accounts	1,525,278	1,057,612
Cash reserve requirement	2,089,930	2,048,705
Other Deposits	10,629	10,418
	3,625,837	**3,116,735**

Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES

	2019 K'000	2018 K'000
Deposits from government and government entities	1,351,160	1,505,423
	1,351,160	**1,505,423**

Note 17: SECURITIES ISSUED

	2019 K'000	2018 K'000
Central bank bills issued	1,775,731	2,402,654
	1,775,731	**2,402,654**

Securities issued are debt securities issued by the Bank of Papua New Guinea for terms of twenty-eight days, three or four months. CBB Bond has tenures 1 – 10 years. These bills and are used to manage liquidity in the money and open market operations in the domestic financial markets.

Note 18: CURRENCY IN CIRCULATION

	2019 K'000	2018 K'000
Currency in Circulation	2,298,574	2,151,993
	2,298,574	**2,151,993**

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 face value, which is equivalent to its fair value in the statement of financial position.

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Note 19: OTHER FINANCIAL LIABILITIES

	2019 K'000	2018 K'000
Foreign Currency		
Foreign currency deposits	1,794	13,644
	1,794	**13,644**
Local Currency		
Expense creditors	38,871	37,487
Lease Liability	12,860	-
	51,731	**37,487**

Expense creditors include cheques or warrant 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

	2019 K'000	2018 K'000
Provision for gratuity	4,497	3,407
Provision for long service leave	22,532	20,890
Provision for annual leave	6,769	3,664
	33,798	**27,961**
Reconciliation of leave provisions		
Balance at 1 January	27,961	23,943
Net charged to statement of profit or loss	5,837	4,018
Balance at 31 December	**33,798**	**27,961**

Note 21: LEASES

A. Leases as lessee

Right-of-use assets

Right-of-use assets relate to leased offices and warehouses that are presented within property and equipment.

	2019 K'000	2018 K'000
Balance at 1 January	15,200	-
Depreciation charge for the year	(4,368)	-
Additions	1,655	-
Balance at 31 December	**12,487**	-

Lease liabilities

The following table sets out a maturity analysis of lease payments, included under Other financial liabilities on Note 24(iii)(c).

	2019 K'000	2018 K'000
One to three months	1,074	-
Three to twelve months	2,756	-
One to five years	9,030	-
More than five years	-	-
	12,860	-

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Amounts recognised in profit or loss

2019 – Leases under IFRS 16	2019 K'000	2018 K'000
Interest expense on lease liabilities	882	-
Expenses relating to short-term leases	4,799	-
Amounts recognised in statement of cash flows		
Total cash outflow for leases	10,050	-

B. Leases as lessor

Operating lease
The Bank leases out its investment property. The Bank has classified these leases as operating leases, because they do not transfer substantially all of the risks and rewards incidental to the ownership of the assets.

The following table sets out a maturity analysis of lease receivables, showing the undiscounted lease payments to be received after the reporting date.

2019 – Operating leases under IFRS 16

	2019 K'000
Less than one year	3,635
One to two years	386
Two to five years	32
More than five years	Nil
Total	**4,053**

Note 22: SHARE CAPITAL

At 31 December 2019, the authorised and subscribed capital of the Bank was K145.5 million (2018: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2019 K'000	2018 K'000
Capital		
At the beginning of the year	145,540	145,540
At the end of the year	**145,540**	**145,540**
Other Reserves		
Gold revaluation reserve	197,412	161,108
Property revaluation reserve	95,028	83,234
Unrealised gain/(loss) reserve	299,888	63,030
Building reserve	73,800	73,800
General reserve	30,000	-
Retained earnings	418,662	412,152
Total other reserves	**1,114,790**	**793,324**
Total owner's equity	**1,260,330**	**938,864**

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Note 23: SEGMENT REPORTING

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

Note 24: RISK MANAGEMENT

Note 24(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 staffs 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 24(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.

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Note 24(ii): CREDIT RISK (continued)

(b) Concentration of Credit Exposure

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

	2019 K'000	2018 K'000
Foreign Governments, Banks & Financial Organizations		
Nostro accounts	1,804,862	1,640,037
Foreign investments (note 9)	5,775,555	5,564,449
Assets held with IMF and other financial organizations	30,209	37,187
Accrued interest receivable	19,714	19,462
Papua New Guinea Government		
Government of Papua New Guinea securities (note 10)	2,408,970	2,660,968
Temporary advance to PNG government (note 11)	125,481	124,025
Accrued interest receivable (note 11)	-	-
PNG commercial banks (note 11)	-	25,000
Bank staff and employees (note 11)	3,940	3,328
Other Government Institutions (note 11)	1,386	1,386
	10,170,117	**10,075,842**

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the statement of financial position. 22% (2018: 16%) of the total assets have a credit rating of A-1+ or above in short term investments and 34% (2018: 31%) of long term investments have a credit of A+ or above.

(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:		**2019 K'000**	**% of 2019 Financial Assets**	**2018 K'000**	**% of 2018 Financial Assets**
Short term foreign investments					
	A-1+	1,783,152	22	1,328,791	16
	A-1	147,583	1	521,558	7
	A-2	69,244	1	93,720	1
	A-3	-	-	-	-
	NR	148,056	2	158,513	2
		2,148,035	**26**	**2,102,582**	**26**
Long term foreign investments					
	AAA	2,157,719	26	1,793,893	22
	AA+	-	-	157,848	2
	AA	631,787	8	527,593	7
	AA-	-	-	23,839	-
	A+	-	-	24,060	-
	A	426,528	5	492,083	6
	A-	-	-	-	-
	BBB+	-	-	-	-
	BBB	411,486	5	442,551	5
	BBB-	-	-	-	-
		3,627,520	**44**	**3,461,867**	**42**
Total foreign investments		**5,775,555**	**70**	**5,564,449**	**68**

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Note 24(ii): CREDIT RISK (continued)

(d) Credit Exposure by Credit Rating

Investment in Financial Assets:	2019 K'000	% of 2019 Financial Assets	2018 K'000	% of 2018 Financial Assets
Short term domestic investments				
B	295,748	4	593,518	7
	295,748	**4**	**593,518**	**7**
Long term domestic investments				
B	2,113,222	26	2,067,450	25
	2,113,222	**26**	**2,067,450**	**25**
Total domestic investments	**2,408,970**	**30**	**2,660,968**	**32**
Total investments	**8,184,525**	**100**	**8,225,417**	**100**

The majority of financial assets are measured at FVTPL. The ECL allowances related to the treasury bills, loans and advances measured at amortised cost and loans to the PNG government, are immaterial, hence no quantitative disclosure of ECL have been made. No financial assets designated at FVTPL have been reclassified to amortised cost.

Note 24(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 2019 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

Currency of Denomination As at 31 December 2019	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	Total K'000
Foreign currency assets:								
Foreign currency	1,041,914	70,865	597,198	65,014	20,434	-	9,437	1,804,862
Investments	4,719,841	84,087	897,411	92,451	-	-	-	5,793,790
Derivative assets	(18,235)	-	-	-	-	-	-	(18,235)
Assets held with IMF	-	-	-	-	-	30,209	-	30,209
Accrued interest	17,763	220	1,677	54	-	-	-	19,714
	5,761,283	**155,172**	**1,496,286**	**157,519**	**20,434**	**30,209**	**9,437**	**7,630,340**
Foreign currency liabilities:								
Liabilities with IMF	-	-	-	-	-	597,335	-	597,335
Foreign currency liabilities	1,794	-	-	-	-	-	-	1,794
	1,794	**-**	**-**	**-**	**-**	**597,335**		**599,129**
Net Foreign currency exposure	**5,759,489**	**155,172**	**1,496,286**	**157,519**	**20,434**	**(567,126)**	**9,437**	**7,031,211**

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Note 24(iii): MARKET RISK (continued)

As at 31 December 2018	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	Total K'000
Foreign currency assets:								
Foreign currency	802,962	142,114	530,818	152,458	9,676	-	2,009	1,640,037
Investments	4,800,440	31,431	563,875	25,168	-	-	-	5,420,914
Derivative assets	143,535	-	-	-	-	-	-	143,535
Assets held with IMF	-	-	-	-	-	37,187	-	37,187
Accrued interest	16,971	599	1,840	52	-	-	-	19,462
	5,763,908	**174,144**	**1,096,533**	**177,678**	**9,676**	**37,187**	**2,009**	**7,261,135**
Foreign currency liabilities:								
Liabilities with IMF	-	-	-	-	-	593,735	-	593,735
Foreign currency liabilities	13,644	-	-	-	-	-	-	13,644
	13,644	**-**	**-**	**-**	**-**	**593,735**	**-**	**607,379**
Net Foreign currency exposure	**5,750,264**	**174,144**	**1,096,533**	**177,678**	**9,676**	**(556,548)**	**2,009**	**6,653,756**

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.

The table below summarizes 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 reporting date to the contractual maturity date.

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Note 24(iii): MARKET RISK *(c) LIQUIDITY RISK (continued)*

As at 31 December 2019:	Balance Total K'000	Maturity Period					No specified maturity K'000
		On demand	0 to 3 months	3 to 12 Months	1 to 5 years	over 5 years	
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	1,804,862	915,250	889,612	-	-	-	-
Financial Assets at fair value	5,775,555	-	1,461,471	671,788	3,264,278	378,018	-
Assets held with IMF	30,209	-	-	-	-	-	30,209
Accrued interest	19,714	-	16,451	724	2,539	-	-
	7,630,340	**915,250**	**2,367,534**	**672,512**	**3,266,817**	**378,018**	**30,209**
Local Currency Financial Assets:							
Government of Papua New Guinea Securities	2,408,970	-	-	295,747	375,800	1,737,423	-
Loans and advances	126,093	-	126,093	-	-	-	-
Accrued interest and receivables	58,947	-	517	10,493	10,441	37,496	-
	2,594,010	**-**	**126,610**	**306,240**	**386,241**	**1,774,919**	**-**
Non-financial assets:							
Gold	218,020	-	-	-	-	-	218,020
Property and equipment	448,424	-	-	-	-	-	448,424
Investment properties	39,170	-	-	-	-	-	39,170
Other financial assets	68,707	-	-	-	-	-	68,707
	774,321	**-**	**-**	**-**	**-**	**-**	**774,321**
Total Assets	**10,998,671**	**915,250**	**2,494,144**	**978,752**	**3,653,058**	**2,152,937**	**804,530**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	597,335	-	-	-	-	-	597,335
Other financial liabilities	1,794	-	1,794	-	-	-	-
	599,129	**-**	**1,794**	**-**	**-**	**-**	**597,335**
Local Currency Financial Liabilities:							
Deposits from bank and third parties	3,625,837	3,625,837	-	-	-	-	-
Deposits from Government	1,351,160	1,351,160	-	-	-	-	-
Securities issued	1,775,731	-	1,297,426	31,001	67,270	380,034	-
Accrued interest payable	2,381	-	2,381	-	-	-	-
Currency in Circulation	2,298,574	2,298,574	-	-	-	-	-
Lease Liability	12,860	-	1,074	2,756	9,030	-	-
Other financial liabilities	38,871	-	27,242	-	-	11,629	-
	9,105,414	**7,275,571**	**1,328,123**	**33,757**	**76,300**	**391,663**	**-**
Non-Financial Liabilities:							
Employee Provision	**33,798**	-	**33,798**	-	-	-	-
Total Liabilities	**9,738,341**	**7,275,571**	**1,363,715**	**33,757**	**76,300**	**391,663**	**597,335**

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Note 24(iii): MARKET RISK *(c) LIQUIDITY RISK (continued)*

As at 31 December 2018:	Balance Total K'000	Maturity Period On demand	0 to 3 months	3 to 12 Months	1 to 5 years	over 5 years	No specified maturity K'000
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	1,640,037	1,056,844	583,193	-	-	-	-
Financial Assets at fair value	5,564,449	-	1,194,186	800,283	3,211,393	358,587	-
Assets held with IMF	37,187	-	-	-	-	-	37,187
Accrued interest	19,462	-	15,627	3,835	-	-	-
	7,261,135	**1,056,844**	**1,793,006**	**804,118**	**3,211,393**	**358,587**	**37,187**
Local Currency Financial Assets:							
Government of Papua New Guinea Securities	2,660,968	-	232,362	598,774	946,574	883,258	-
Loans and advances	149,025	-	149,025	-	-	-	-
Accrued interest and receivables	63,434	-	7,967	13,979	25,615	15,873	-
	2,873,427	**-**	**389,354**	**612,753**	**972,189**	**899,131**	**-**
Non-financial assets:							
Gold	181,716	-	-	-	-	-	181,716
Property and equipment	361,831	-	-	-	-	-	361,831
Investment properties	41,460	-	-	-	-	-	41,460
Other financial assets	70,678	-	-	-	-	-	70,678
	655,685	**-**	**-**	**-**	**-**	**-**	**655,685**
Total Assets	**10,790,247**	**1,056,844**	**2,182,360**	**1,416,871**	**4,183,582**	**1,257,718**	**692,872**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	593,735	-	-	-	-	-	593,735
Other financial liabilities	13,644	-	13,644	-	-	-	-
	607,379	**-**	**13,644**	**-**	**-**	**-**	**593,735**
Local Currency Financial Liabilities:							
Deposits from bank and third parties	3,116,735	3,116,735	-	-	-	-	-
Deposits from Government	1,505,423	1,505,423	-	-	-	-	-
Securities issued	2,402,654	-	2,161,297	108,845	4,899	127,613	-
Accrued interest payable	1,751	-	1,751	-	-	-	-
Currency in Circulation	2,151,993	2,151,993	-	-	-	-	-
Other financial liabilities	37,487	-	37,487	-	-	-	-
	9,216,043	**6,774,151**	**2,200,535**	**108,845**	**4,899**	**127,613**	**-**
Non-Financial Liabilities:							
Employee Provision	**27,961**	-	**27,961**	-	-	-	-
Total Liabilities	**9,851,383**	**6,774,151**	**2,242,140**	**108,845**	**4,899**	**127,613**	**593,735**

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Note 24(iv): FAIR VALUE

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the bank has access at that date. The fair value of a liability reflects its non-performance risk. IFRS requires that the fair value of the financial assets and liabilities be disclosed according to their classification under IFRS 9. The following table summarises the financial assets and liabilities in accordance with IFRS 9 classifications.

	2019 K'000	2018 K'000
Financial Assets		
Cash and cash equivalents	1,804,862	1,640,037
At fair value through profit/(loss)	7,918,987	7,669,086
Loans & Advances measured at amortised cost	204,754	259,073
Treasury Bills measured at amortised cost	295,747	593,518
	10,224,350	**10,161,714**
Financial Liabilities		
At fair value through profit/(loss)	599,129	607,379
At amortised cost	9,105,414	9,216,043
	9,704,543	**9,823,422**

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

FAIR VALUE HIERARCHY

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the 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.

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Note 24(iv): FAIR VALUE (continued)

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.

31-Dec-19	**Level 1**	**Level 2**	**Level 3**	**Total**
	K'000	**K'000**	**K'000**	**K'000**
Financial assets held at fair value through profit or loss				
- Domestic Government Securities - inscribed stock	-	-	2,113,223	2,113,223
- Foreign Government and semi-Government bonds	1,709,398	-	-	1,709,398
- Derivatives managed by external fund managers	-	(18,235)	-	(18,235)
- Investments in bonds and other instruments managed by external fund managers	4,084,392	-	-	4,084,392
- Assets held with IMF	-	30,209	-	30,209
Total assets at fair value through profit or loss	**5,793,790**	**11,974**	**2,113,223**	**7,918,987**
Non financial assets at fair value				
- Gold	218,020	-	-	218,020
- Property and equipment	-	-	448,424	448,424
- Investment property	-	-	39,170	39,170
Total assets at fair value	**218,020**	**-**	**487,594**	**705,614**
Financial liabilities held at fair value through profit & loss				
- Derivatives	-	1,794	-	1,794
- Liabilities with IMF	-	597,335	-	597,335
Total liabilities at fair value through profit or loss	**-**	**599,129**	**-**	**599,129**

31-Dec-18	**Level 1**	**Level 2**	**Level 3**	**Total**
	K'000	**K'000**	**K'000**	**K'000**
Financial assets held at fair value through profit or loss				
- Domestic Government Securities - inscribed stock	-	-	2,067,450	2,067,450
- Foreign Government and semi-Government bonds	-	1,691,076	-	1,691,076
- Derivatives managed by external fund managers	-	143,535	-	143,535
- Investments in bonds and other instruments managed by external fund managers	3,729,838	-	-	3,729,838
- Assets held with IMF	-	37,187	-	37,187
Total assets at fair value through profit or loss	**3,729,838**	**1,871,798**	**2,067,450**	**7,669,086**
Non financial assets at fair value				
- Gold	181,716	-	-	181,716
- Property and equipment	-	-	361,831	361,831
- Investment property	-	-	41,460	41,460
Total assets at fair value	**181,716**	**-**	**403,291**	**585,007**
Financial liabilities held at fair value through profit & loss				
- Derivatives	-	13,644	-	13,644
- Liabilities with IMF	-	593,735	-	593,735
Total liabilities at fair value through profit or loss	**-**	**607,379**	**-**	**607,379**

As at 31 December 2019, there were no movements between stages for any transfers to level 3.

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Note 24(iv): FAIR VALUE (continued)

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2019:

	Level 3
	K'000
Opening balance	2,067,450
Maturities, net of additional investment	(39,298)
Fair value revaluation gains/(losses) on level 3 instruments	85,070
Closing balance	2,113,222
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.	**86,070**

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2018:

	Level 3
	K'000
Opening balance	3,264,954
Additional investment, net of maturities	(1,202,777)
Fair value revaluation gains/(losses) on level 3 instruments	5,273
Closing balance	2,067,450
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.	**5,273**

	Valuation Technique	**Unobservable Input**	**Range of Inputs**		**Fair value movement due to change in unobservable Input:**	
			2019	**2018**	**Increase**	**Decrease**
Domestic Government Securities - inscribed stock	Discounted cash flows present value method	Current market yield	8% to 14%	9% to 12.6%	Decrease	Increase
Investment property	Income capitalisation	Capitalisation rate	10% to 14%	10% to 14%	Decrease	Increase

Note 24(v): SENSITIVITY ANALYSIS

The sensitivity of the Bank's profit and equity to a movement of +/- 10 per cent in the value of the Kina as at 31 December 2019 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2019 K'000	**2018 K'000**
Changes in profit/equity due to a 10 per cent appreciation in the value of the Kina	(784,836)	(744,285)
Changes in profit/equity due to a 10 per cent depreciation in the value of the Kina	784,836	744,285

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.

	2019 K'000	**2018 K'000**
Changes in profit/equity due to an increase of 1 percentage point	90,925	92,160
Changes in profit/equity due to a decrease of 1 percentage point	(90,925)	(92,160)

Note 25: EVENTS AFTER THE BALANCE DATE

At the date of finalisation of the annual financial statements, there were no material events that occurred subsequent to the statement of financial position date that require adjustment to the financial statements. However, the Coronavirus COVID-19 outbreak is a material subsequent event that requires disclosure in the financial statements.

On March 11, 2020, the World Health Organisation declared the Coronavirus COVID-19 outbreak to be a pandemic. Many governments are taking increasingly stringent steps to help contain the spread of the virus, including: requiring self-isolation/quarantine by those potentially affected, implementing social distancing measures, and controlling or closing borders and "locking-down" cities/regions or even entire countries. The pandemic is an unprecedented challenge for humanity and for the economy globally, and at the date of finalisation of the financial statements its effects are subject to significant levels of uncertainty. There is potentially adverse effect on the foreign exchange reserves as the global equity markets experience negative shocks and volatility. The Bank continues to monitor the markets to be proactive in maintaining as far as possible the safety of the foreign exchange reserves portfolio. There is, however, a high chance that this continued pressure on global markets, as a result of the COVID-19 pandemic, would lead to significant unrealised market losses and/or withdrawals by Government to fund emergency operations. On the other hand, there could be delays to execution of Government and associated spending due to supply disruptions in the short-term and measures to contain the disease, thus off-setting the impact of any withdrawals.
In light of the above, management has re-assessed the appropriateness of the use of the going concern assumption in the preparation of these financial statements. Based on the assessment performed, management is of the view that the significant doubt associated with the current uncertainties related to the COVID-19 virus currently does not result in a material uncertainty related to such events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern.

Note 26: CONTINGENT LIABILITIES

The Bank had no contingent liabilities at 31 December 2019 (2018: 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 27: CAPITAL COMMITMENTS

The Bank has no capital commitments.

Note 28: 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 32 in total (2018: 28), including the Governor, 1 Deputy Governor, 3 Assistant Governors, 6 non-executive Board members and 21 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

	2019 K'000	2018 K'000
Short term benefits	12,078	13,244
Post-employment benefits	907	831
Other long term benefits	6,753	5,101
	19,738	**19,176**

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 and benefits related to loans and advances to staff. The components of benefits are reported on an accruals basis.

As at 31 December 2019, the loans owed by the key management personnel to the Bank were K4,300,192 (2018: K5,431,930).

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Note 29: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,340,625 (2018: K1,430,162). 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 30: 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:

(a) 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.

(b) Acting as the agent of the Government or its agencies and institutions, providing guarantees, participating in loans to Government departments and corporations.

(c) As the agent of the Government managing public debt and foreign reserves.

Balances with the Government of Papua New Guinea are disclosed in note 16 Deposits from Government and Government Entities and note 11 for TAF reflecting Government loan balances with BPNG.

Transactions with the Government of Papua New Guinea are disclosed in Note 3 Interest revenue – domestic operations.

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Bank of Papua New Guinea

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DECLARATION BY MANAGEMENT

In our 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 include 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 31st December 2019.

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

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Loi M Bakani CMG
Governor

....
Joseph M Teria
Deputy Governor

30th June 2020