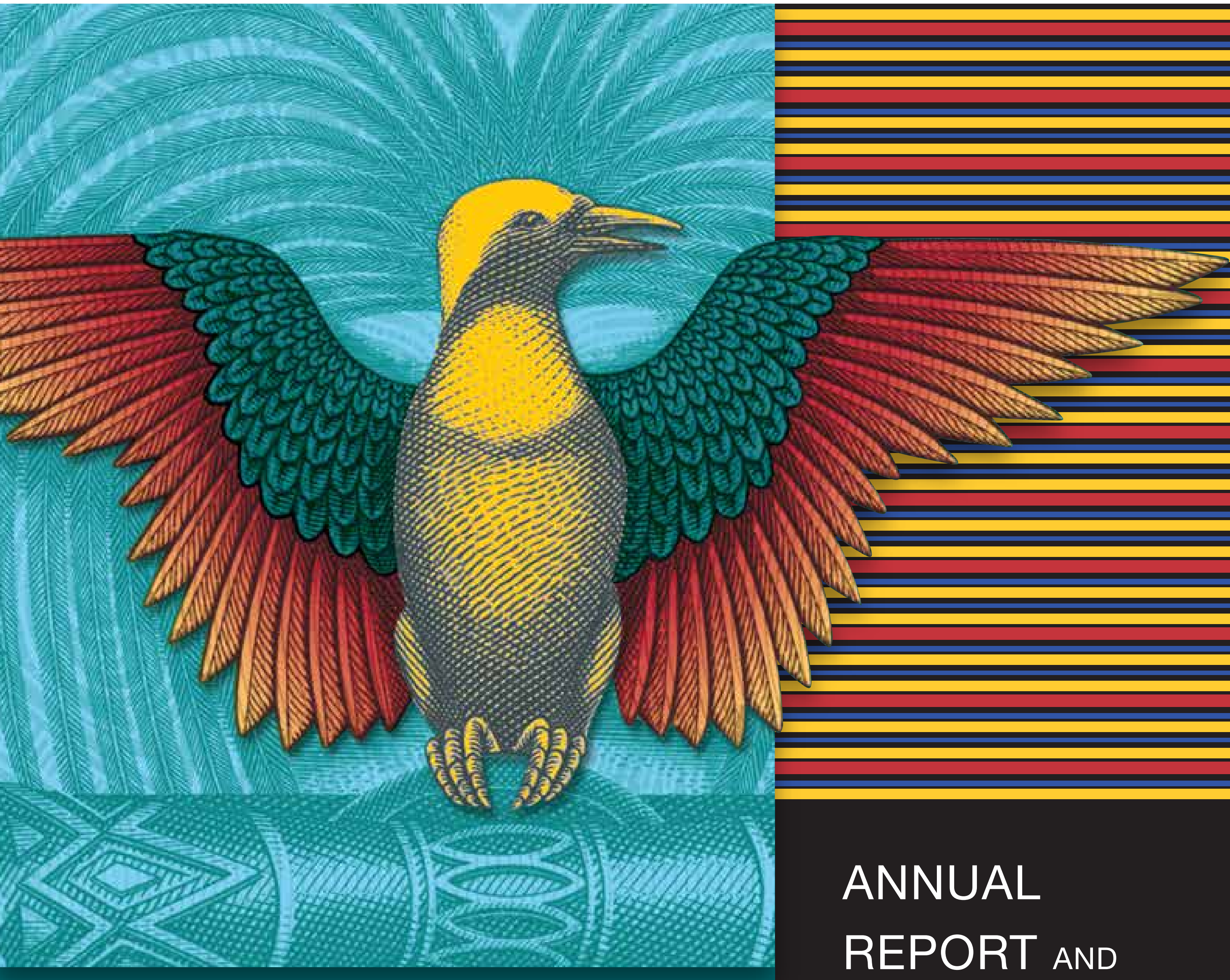
BANK OF PAPUA NEW GUINEA



ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2017

BANK OF PAPUA NEW GUINEA

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2017

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

(a) to formulate and implement monetary policy with a view to achieving and maintaining price stability; and

(b) to formulate financial regulation and prudential standards to ensure stability of the financial system in Papua New Guinea; and

(c) to promote an efficient national and international payments system; and

(d) subject to the above, to promote macro-economic growth in Papua New Guinea.

Central Banking Act 2000

Head Office	ToRobert Haus Douglas Street Port Moresby
Postal Address	PO Box 121 Port Moresby
Telephone	(675) 322 7200
Email	info@bankpng.gov.pg
Facsimile	(675) 321 1617
Website	www.bankpng.gov.pg

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Governor's Foreword

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

Economic activity in Papua New Guinea picked up in 2017 compared to 2016, with growth of around 3 percent, making it the sixteenth consecutive year of growth.

International prices for some of Papua New Guinea's export commodities increased in 2017 and led to a higher overall balance of payments surplus for the year, compared to 2016.

Annual headline domestic inflation eased to 4.7 percent in 2017, from 6.6 percent in 2016. This level was considered to be manageable, constituting price stability, which is defined as low inflation rate over a reasonable period of time.

However commodity prices were not as high as the price levels experienced around 2011 and some prices were still low. This posed several challenges for the country during the year. These included higher demand for foreign exchange relative to supply and lower growth in the Government's revenue base.

Added to the difficulty of meeting its budget appropriations for 2017, the Government's major financial commitments during the year also included the funding of the 2017 national elections and the start of preparations for PNG's first time hosting of the year-long APEC meetings and related activities. The preparations, including infrastructure development, contributed to a high budget deficit in 2017.

The Bank faced a number of challenges in monetary policy implementation during the year, including increased financing of the National Budget, which injected more liquidity into the banking system.

I am pleased to present in this Annual Report a summary of our activities and achievements as the Central Bank of Papua New Guinea during 2017.

While managing the high level of domestic liquidity continued to be a key challenge throughout 2017, the high liquidity level has not translated to higher inflation for some years now. Firms have been able to absorb costs, and increased competition among wholesalers and retailers, as well as cheaper imports from alternative overseas markets has contributed to the manageable inflation level. With the domestic foreign exchange market situation, the Central Bank continued to assist the market in supplying US dollars in its interventions, although there were improved foreign exchange inflows from the major commodity exporters. In spite of this, a backlog of sell kina orders continued.

The Bank issued further foreign exchange directives in April 2017 to deal with certain practices by the authorised foreign exchange dealers (AFEDs). These directives included extending the coverage of the trading margin to all currencies and transactions, except over-the-counter currency exchange, prohibiting the settlement of trade finance arrangements in foreign currency, and the requirement for AFEDs to submit their trading book positions and inter-bank turnover reports.

During the year the Bank, with assistance from AusAID, launched the National Anti-Money Laundering and Counter Terrorist Financing (AML/CTF) Strategic Plan 2017-2022. The Strategic Plan outlines the vision for a strengthened AML/CTF system in PNG and details its five key objectives and implementation program. The Strategic Plan and the establishment of the Financial Analysis and Supervision Unit (FASU) within the Bank represent a strong commitment to addressing money laundering and terrorist financing activities in Papua New Guinea.

Modernising currency management was firmly on the agenda during 2017, with plans well under way for redesigning the currency processing facility and upgrading equipment and software. The Bank resized the K2 and K50 notes as part of an ongoing program so all currency banknotes can be differentiated easily by their size. The commissioning of special commemorative notes and coins for the 2018 APEC Leaders' Summit also took place in 2017, which are expected to be launched before the APEC Leaders' Summit in November 2018.

The Bank's ongoing research project on blockchain technology as an instrument for enhancing financial inclusion in PNG continued throughout 2017. Commitment to technological innovation to solve real problems placed the Bank firmly on the international stage. The Bank supported the world's largest blockchain conference, London Blockchain Week 2017, delivered the keynote presentation, sponsored the Blockchain Hackathon and showcased IDBox, a device for creating and confirming identity – an important requirement for financial inclusion activities.

The IDBox was successfully trialled in Lalaura, Central Province, while hosting of the first blockchain seminar in PNG was well-received by domestic and international stakeholders.

The Bank has a long-standing priority of building and maintaining the capacity of our staff. We encourage them and support their participation in a wide range of formal studies and professional development activities. I acknowledge the assistance we received in training and capacity building from the many reputable institutions and organisations in PNG and abroad. These include universities and colleges, the International Monetary Fund (IMF), the Pacific Financial Technical Assistance Centre (PFTAC), SEACEN Centre, Alliance for Financial Inclusion, Austrac, Australian Business Volunteers (ABV), APRA, Reserve Bank of Australia (RBA), AusAID, Pacific Financial Inclusion Programme (PFIP), ADB and the World Bank Group.

"The Bank's ongoing research project on blockchain technology as an instrument for enhancing financial inclusion in PNG continued throughout 2017."

During 2017 the Bank in partnership with the PNG Institute of Directors and the University of PNG commenced discussions to establish a learning and development framework for qualification of company directors. We are confident this initiative will lead to a stronger commitment to good corporate governance in the future, as more business people are exposed to the principles and practices that define effective and ethical company directorship.

In acknowledging the many successful events and excellent achievements of the Bank in 2017, which are detailed in the body of this Report, I wish to extend my sincere thanks to my fellow Board members, Deputy Governor, Assistant Governors, the senior management team and the staff of the Bank for their commitment and support during the year.

As we head into 2018, I look forward to another productive year to continue our work towards achieving our vision of being 'a contemporary central bank and regulator excelling in performing its core functions and making a distinct and valuable contribution to the financial stability and economic prosperity of Papua New Guinea'.

Loi M. Bakani CMG

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

Highlights

National Switch project gains momentum

L to R seated: BPC Banking Technologies' Managing Director Asia Pacific, Rajan Narayan, Governor of BPNG Loi M Bakani CMG and Assistant-Governor Ellison Pidik.

L to R standing: Assistant-Governor Joe Teria, Board Member John Leahy, Board Member Richard Kuna, Andrew Mason, Board Member Fr Denny Bray Guka, BPC Banking Technologies' Senior Project Manager Asia Pacific, Giovanni Calingasan, Gaona Gwaibo, Board Member Christopher Hnanguie, Board Member Simon Tosali, Theresa Lyon and Assistant-Governor Elizabeth Genia.

The first step toward implementing the planned Retail Electronic Payments System (REPS) was taken in 2017, with the signing of a contract for the supply and installation of a national card and mobile payments switch.

REPS will allow microfinance companies and microbanks, savings and loans societies and other smaller financial institutions entry into the National Payment System (NPS) to offer plastic card and mobile payment services to their customers. Once REPS is in place more people and businesses will have access to financial services throughout PNG, particularly in the rural areas. (See page 25)

In August the Bank hosted the inaugural PNG Blockchain Seminar, attended by 240 delegates. Guest speakers included 9 overseas-based experts from a range of blockchain industry organisations.

Structural work nears completion

The structural phase of the Currency Distribution Facility building project in Lae, Morobe Province was substantially completed by the end of 2017.

Task force lays foundations for 'fit and proper' company directors

The Bank, along with PNG Institute of Directors and the University of PNG, established a task force to develop a learning and development path for qualification of company directors. (See page 24)

2017 – a year of successful Financial inclusion activities

During the year the Bank, working cooperatively with a number of financial organisations committed to achieving financial inclusion, achieved a number of milestones. (See page 32)

In May the Bank, in association with CEFI, hosted the Pacific Islands Regional Initiative (PIRI). PIRI is an annual forum for all central bank governors from the Pacific Region. (See page 32)

The Financial Inclusion Innovation Summit was held in August. The Bank and CEFI collaborated with organisations including the Foundation for Development Cooperation, Microfinance Pasifika and the Pacific Financial Inclusion Program in staging the successful conference. (See page 32)

From London to Lalaura

The Bank successfully tested IDBox in a field trial in the village of Lalaura, Abau District in Central Province, a long way from its debut in London, England at Blockchain Week, where the concept was originally developed.

IDBox is designed to confirm a person’s identity so that the financial transactions they enter into can be validated and recorded with certainty and confidence. Designed specifically to meet the challenges of remote PNG locations, IDBox does not need access to electricity, Internet or Smartphone technology, a world first.

Investment opportunity seminars raise awareness

Over the course of 2017 the Bank hosted a series of seminars around Papua New Guinea for local business houses and members of the public, presenting information on investment opportunities offered by the Bank and the National Government and the benefits of KATS. (See page 25)

Mission Vision Values

Mission

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

Vision

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

Values

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

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

With **TRANSPARENCY** our decisions stand scrutiny.

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

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

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

Governance

Governor Loi M. Bakani CMG

Dr Gae Kauzi

Mr John Leahy

Bishop Denny Bray Guka

Mr Christopher Taylor Hnanguie

Mr Richard Kuna

Mr Simon Tosali

Members of the Board of the Bank of Papua New Guinea

31 December 2017

The Bank of Papua New Guinea ('Bank' or the 'Central Bank'), like other central banks, and as one of the cornerstones of the PNG financial system, is a strong advocate of adherence to good corporate governance practices and principles. In line with the *Central Banking Act 2000* (CBA 2000) and its strategic plans, the Bank has adopted best corporate governance practices, principles and standards, which are reflected in its operations processes and procedures. These practices have been strengthened through the Board and its committees, effective organisational structures, improved management reporting systems and effective internal and external audit processes.

Under the CBA 2000, the Governor and the Board of the Bank have distinct roles and responsibilities. The Board is responsible for determining the policy of the Bank, other than the formulation of monetary policy and regulation of the financial system, which are the responsibility of the Governor.

The Governor determines all matters of internal management, while the Board adopts appropriate practices of good governance to assist and oversee the Governor in performing his roles and responsibilities.

Governance

Composition of the Board

Under the terms of the CBA 2000, the Board comprises members who are either *ex officio* or *non-ex officio*. The *ex officio* members are appointed by virtue of the offices they hold. The *non-ex officio* members are appointed by the Head of State for a term of three years.

The Governor, who is also the Chairman of the Board, is appointed by the Head of State for a term of up to seven years. Selection and appointment of the Governor is a stringent process, as required under the terms of the CBA 2000 and the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*. This Act specifies that the Governor is 'of good moral standing' with recognised professional experience in banking and financial matters.

The Deputy Governor, appointed for a term of up to five years by the Governor in consultation with the Minister for Treasury, is a member of the Board and presides at the Board meetings in the absence of the Governor. The Governor has the discretion to appoint either one or two Deputy Governors.

The five other *ex officio* members of the Board are heads of a number of prominent institutions within the PNG community. These are the Chairman of the PNG Council of Churches, the President of Certified Practising Accountants Papua New Guinea (CPA PNG), the Chairman of the Securities Commission of PNG, the President of the Papua New Guinea Trade Union Congress and the President of the Papua New Guinea Chamber of Commerce and Industry.

Acting on advice, the Head of State appoints up to three *non-ex officio* members, from persons of good moral standing and recognised professional experience in monetary and financial matters.

All Board members are required to meet the key standards of good governance. For example, they must pass the 'fit and proper persons' test before they are admitted to the Board.

Management Structure

The Bank has an established management structure and clear management reporting lines, conforming with principles of good corporate governance. Four Assistant Governors report directly to the Governor. The Assistant Governors are responsible for the Bank's functional areas, made up of related Departments comprised of various units.

The Corporate Secretary, Internal Audit Department and Financial Analysis and Supervision Unit also report directly to the Governor.

A number of inter-departmental management committees are established to perform a range of functional and management responsibilities for and on behalf of the Governor.

Funding

The Bank's independence and autonomy is vital for fulfilling its legislated mandate and maintaining the integrity of its operation and policy decision-making. Accordingly, the Bank is a self-funding institution, with its own capital and reserves, and is not dependent on Government or other sources of funding for its operations.

The Board

Governors

Governor and Chairman

Loi M. Bakani CMG

Mr Loi M. Bakani CMG was appointed Governor and Chairman of the Board of the Bank in December 2009. He was reappointed for a further 7 year term in December 2016. He is also the Registrar of Savings and Loan Societies in PNG.

Mr Bakani is a Member of the Board of SEACEN, Alternative Governor for IMF Annual Meetings, Chairman of the Microfinance Expansion Project, Chairman of the Centre of Excellence for Financial Inclusion (CEFI), Director of the PNG Institute of Directors (PNGID), Chairman of the PNG Institute of Banking & Business Management (IBBM) and a Member of the Advisory Board of Port Moresby Senior AFL competition.

He holds a Bachelor of Economics degree from the University of PNG and a Master's degree in Commerce majoring in Economics from the University of Wollongong, Australia.

Deputy Governor

Dr Gae Kauzi

Dr Kauzi was appointed Deputy Governor and a member of the Board in July 2016.

Dr Kauzi holds a Bachelor of Economics degree with Honours from the University of Papua New Guinea, a Masters degree in Policy Economics from the University of Illinois, USA and a Doctor of Philosophy in Economics from Monash University, Australia.

Members of the Board

Mr John Leahy

Mr Leahy was appointed the President of the Papua New Guinea Chamber of Commerce and Industry in March 2008 and by virtue of that position is an *ex officio* member of the Board.

Mr Leahy is also a Director of a number of companies, including BNG Trading Group Ltd and subsidiaries.

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

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

Bishop Denny Bray Guka

Bishop Denny Guka was appointed as the Chairman of the PNG Council of Churches in February 2012 and by virtue of that position is an *ex officio* member of the Board.

He is Bishop of the Anglican Diocese of Port Moresby, Ecumenical Bishop for the Anglican Church of PNG and is Chairman of Anglicare PNG. He is also a member of the Release on License Committee and the Lawyers Statutory Committee.

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

Mr Christopher Taylor Hnanguie

Mr Hnanguie was appointed an *ex officio* member of the Board in May 2017 in his capacity as Executive Chairman of the Securities Commission of PNG.

He holds a Master's degree in Business Economics from the University of Asia and the Pacific in The Philippines, a Master's degree in Business Administration from the Ateneo de Manila University in The Philippines and a Master's degree in International Political Economy from Victoria University of Wellington, New Zealand.

Mr Simon Tosali

Mr Simon Tosali was appointed in March 2016 for a three year term as a *non-ex officio* member of the Board.

He is a former senior public servant and a former Secretary for the Department of Treasury. Mr Tosali has served on various corporate boards during his time as Secretary, including the Boards of Ok Tedi Mining Limited, the Independent Public Business Corporation (IPBC), Air Niugini and Mineral Resources Development Corporation (MRDC).

He holds a Bachelor of Economics degree with Honours from the University of Papua New Guinea and a Master's degree in Economics from the University of Sydney, Australia.

Mr Tosali retired from the public service in 2013 and is now a private consultant.

Mr Richard Kuna

Mr Kuna was appointed President of CPA PNG in November 2015 and by virtue of that position is an *ex officio* member of the Board.

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

Mr Kuna has a Bachelor of Business in Accounting from the University of Technology, Sydney Australia

He is a Certified Practising Accountant, qualified to practise in Australia and PNG.

Governance

Board Meetings

The Board meets at least once every three months. The March 2017 meeting was held in Vanimo, Sandaun Province. Two meetings were held in Port Moresby (June and December) and the September meeting was held in Pohnpei, Federated States of Micronesia.

A quorum of six members is required to transact any business of the Board.

Board Member	Meetings Eligible to Attend	Meetings Attended
Mr Loi M. Bakani CMG	4	4
Dr Gae Kauzi	4	3
Mr John Leahy	4	4
Bishop Denny Bray Guka	4	4
Mr Richard Kuna	4	4
Mr Simon Tosali	4	4
Mr Christopher Taylor Hnanguie	2	2

Board Committees

Under the terms of the CBA 2000, from time to time the Board may appoint Committees to perform any of its functions and responsibilities, as defined in the charter of each individual Committee. The Committees generally comprise non-executive Board members.

Two Board Committees operated in 2017.

Board Audit & Governance Committee

The Board Audit & Governance Committee comprised non-executive directors. Mr Alex Tongayu chaired the Committee until the end of his term on the Board in May 2017, when Mr Richard Kuna was appointed Chairman. During the year the members of the Committee were Mr John Leahy, Mr Richard Kuna and Mr Christopher Hnanguie.

The Committee's role is to provide the Board with a level of understanding of the Bank's operations and management, as well as assisting the Board to ensure the Bank's performance in financial reporting, internal control and governance practices and processes meet the required standards and expectations.

The Committee meets four times a year, prior to each scheduled Board meeting.

Board Remuneration & Succession Planning Committee

During the year the Board Remuneration & Succession Planning Committee comprised non-executive directors, Mr John Leahy as the Chairman and Bishop Denny Guka and Mr Simon Tosali as members.

The Committee's primary responsibility is to assist the Board to determine the Bank's staff employment terms and conditions in consultation with other relevant government agencies. It is also responsible for succession planning and for assessing the performance and appointment of the Governor in accordance with the *Statutory Regulatory Authority (Appointment to Certain Offices) Act*.

The Committee meets at least twice a year and otherwise as required.

Internal Management Committees

Several internal committees continued through 2017, each with specific roles and responsibilities set out in individual charters. These included the Executive Committee, the Monetary Policy Committee, the Investment Committee, the Currency Committee, the Tender Committee and the Information Technology Governance Committee.

The Governor chairs the Executive Committee. The Deputy Governor or one of the Assistant Governors chairs the other management committees.

Internal Audit

A strong, independent and objective internal audit function is a key part of the Bank's overall commitment to good corporate governance practice. Over the course of 2017 the Bank's internal audit team undertook an ongoing program of routine audits as well as a number of specific reviews.

Risk Management

During 2017 the Bank continued its program of establishing an effective risk management policy and framework. Risk management activities undertaken during the year included risk assessment for strategic projects, such as currency processes and the currency distribution facility at Lae.

External Checks and Balances

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

Annual Financial Statements Audit

Under the terms of the CBA 2000, the Auditor-General audits the Bank's financial statements every year.

Employment Conditions

Staff employment terms and conditions are subject to approval by the Department of Personnel Management through the Salaries and Conditions Monitoring Committee.

The Governor's terms and conditions are subject to approval by the external parliamentary agency, the Salaries Review Committee.

Peer Review

The Bank continues to maintain a practice of peer reviews with a range of organisations, including the central banks of Australia and New Zealand, the IMF, other regulatory authorities, such as the Australian Prudential Regulatory Authority (APRA) and through its membership of SEACEN and PFTAC.

Co-operation with Government Agencies

The Bank continues its relationships with other Government agencies in its operations, which helps to mitigate the risk of fraud and other threats to the PNG financial and payments system.

Setting the Right Example

The Bank sets its expectations through its Values Statement, which provides clear guidance to Bank employees to conduct themselves with the highest standard of behaviour.

The September 2017 Board Meeting was held in Pohnpei, Federated States of Micronesia (FSM). The meeting provided the opportunity to hold a series of valuable senior level information sessions with FSM government and industry leaders.

Financial Management

The Bank's comprehensive financial accounting systems enable timely recording, monitoring and reporting of all operations transactions.

Operating Income

Total operating income for the year ended 31 December 2017 was K415 million, compared with K352 million in 2016. The income was derived mainly from interest on overseas investments, fees and commissions on foreign exchange trading and interest on domestic investments in government securities.

Operating Expenditure

Total operating expenditure, comprising interest expense and general administration costs, was K242 million, an increase of K61 million from the 2016 level of K181 million.
General administration costs were up by K50 million, largely due to increases in staff costs, Bank premises and equipment costs and impairment in property valuation. Total interest expense was higher than the 2016 level by K9 million, due to an increase in Central Bank Bill holdings.

Unrealised Gain/(Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K193.1 million for the year ended 31 December 2017 which was transferred to the Unrealised Profits/ (Loss) Reserve. This was a direct result of the depreciation of the Kina against most major currencies during the financial year. Gold valuation gain of K23.1 million was transferred to the Gold Reserve.

Appropriation

Under the terms of the CBA 2000, the Board of the Bank of Papua New Guinea, in consultation with the Minister for Treasury, determines the allocation of the Bank's operating profit, including the amount to be allocated to the Bank's retained earnings and any balance of net profits to be paid into the Government's Consolidated Revenue Fund (CRF).

However, if the assets of the Bank are less than the sum of its liabilities and paid up capital, or would be if a payment were made, the Board can decide that no amount is to be paid into the CRF.

Furthermore, under the terms of Section 51(1) of the CBA 2000, net non-operating profits arising from revaluations of the Bank's assets and liabilities and/or from foreign exchange movements shall not be available for payment into the CRF.

Net Operating Profit

The Bank recorded a net operating profit of K173.8 million for 2017, compared with K170.5 for the 2016 year.

Distribution of Profit

	2013 K'm	2014 K'm	2015 K'm	2016 K'm	2017 K'm
Total Comprehensive Income/(Loss)	608.1	139.5	680.7	441.2	407.3
Unrealised profit/(loss)	505.2	49.8	541.2	270.7	233.5
DISTRIBUTABLE PROFIT/(LOSS)	**102.9**	**89.7**	**139.5**	**170.5**	**173.8**
ALLOCATIONS MADE					
Currency Movement Reserve	-	-	-	-	-
Property Revaluation Reserve	15.6	-	-	0.2	-
Unrealised Profits Reserve	517.6	42.2	536.4	251.5	193.1
Gold Reserve	(28.0)	7.6	4.8	19.0	23.1
Retained Profit/(Loss)	102.9	89.7	139.5	70.5	73.8
Consolidated Revenue Fund (Government)	-	-	90.0	100.0*	100

** In consultation with the Minister for Treasury, the Bank paid a dividend of K100 million to the Government in 2017 from retained profits from the 2016 financial year.*

2018 Budget Forecast

	Budget 2018 K'm	Actual 2017 K'm
Operating Income		
Interest received – overseas	89.1	61.2
Interest received – domestic	247.7	322.8
International trading/foreign exchange fees	15.0	17.2
Other income	9.2	14.2
TOTAL INCOME	**361.0**	**415.4**
Operating Payments		
Interest payments – domestic operations	62.6	33.8
Financial markets and external fund manager expenses	11.3	7.7
Staff costs	72.2	67.1
Staff training and development	8.5	5.4
Premises and equipment	22.0	39.7
Depreciation of property, plant and equipment	12.9	12.6
Amortisation of notes and coins production	15.9	10.0
Currency distribution expenses	1.5	1.3
Audit fee	1.7	1.1
Travel	10.3	10.4
Legal and consultancy fees	8.5	7.4
Board and meeting expenses	2.0	1.7
Information & communication technology	8.3	0.0
Special projects	15.8	0.0
Revaluation decrease from property valuation	0.0	30.5
Other expenses	24.8	12.9
TOTAL PAYMENTS	**278.1**	**241.6**
NET OPERATING PROFIT/LOSS	**82.7**	**173.8**

Core Functions

MONETARY POLICY

Formulating and implementing monetary policy is one of the Bank's core objectives under the CBA 2000.

MONETARY POLICY FORMULATION

During the year the Bank released two monetary policy statements as required by the Act, on 31 March and 30 September.

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

The Bank considers development in the same variables each month in setting the policy signalling rate, the Kina Facility Rate (KFR). Assessment of the quarterly Consumer Price Index (CPI) released by the National Statistical Office (NSO) and the monthly Retail Price Index (RPI) compiled by the Bank are key inputs into setting the KFR.

Over the course of 2017 the Bank's estimates and projections of gross domestic product (GDP), balance of payments and inflation were discussed in consultative meetings with the Department of Treasury, which uses the information as inputs into formulating fiscal policy, notably the 2017 National and Supplementary budgets.

Inflation outcomes for 2017 were within the Bank's inflation forecast of 6.0 percent for the year. Considering this, and consistent with the National Government's fiscal policy intention to stimulate economic activity after the LNG construction phase and the slowdown in growth, the Bank took an accommodative approach by maintaining its neutral stance of monetary policy in 2017.

MONETARY POLICY IMPLEMENTATION

The Bank's main instruments of implementing monetary policy are the release of the six-monthly Monetary Policy Statement, the monthly KFR and Open Market Operations (OMOs), involving the auction of Central Bank Bills (CBBs), Treasury bills and Inscribed stock. The Bank also uses its direct policy instrument, the Cash Reserve Requirement (CRR), for liquidity management.

Inflation trended downward in 2017, with 6.0 percent in March, 5.8 percent in June and 5.1 percent in September. Also acknowledging the relatively stable outcomes in other macroeconomic indicators, the Bank maintained its neutral stance of monetary policy by keeping the KFR at 6.25 percent throughout the year. Commercial banks maintained their Indicator Lending Rates (ILRs) between 11.20-11.70 percent.

High levels of liquidity persisted in 2017. Accordingly the Bank continued to issue Central Bank Bills to manage liquidity, complemented by the Government's issuance of Treasury bills and Treasury bonds (Inscribed stocks) for budget financing.

The CBB Tap facility continued to operate in 2017, with the Bank on-selling K200 million Treasury bills as CBBs to the public. The Government retired the K200 million when it matured in August 2017. This facility was replaced by a new Tap facility in April 2017, with a net issuance of K62.2 million.

Repurchase Agreement (Repo)

Trading in the unsecured Repo market was active in the first and last quarters of 2017.

Cash Reserve Requirement (CRR)

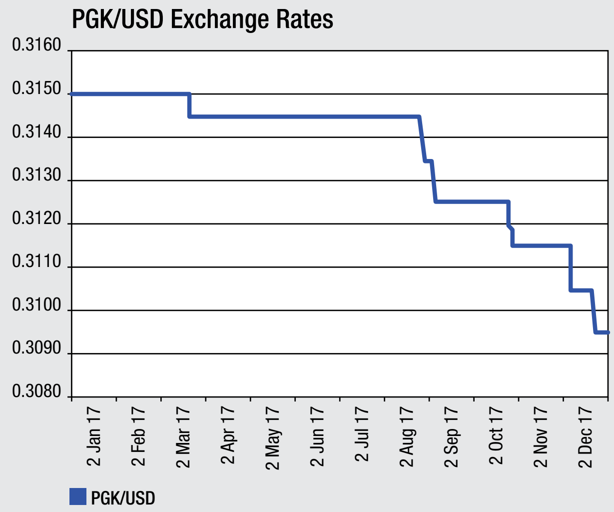
The CRR was maintained at 10.0 percent throughout the year.

Minimum Liquid Asset Ratio (MLAR)

The MLAR remained at zero throughout 2017.

FOREIGN EXCHANGE MANAGEMENT

The level of foreign exchange inflows into the market continued to improve over the course of 2017, helped by improved commodity prices, the end of the El Niño drought and the impact of the foreign exchange market directives, issued in 2016 and in April 2017. The increase in inflows was mainly driven by the Mining, Finance & Business and Agriculture sectors. As a result, the turn-around time for import orders to be filled in the market was faster than in previous years. However, import demand continued to rise, increasing to over K700.0 million in 2017.



While inflows in the Mining, Finance & Business and Agriculture sectors increased, in 2017 foreign currency inflows declined by 0.8 percent compared to a 2.7 percent decline in outflows. The resumptions of Ok Tedi Mine after the El Niño drought, improved commodity prices. The decline in outflows was mainly attributed to the decline in servicing of small transactions.

Major Sector Contributions to Foreign Exchange Flows

	2016 K'm	2017 K'm	Change
Inflows			
Mining	4,143.8	4,737.0	14%
Finance & Business	1,873.9	2,184.0	17%
Gas	403.4	594.0	47%
Agriculture	2,825.7	2,207.0	-22%
Others*	4,623.8	3,988.1	-14%
Total Inflows	**13,870.6**	**13,710.1**	**-1%**
Outflows			
Finance & Business	2,873.4	3,199.0	11%
Retail	2,024.8	2,379.0	17%
Manufacturing	1,538.6	1,771.0	15%
Petroleum	1,471.3	1,708.0	16%
Others**	6,915.2	5,293.3	-23%
Total Outflows	**14,823.3**	**14,350.3**	**-3%**

** 'Others' include Construction, Forestry, Manufacturing, Retail and Wholesale.*
*** 'Others' include Agriculture, Construction, Forestry, Gas, Marine, Mining, Transport and Wholesale.*

Kina Trading Margin

In 2017 all AFEDs complied with the kina trading margin, keeping the margins for quoting foreign exchange deals within the specified 75 basis points limit above and below the interbank mid-rate throughout the year.

Intervention

The Bank intervened regularly in the domestic foreign exchange market to provide foreign currency liquidity. In 2017 the Bank sold a total of US$226.7 million in the domestic foreign exchange market, lower than US$424.0 million in 2016. Due to the mismatch in foreign exchange flows, the Bank also provided US Dollars to targeted sectors that are of national and strategic importance.

Core Functions

Exchange Rates

	End of Dec 2016	End of Dec 2017	YTD (% Change)
PGK/USD	0.3150	0.3095	-1.7%
PGK/AUD	0.4354	0.3967	-8.9%
PGK/EUR	0.2989	0.2590	-13.3%
PGK/GBP	0.2564	0.2299	-10.3%
PGK/JPY	36.75	34.90	-5.0%
PGK TWI	32.00	29.49	-7.8%

Foreign Currency and Interest Rates Risks

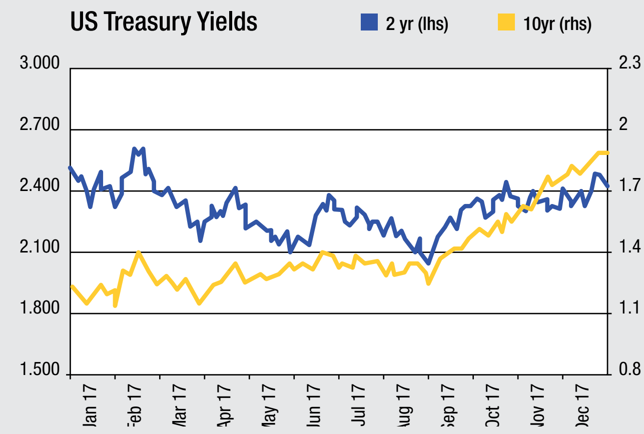
Global economic growth gained momentum in 2017. Contributing factors included loose financial conditions, more supportive fiscal policies in some major economies following years of harsh fiscal consolidation, low inflation and strong global trade. However the pace of economic recovery was restrained by a number of natural disasters, geo-political events (such as Brexit and elections in some of the major economies in Europe) and heightened uncertainty related to potential policy changes in the US and other major economies.

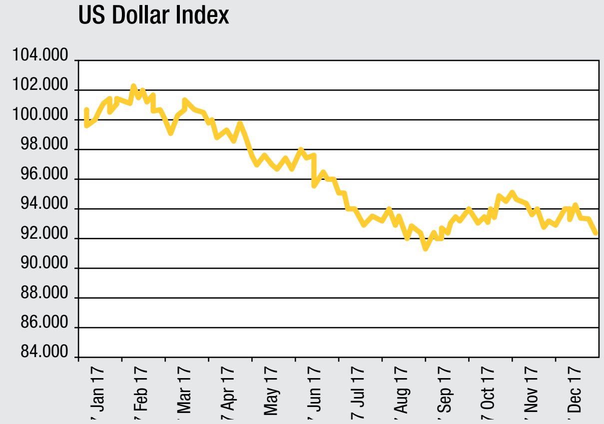
Responding to this economic climate, many central banks in developed economies maintained accommodative monetary policy stances, with the exception of the US. Interest rates were maintained at or close to record lows and some major central banks continued to use unconventional monetary policy tools to stimulate domestic demand.

The Euro area economy also continued to recover on the back of accommodative monetary policy, solid job gains and improved global demand.

Emerging economies generally fared well in 2017 with a backdrop of steady global growth, a pickup in industrial commodity prices and modest inflation rates included in the contributing factors. US dollar weakness continued to fuel momentum in the Chinese economy. Brazil was the strongest index market.

Interest rates in the US continued upward from 2016. At its last meeting for 2017, the Federal Reserve announced its decision to raise interest rates by 25 basis points to 1.50 percent and foreshadowed further gradual increases in 2018. By the third





quarter of 2017, growth in the US had risen to 3.3 percent quarter on quarter, as economic activity gained traction and the unemployment rate fell to a near all-time low.

In response to these market conditions, the Bank maintained an accommodative portfolio duration and currency exposure strategy throughout 2017.

FOREIGN RESERVES MANAGEMENT

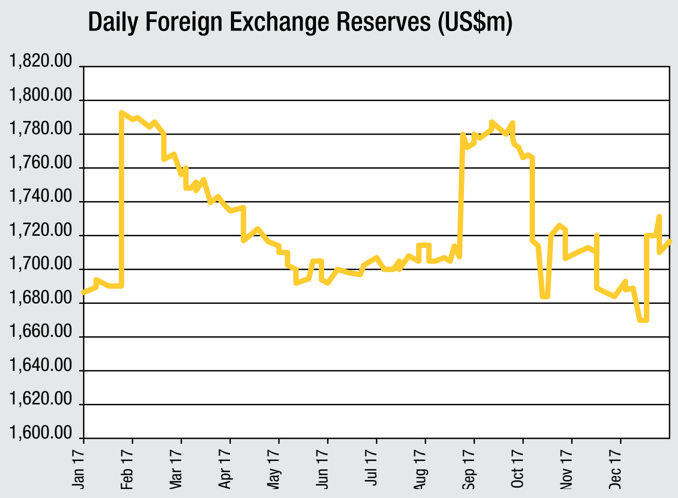
The Bank of Papua New Guinea is responsible for the management of PNG's gold, foreign exchange and other international reserves.

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

- support price stability (a core objective of the Bank's monetary policy)
- service the State's foreign debt
- minimise the impact of external shocks on the domestic economy.

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

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



In 2017 the level of foreign reserves increased from US$1.685 billion (K5.3 billion) to US$1.718 (K5.463 billion) by the end of December 2017. The increase in foreign reserves was attributed to larger than expected inflows from concessional loans and dividend payments, mainly from Eda Oil and Ok Tedi mine.

Inflows into the foreign exchange reserves in 2017 totalled US$496.2 million, compared to outflows of US$515.89 million. Inflows comprised overseas loans totalling US$205.4 million (concessional and commercial), Mineral Tax of US$212.0 million, LNG proceeds of US$18.4 million (royalties and development levy) and investments income of US$8.0 million.

Outflows mainly comprised the Bank's intervention in the domestic foreign exchange spot market of US$226.6 million and Government foreign debt repayments of US$211.9 million.

Fund Performance

In-house managed funds

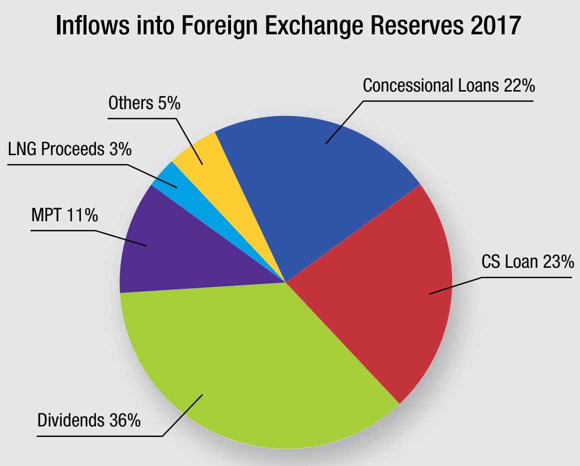
The Bank's in-house managed reserves generated portfolio returns of 1.66 percent over the year to December 2017, compared to 1.20 percent in 2016. The return was generated mainly from Australian dollar money market and bond investments.

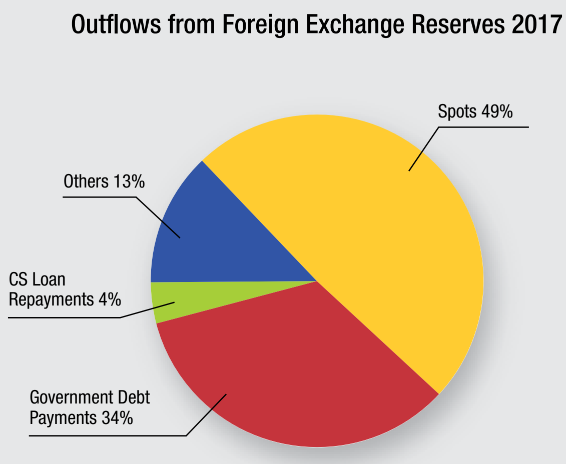
Outsourced funds

The Bank's outsourced funds in 2017 increased to a total value of US$1,151.70 million with an average return of 1.18 percent. This compares favourably to the Citi Group 1-3 year fully hedged World Government Bond Benchmark return of 0.92 percent.

Average Annual Return (%)

Source	2017	2016	2015
In house funds management	1.66	1.20	0.97
Outsourced funds	1.18	1.59	0.76
Benchmark Citi Group 1-3 year World Government Bond Index	0.92	1.18	0.71





Composition of Foreign Exchange Reserves

The total foreign exchange reserve level as at 31 December 2017 was US$1,718.31 million.

	Foreign Exchange Reserves 2017					
	In-house Managed Reserves	Externally Managed Reserves	Gold	Total Invested Foreign Exchange Reserves	IBR	Total Foreign Exchange Reserves
Date	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)
31 Dec 17	510.74	1,151.70	55.63	1,718.06	0.25	1,718.31
31 Dec 16	496.81	1,138.48	49.86	1,685.14	0.25	1,685.39
Change	13.93	13.22	5.77	32.92	0.00	32.92
Change (%)	3%	1%	12%	2%	0%	2%

International Transactions Monitoring

Foreign Exchange Control Directives

Following on from a series of directives in 2015 and 2016, the Bank issued additional foreign exchange control directives in April 2017 to the authorised foreign exchange dealers (AFEDs).

The directives expanded the coverage of the trading margin to all currencies and transactions, except over-the-counter cash exchange transactions.

The 2017 Directive prohibits the settlement of trade finance arrangements in foreign currency and sets conditions for AFEDs to submit their trading book positions and their inter-bank turnover reports.

All authorised dealers complied with the directives over the course of 2017.

Foreign Currency Accounts (FCA)

In line with a previously issued directive, the Bank received 167 applications from onshore foreign currency account holders, explaining their need for such an account. The Bank approved 60 applications and declined the others, advising these FCA holders to close their accounts.

The directives also make special allowances for specific cases. During 2017 the Bank received and reviewed 21 new applications to open domestic and offshore foreign currency accounts. The Bank approved 14 of these applications, declining the remaining 7 applications.

Gold Export Licences

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

Applications received in 2017	19
Applications approved and renewed – Gold Exports Limited – Golden Valley Enterprises Limited – Issacc Lete Lumbu Gold Buyers Ltd – Italpreziosi South Pacific Limited – Vertic Ltd – Aviga Impex Limited – Meekom Minerals Limited – Niella AU Limited	8
New applications approved – Bougainville Gold Exchange Limited – International Bullion Group Limited – Panners Gold Limited – Metals Refining Operations – Mi-Do Gold Buyers & Exporters Limited	5
Applications requiring more information	5
Applications cancelled	1

Domestic Lending in Foreign Currency

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

Applications approved and renewed in 2017	8
Value of transactions (K'm)	K402.4

Contingent Guarantees in Favour of Non-Residents

The Bank's prior approval is required to issue guarantees (or indemnities) for the benefit of non-residents.

Applications received in 2017	6
Applications approved	6

Cash taken out of PNG

The Bank's prior approval is required to remove or take cash and numismatic banknotes in excess of K20,000.00 in value out of the country.

Applications received and reviewed in 2017	13
Applications approved	13
Value of approved transactions (K'm)	0.7
Value of physical cash removed or taken out of PNG (K'm)	0.1
Value of approved numismatic notes exported (K'm)	0.6

FINANCIAL SYSTEM

The financial system of PNG includes institutions authorised, regulated and supervised by the Bank of Papua New Guinea ('regulated institutions') and financial institutions regulated by other authorities.

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

This is achieved through:

- Setting licensing requirements
- Promoting proper standards of conduct
- Setting prudential standards and guidelines for sound and prudent business practices
- Ensuring the institutions comply with the relevant legislation and prudential standards through effective supervisory activities.

The Financial System

Type of institution	31 Dec 2017	31 Dec 2016
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	12	12
Savings & loan societies (SLSs)	22	22
Authorised Trustees (ASFs)	4	4
Licensed investment managers (LIMs)	5	5
Licensed fund administrators (LFAs)	3	3
Life insurance companies (LICs)	4	4
Life insurance brokers (LIBs)	4	4
Authorised money changers	8	9
Money remitter	1	1
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operator	1	1
Total assets (K billion)	**50.2**	**47.9**
Banking industry (%)	74.7	76.0
Authorised Trustees (ASFs) (%)	24.4	23.2
LICs (%)	0.9	0.8
Total deposits (K billion)	**28.2**	**27.9**
Commercial banks (%)	94.4	94.8
LFIs (%)	2.8	2.1
SLSs (%)	2.1	2.4
Microbanks (%)	0.7	0.7
Total loans outstanding (K billion)	**18.5**	**17.5**

REGULATION AND SUPERVISION

Licences and Approvals

In 2017 the Bank considered and made decisions on several applications regarding expansion, closure, relocation of operations and new licences. During the year, the Bank:

- assessed 9 applications (granted 1 licence, gave 2 approvals in principle, rejected 1 application, 5 applications in progress)
- revoked 1 licence
- granted 5 branch openings, 1 relocation and 1 extension of banking hours.

In January 2017 the Bank gave approval to BSP Finance Limited to establish a subsidiary in Solomon Islands. The subsidiary also received regulatory approval from the Central Bank of Solomon Islands to operate.

In April 2017 BSP Finance Limited entered into a partnership with RMA Financial Services, following approval from the National Bank of Cambodia. The name of the enterprise was changed from RMA Financial Services to BSP Finance Cambodia.

Kina Bank Limited and its major shareholder Fu Shan Investments Limited (Fu Shan) continued the divestment process of the escrowed shares of Fu Shan with the Bank. The Bank of Papua New Guinea continued to take an active role in the process.

Directives

In November 2017 the Bank completed drafting 4 key directives with the assistance of the World Bank, and released them for industry comment. The directives aimed at supporting the *National Payments System Act 2013*, with the focus on payment oversight, retail payments instruments, electronic funds transfer and agents.

Prudential Standards

Superannuation and Life Insurance

The prudential standards for superannuation funds on Management Expense Ratio and Bad and Doubtful Debts were revoked in April 2017.

Supervisory Enforcement Actions

Reviews

As part of its supervisory role, the Bank conducts prudential reviews or examinations of regulated institutions, aiming to strengthen their risk management systems and compliance capacity.

During 2017 the Bank conducted 15 on-site prudential reviews or examinations, including reviews on the 4 commercial banks, 3 licensed financial institutions, 8 savings and loan societies, 1 authorised superannuation fund and 1 fund administrator.

The Bank also held nine prudential consultations with 2 licensed financial institutions, 1 savings and loan society, 3 life insurance companies and 3 life insurance brokers.

Supervisory Colleges

A Supervisory College provides an opportunity for supervisors from different jurisdictions to meet with representatives of a cross-border bank, to discuss the bank's activities and operations. The aim is to help college members develop a better understanding of the cross-border bank's risk profile and vulnerabilities, and to provide them with a framework for addressing key issues from a supervisory perspective.

In 2017 the Bank participated in three supervisory colleges.

Employee Superannuation Contribution Enforcement

During the year the Bank, Nambawan Super and Nasfund visited non-complying employers in a number of regional centres.

The Bank also collaborated with other partners and the regulatory authorities to promote awareness of and compliance with the range of employment and associated laws operating in PNG.

As part of these awareness building activities, the Bank participated in a workshop in November, which also included the Internal Revenue Commission (IRC), the Investment Promotion Authority (IPA), the Department of Labour and Industrial Relations (DLIR) and a number of superannuation funds. Representatives from over 200 security firms attended a workshop, held in Lae, Morobe Province. The Bank and its partners also met with the Morobe Provincial Administrator and the Chamber of Commerce, Lae Chapter, to enlist their assistance in encouraging local companies to comply with the superannuation laws.

Joining a taskforce with DLIR, IPA, PNG Immigration & Citizenship Service Authority, PNG Customs and Department of Police, the Bank also visited several NCD-based foreign-owned organisations, to confirm their compliance with the *Superannuation (General Provisions) Act 2000.* A number of employer organisations were found to be non-compliant and further enforcement actions were ordered.

The Bank conducted an advertising campaign during the year, generating over 90 queries from members of the public about superannuation issues. Complaints about employers were referred to the ASFs to check on the compliance status of the employers.

Statutory Administration, Management and Liquidation Activities

In 2017 Police & State Services Savings and Loan Society and CBO Savings and Loan Society were placed under administration.

The liquidation process for Workers Mutual Insurance (PNG) Limited and Eastern Highlands Savings and Loan Society Limited continued through the year.

Regulation and Supervision Development

Online reporting

The Bank continued its focus on online reporting. By the end of 2017 most institutions in the financial system had moved to online reporting, including the 4 commercial banks, 11 of the 12 LFIs, the 4 ASFs, 2 of the 4 LICs and 4 of the 22 SLSs.

Directors Pipeline Project

In 2017 the Bank established a task force with PNG Institute of Directors (PNGID) and the University of PNG (UPNG) to establish a framework through which Papua New Guineans can become qualified company directors.

The program was designed to provide training and experience in corporate governance practice by means of three components. The first component is a post-graduate diploma program offered by UPNG. The second, provided by PNGID aims to build good governance capacity of current board members. The third, a Director Cadetship administered by the Bank in collaboration with LFIs, consists of a full ‘fit and proper person’ recruitment process for candidates for board positions on an LFI as a trainee director.

ASF Board Governance Reviews

In 2017 the Bank conducted board governance and performance reviews on ASFs Nambawan Super, NasFund and Defence Force Retirement Benefits Fund and their subsidiary companies. The resulting reports were provided to each ASF and its subsidiaries with recommendations for improvement.

Risk Based Supervisory Framework Enhancement Program

At the Bank’s request, a Pacific Technical Assistance Centre (PFTAC) mission visited the Bank to help enhance the supervision framework and develop a functioning risk-based approach to supervision.

The mission’s initial visit in February resulted in a series of recommendations. The first phase of the resulting project was conducted in the last quarter of the year. In this phase the Bank produced a quantitative risk rating model, a supervisory action planning process and a supervisory action framework.

Financial Services Sector Review

The Financial Sector Development Strategy (FSDS) was finalised in 2017 and endorsed by the Bank and the Department of Treasury, ready for submission to the National Executive Council for approval and subsequent implementation.

PAYMENT SYSTEM

NATIONAL PAYMENT SYSTEM RESPONSIBILITIES

In line with the *National Payment System Act 2013*, the Bank of Papua New Guinea has responsibility for the National Payment System (NPS), which aims to transfer money from payer to payee, effectively and efficiently. The NPS is part of the core financial infrastructure that supports the PNG economy. The Kina Automated Transfer System (KATS) was developed to implement the NPS.

Over the course of the year the Bank continued to enhance and improve the NPS.

Combatting money laundering

Following the implementation of the Anti-Money Laundering (AML) module in KATS in 2016, the Bank started work on developing the reporting structure in 2017.

During the year the Bank proceeded with the implementation of the SWIFT Sanction Screening tool to monitor the internal and national lists required under AML/CTF reporting.

Cheque clearance

In January 2017 the Bank reduced the cheque dishonour period from three to two business days, in so doing enabling faster clearance and access to funds.

National Switch

The National Switch project gained momentum during 2017 with the selection and awarding of the contract of the business solution that will operate the Switch.

When in place, the Switch will provide access and system compatibility to all payment service providers, including mobile banking service providers, enabling all providers to exchange and use information across the NPS. The aim is to give all providers equal access to the payments system. The Switch will also facilitate the role of Digital Financial Services, an area that is emphasised in the National Financial Inclusion Strategy 2016-2020.

Payments Education and Awareness

The Bank continued with its program of building awareness of the NPS, following on from the release of the KATS information booklet in 2016. The 2017 awareness program, consisting of a series of public workshops around PNG, focused on investment in Government securities to foster a savings culture and explain the role of KATS to facilitate investing.

The Bank's other NPS responsibilities include currency management and government banking and agency services.

Currency management

Currency banknotes and coins

One of the Bank's key responsibilities is to issue currency notes and coins. This role involves ensuring an adequate supply of quality currency in circulation, withdrawing damaged and soiled banknotes from circulation and monitoring the overall supply of currency.

Bank note supply

The Bank's long-standing supplier agreement for printing banknotes was reviewed, updated and finalised by the end of 2017. In line with best practice corporate governance, the new agreement includes a tender process for materials supply.

Clean banknote policy

The Bank continued the Clean Banknote Policy Awareness program during the year. This important ongoing activity seeks to educate the general public on proper ways of handling banknotes, the different security features on banknotes, how to identify different characteristics of unfit notes and how to tell genuine banknotes from counterfeits.

Currency distribution

Cash Distribution Centres (CDCs)

The Bank distributes cash from its head office in Port Moresby and from CDCs in Lae, Morobe province and Kokopo, East New Britain province.

Port Moresby currency management modernisation

During the year the Bank commenced a project to update the currency operation at Port Moresby head office. The project involves upgrading security and work processes and introducing a management system to control and monitor supply and distribution.

In 2017 the Bank achieved several milestones in the project, including redesigning the facility, awarding the construction contract, selecting the supplier of currency processing machines and software and appointing a security consultant.

During the year the Bank also implemented an electronic queue management system improving the workflow of customer services in the Bank's internal banking chamber.

Lae Currency Distribution Facility

Progress on the Lae CDF building project slowed in 2017. Work on the foundations took longer than expected, a result of special requirements associated with the building's purpose. However, by the end of the year the structural work neared completion.

Currency development

Banknotes re-sized

As part of the banknote reform program to differentiate the sizes of each denomination, the Bank re-sized the K2 note to 70mm x 125mm and the K50 note to 70 x 145mm, taking delivery of the re-sized notes in December 2017. Both banknotes retained their original design elements and security features of the existing notes. An additional security feature, the SPARK® Live Truspin, was added to the K50 banknote.

APEC Commemorative Note and Coin

During the year the Bank commissioned a limited supply of a special K100 banknote to commemorate the 2018 APEC Summit to be hosted by the Government of Papua New Guinea. The Bank also commissioned a special coloured 50 toea circulating coin and numismatic coin depicting the APEC logo design. Both the commemorative note and coin will be released in 2018.

Assistant-Governor Elizabeth Genia (second from right) meets crew members on the construction site of the Lae Currency Distribution Facility.

Banknotes and Coins in Circulation

Total currency in circulation decreased slightly to K2.07 billion in 2017, down from K2.11 billion in 2016. The decline was attributed to a lower demand for K20, K50 and K100 notes in 2017 than in the previous year. The Bank also recorded a slight increase in demand for K1 and 20 toea coins in 2017 over the 2016 figures.

Notes and Coins in Circulation

Notes Denomination	Value K'm 2017	Value K'm 2016	Value K'm 2015	Value K'm 2014
K2	56.1	56.2	52.7	49.9
K5	57.7	59.1	52.4	51.4
K10	84.1	85.1	72.6	69.0
K20	192.2	210.2	185.0	207.4
K50	488.7	491.1	407.2	445.6
K100	1,112.7	1,132.4	969.0	953.51
Sub Total	**1,991.5**	**2,034.1**	**1,738.9**	**1,776.8**
Coins Denomination				
K2	0.2	0.2	0.2	0.2
K1	26.8	25.4	24.3	23.2
50 Toea	7.5	7.1	6.8	6.5
20 Toea	21.6	20.9	20.1	20.1
10 Toea	21.9	21.1	20.1	19.4
05 Toea	6.7	6.6	6.4	6.2
Sub Total	**84.7**	**81.3**	**77.9**	**75.6**
Total	**2,076.2**	**2,115.4**	**1,816.8**	**1,852.4**

New Notes and Coins issued in 2017

Notes Denomination	Value K'm 2017	Value K'm 2016	Value K'm 2015	Value K'm 2014
K2	21.8	21.3	21.7	23.7
K5	23.3	25.6	24.9	24.9
K10	25.9	37.7	34.5	33.5
K20	51.2	93.7	74.8	92.6
K50	154.3	171.8	142.5	145.7
K100	101.0	256.8	215.0	269.9
Sub Total	**377.4**	**606.9**	**513.4**	**590.3**
Coins Denomination				
K1	1.40	1.00	1.20	1.70
50 Toea	0.37	0.34	0.40	0.00
20 Toea	0.70	0.59	0.14	0.80
10 Toea	0.84	0.86	0.83	0.60
05 Toea	0.12	0.20	0.28	0.07
Sub Total	**3.42**	**2.99**	**2.85**	**3.17**
Total	**380.83**	**609.89**	**516.25**	**593.47**

Destruction of Soiled Banknotes

	VALUE OF SOILED NOTES DESTROYED			
Notes Denomination	K'm 2017	K'm 2016	K'm 2015	K'm 2014
K2	20.1	19.7	16.9	23.4
K5	24.1	18.5	22.7	24.7
K10	26.3	23.6	31.7	46.0
K20	54.7	67.9	99.5	102.6
K50	112.1	109.8	152.5	144.1
K100	125.9	142.7	157.5	199.9
Total	**363.3**	**382.2**	**480.8**	**540.8**

Numismatic Items

The Bank sells commemorative items to the public and currency collectors worldwide. Total value of sales was K0.6 million in 2017, compared to K0.014 in 2016.

The most popular items purchased during the year were the 2016 re-sized K5 sheets, 2012 gold coin sets, 2015 XV Pacific Games and 2015 UPNG coin sets. The Bank also produced a special coloured silver K5 coin to commemorate the 2017 Rugby League World Cup.

GOVERNMENT BANKING AND AGENCY SERVICES

Government Banking

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

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

Over the course of 2017 financial institutions and other organisations continued making tax payments through KATS to IRC accounts maintained at the Bank. Government and other statutory authorities' cheques were cleared through the Automated Clearing House (ACH), part of the KATS cheque truncation facility. The ACH and other improvements to cheque processing procedures demonstrated their effectiveness, with no major incident of fraud reported in Government drawing accounts during 2017.

Apart from the 45 National Departments' Drawing Accounts, the Government also maintained a total of 87 trust accounts with the Bank during 2017. The trust accounts balance as at 31 December 2017 was K333.0 million, compared with K319.8 million at the end of 2016. During the year, large transactions continued to be processed for the Provincial and District Services Improvement Projects, Provincial Governments grants, Tuition Fee Free Education, Autonomous Bougainville Government Grants, Medical Supplies and Infrastructure Developments Projects co-ordinated by Department of Works.

In 2017 the National Government also implemented its Integrated Financial Management System (IFMS) roll-out program for the Provinces and Districts. The Provinces and Districts will continue to maintain their Drawing Accounts at the Bank. Pilot projects were implemented in East New Britain and Central Provinces, with two Provincial Finance Drawing Accounts and eight District Finance Drawing Accounts opened and operating.

The automation of PNG Custom Service payments went live in January 2017, enabling e-payment processing for all payments and automatic reconciliation with Customs' ASYCUDA System.

Temporary Advance Facility

The National Government operates a Temporary Advance Facility (TAF) with the Bank of Papua New Guinea to meet short-term cash flow mismatches during the year. The TAF is renewable every six months on request by the Minister for Treasury after the outstanding balance is repaid.

The TAF limit remained at K200 million. During 2017 the Government used the facility frequently to meet temporary mismatches in its cashflow.

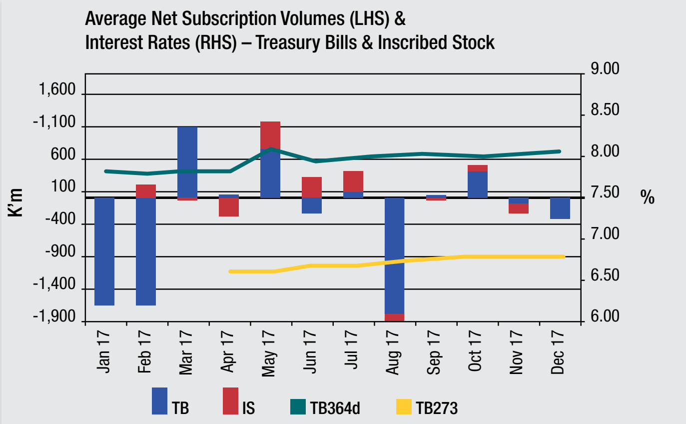
Government Agent Operations

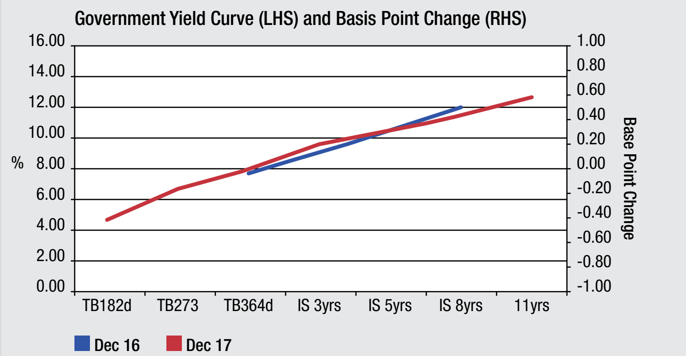
The Bank of Papua New Guinea is the agent for the Government as an authorised issuer, registrar and paying agent for Government securities.

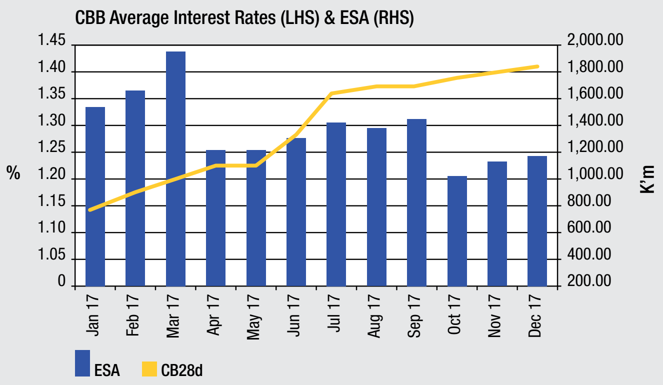
Treasury Bills and Treasury Bonds (Inscribed Stock)

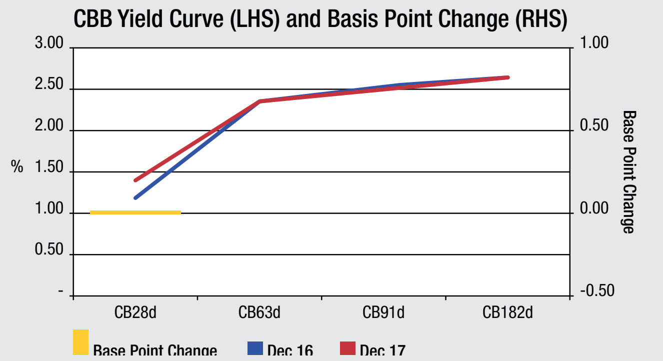
The Bank continued to consult closely with the Government on matters concerning the coordination of budget financing. In 2017 the Government issued its Treasury bills in 91, 182, 273 and 364 day terms. The Government introduced 273 day term in April 2017 to manage its rollover risks at the weekly auctions. Treasury Bonds were issued monthly in the 3, 5, 8 and 11 year terms.

The interest rates for Treasury bills and Bonds remained steady in 2017. The Treasury Bills and Bonds auctions in 2017 were mostly undersubscribed reflecting low demand.









Central Bank Bills

The Bank issued its Central Bank Bills (CBB) mainly in the shorter-dated terms, 28, 63 and 91 days, to implement its monetary policy. In 2017 the CBB interest rates remained stable with an upward bias.

Banking system liquidity, as measured by the Exchange Settlement Account (ESA) balances, continued to remain high, around K1.0 billion. The high ESA level reflected retirement of investments in CBBs and Government securities by the two foreign commercial banks complying with their sovereign exposure rules.

'SLACK Arrangement'

In 2017 the Bank continued to take up some of the under-subscriptions under the 'Slack Arrangement' with the Department of Treasury. The Bank took up the 'slack' based on the agreement that these funds were to be used to finance priority government expenditures tied to health, education and key Infrastructure.

Because taking up the slack creates an injection of liquidity, the Bank continued to sterilise this impact by on-selling these Government securities to the commercial banks and the public. To this end a considerable amount of CBBs was issued to commercial banks, non-bank financial companies and savings and loans societies.

Tap facility

The CBB Tap facility aims to encourage investment by individuals, to help develop a savings culture within PNG society. Prior to April 2017 the Tap facility was offered against a purchase of K200.0m from the Department of Treasury. After that date the Tap facility was issued by the Bank against the purchases of undersubscriptions at the Department of Treasury's auctions. Under the new Tap arrangements, both Treasury bills and Treasury bonds are offered. The bonds have longer maturity terms, from up to 2, 4, and 10 years, and the minimum purchase amount was reduced from K10,000 to K5,000 and in multiples of K1,000 thereafter, to encourage investment by individuals.

Government debt

At the end of 2017 total borrowing by the Government from the public amounted to K17.2 billion, an increase of K0.7 billion from the end of 2016. The borrowing comprised K8.0 billion Inscribed stock (2016: K7.8 billion) and K9.2 billion in Treasury bills (2016: K8.7 billion).

Treasury bonds

	K'm
Issued in 2017	888
Maturities in 2017	682
Net Issuance	206
Outstanding as at 31 December 2017	7,979
Outstanding as at 31 December 2016	7,773
Increase in balance	206
BPNG holdings 31 December 2017	2,098
BPNG holdings 31 December 2016	1,899
Net increase in BPNG Holdings	199

Treasury bills

	K'm
Outstanding as at 31 Dec 2016	8,663
Issued in 2017	11,648
Slack issued in 2017	1,599
Maturities in 2017	11,117
Slack maturities in 2017	2,201
Net issuance	531
Outstanding as at 31 Dec 2017	9,194

Central Bank Bills

	K'm
Outstanding as at 31 Dec 2016	2,012
Issued in 2017	23,039
Slack issued in 2017	13,422
Maturities in 2017	22,368
Slack maturities in 2017	15,925
Net issuance	671
Outstanding as at 31 Dec 2017	2,012

Central Bank Bill Tap facility

	K'm
Outstanding as at 31 Dec 2016	179
Balance at 31 Dec 2016	83
BPNG Bond Tap Issued in 2017	154
CBB Tap Maturities in 2017	289
Net issuance	63
Outstanding as at 31 Dec 2017	20

Secondary market development

Throughout the year the Bank continued to use the Registry and Money Market System (RMS) to facilitate secondary market transactions.

Without an active secondary market, primary market investors are unable to sell their Government securities stock quickly in the event they have liquidity needs. The Bank continued to assist such investors purchase their Government securities on the secondary market.

Secondary Functions

ECONOMIC ADVICE TO GOVERNMENT

The Bank provides the National Government with economic advice to help optimise fiscal and economic policy. The Governor is required to advise the Treasurer the effect Government policy will have on monetary policy.

The Governor or his representatives provide economic advice through presentations at various official forums and the Governor's 6 monthly Monetary Policy Statements. Bank staff also present economic information at technical meetings attended by officers from the Department of Treasury and other Government departments.

In accordance with the CBA 2000, special reports must also be provided to the Minister on adverse conditions that threaten the country's monetary stability, affect monetary policy or the economic and financial policies of the Government. No such reports were provided during the year.

INCREASING ECONOMIC KNOWLEDGE

Research activities are key to increasing economic knowledge. The Bank continues to undertake a number of activities to aid policy analysis, decisions and forecasts.

Research Papers

The Bank worked on a number of research papers over the course of 2017. The subjects included:

- Equilibrium Real Effective Exchange Rate
- Excess Liquidity and Its Impact on Monetary Policy
- Effectiveness of Foreign Exchange Intervention in PNG
- Dynamic Effects of Personal and Company Income Tax Change on Government Revenue, Employment, GST and GDP in PNG
- Macroeconomic Impact of Oil Price Shocks in PNG

Business Liaison and Employment Surveys

The Bank continued to collect its routine survey responses for the Business Liaison Survey and Employment Survey, to assist in its understanding of the private sector's impact on macroeconomic growth.

In 2017 the Bank began producing and disseminating to businesses the BLS company reports. The goal was to achieve active engagement with all businesses on the BLS register and improve BLS response rates.

The Bank also began producing a report of the results of the Business Sentiment Survey, which is used to inform the biannual monetary policy stance.

During the year the Bank finalised its work on the BLS resampling. From this a new sample of companies from the private sector was selected to participate in the Bank surveys. The sampling project aimed to ensure that the data produced from the survey reflects the current level of business activity and trends.

Strategic Research Activities

Collaboration with Griffith University

In December the Bank signed a Memorandum of Understanding with the Australian institution Griffith University. The partnering agreement aims to foster collaborative research, build enhanced research capability and capacity for both organisations and facilitate peer review on research in preparation for publication.

Expansion of Monetary and Financial Data Coverage

In 2017 the Bank continued work on addressing data quality and coverage, in line with IMF recommendations, as part of the Monetary and Financial Statistics project.

Secondary Functions

Review of the Kina Facility Rate (KFR)

The Bank continued to work on the review of the KFR and monetary policy transmission mechanisms, producing a set of policy recommendations and options, ready for collaborative research and development.

Balance of Payments System

During the year work on improving the compilation of the Balance of Payments continued. The research considered a range of factors, including coverage, reliability, data sourcing and frequency. Work also progressed on the International Investment Position.

The Bank also achieved improved access to trade data from the Automated System For Customs Data (ASYCUDA) and with improvements to the commercial banks' standard of reporting on domestic foreign currency account balances.

FACILITATING FINANCIAL SERVICES DEVELOPMENT AND INCLUSION

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

The main focus in this area is the Bank's commitment to the successful completion of the National Financial Inclusion Strategy 2016-2020.

Financial inclusion and financial literacy

Key results in 2017	End 2017	End 2016
Total deposit accounts	3,066,133	2,673,782
Number of access points	15,391	14,571
Number of branches	211	215
Number of ATMs	463	463
Number of EFTPOS merchants	14,308	13,460
Number of agents	409	573
Number of mobile financial service accounts	509,033	497,169

The Centre for Excellence in Financial Inclusion (CEFI)

In 2017 the Bank continued to support the work of CEFI, with Governor Bakani CMG as the Chairman.

CEFI is the premier organisation responsible for coordinating all financial inclusion activities in PNG, through the implementation of the National Financial Inclusion and Financial Literacy Strategy (NFIFLS).

During 2017 the National Financial Inclusion Policy was drafted, providing a framework through which all government agencies support financial inclusion efforts.

Over the course of the year CEFI's activities focused on the nine priority areas outlined in the NFIFLS: digital financial services, inclusive insurance, financial consumer protection, informal economy and agriculture finance, SME finance, resources sector engagement (mining areas), data collection and dissemination and Government engagement.

Building effective information flow was a key focus during 2017. To this end, work started on developing a digital dashboard to show the status of financial inclusion activities. As well, financial inclusion information from LFIs was provided to CEFI, the Bank of Papua New Guinea and the Alliance for Financial Inclusion (AFI) for their websites. CEFI also launched a quarterly newsletter (October), established contact with mainstream and social media outlets and revamped the CEFI website.

Other achievements included a study on mobile payments for cocoa farmers in Bougainville, in partnership with Mi-Bank and Market Development Facility and the launch of the Gender and Social Inclusion Policy in May.

Conferences on issues associated with financial inclusion were successfully staged during the year. In May CEFI and the Bank of Papua New Guinea hosted the Pacific Islands Regional Initiative (PIRI), an annual high-level forum for all Pacific Region Central Bank governors. In August CEFI and the Bank collaborated with a number of organisations, including The Foundation for Development Cooperation, Microfinance Pasifika and the Pacific Financial Inclusion Program (PFIP) to host the Financial Inclusion Innovation Summit.

Microfinance Expansion Project

MEP's overarching objective is to reduce poverty by providing financial services to the financially illiterate and potential businesses.

The MEP supported further development of the microfinance sector in PNG in 2017.

Achievements over the course of the year included:

Financial education

Over 200,000 people participated in financial education activities.

Products

16,655 new accounts were opened.

3 Partner Financial Institutions (PFIs) established new delivery channels using ATMs.

The total deposits portfolio increased to K265 million.

The total lending portfolio reached K165 million.

Industry capacity

PFIs recorded improvements in operating results.

The quality of the average lending portfolio improved.

The Risk Share Facility coverage grew.

Profitability improved.

Over 4,500 people received business development service training.

Industry supervision

Implementation of Microfinance Industry standards.

The Gender Equity and Social Inclusion policy was launched.

FINANCIAL INTELLIGENCE MONITORING

The Financial Analysis and Supervision Unit (FASU) is an independent unit with the role of coordinating efforts to protect PNG against money laundering and terrorist financing (AML/CTF) and other serious financial crime.

FASU continued AML/CTF activities throughout 2017, including signing information sharing agreements with other financial intelligence operations, local and international. In December FASU received an onsite visit by Egmont Group, an informal network of international financial intelligence units, to gauge FASU's readiness for membership. Egmont Group members share information with each other and have access to INTERPOL's database.

AML/CTF highlights in 2017 included:

The draft PNG National Risk Assessment report on money laundering and terrorist financing risks in PNG was completed. The Asian Development Bank funded a consultant to help with this project.

The draft National AML/CTF Strategic Plan 2017-2022 was finalised, with assistance from AusAID.

Technology was developed to help reporting entities improve their online reporting, with funding from AusAID.

Three year financial investigation commenced into forestry crime, with assistance from INTERPOL and funding from the German government.

Conducted awareness and education forums on the roles and responsibilities of the FASU and the obligations of the reporting entities.

SOVEREIGN WEALTH FUND SECRETARIAT

Development of the SWF Secretariat slowed during the year.

Institutional Support

STRATEGIC AND OPERATIONAL MANAGEMENT

In the second year of implementation of the Bank's Strategic Plan 2016-2020, the focus was on enhancing the Bank's management system, particularly in the areas of planning, monitoring and reporting.

Key achievements in 2017 included:

- Integration of planning and budgeting functions
- Re-alignment of the Staff Induction Program
- Establishment of a standardised project governance framework.

HUMAN RESOURCE MANAGEMENT

Staff Numbers

31 December 2017

Staff Category	2017	2016	2015
Non-management level staff	388	350	315
Management	57	57	58
Executive	5	5	6
Total employees	450	412	378

Staffing

The Bank continued its focus on attracting, retaining and equipping its staff to achieve the Bank's Vision. In 2017 the number of staff increased to 450 employees, an increase from 412 employees in 2016. Staff turnover was around 9 per cent. The increase in staffing in 2017 was mainly due to expanding functions and workloads, as well as strengthening capacity across the Bank.

Projects undertaken in 2017

- The Bank started the process of identifying staffing requirements for the Lae Cash Processing Facility.
- Commenced work on the strategic program "Implementing Gender Equity and Social Inclusion".
- Aligned the Bank's functional groups with the Strategic Plan, by restructuring and adjusting positions.
- Restructured the Payment Oversight, Compliance and Monitoring Unit as an Office, recognising the growing importance of its regulatory functions.

Employee capacity development

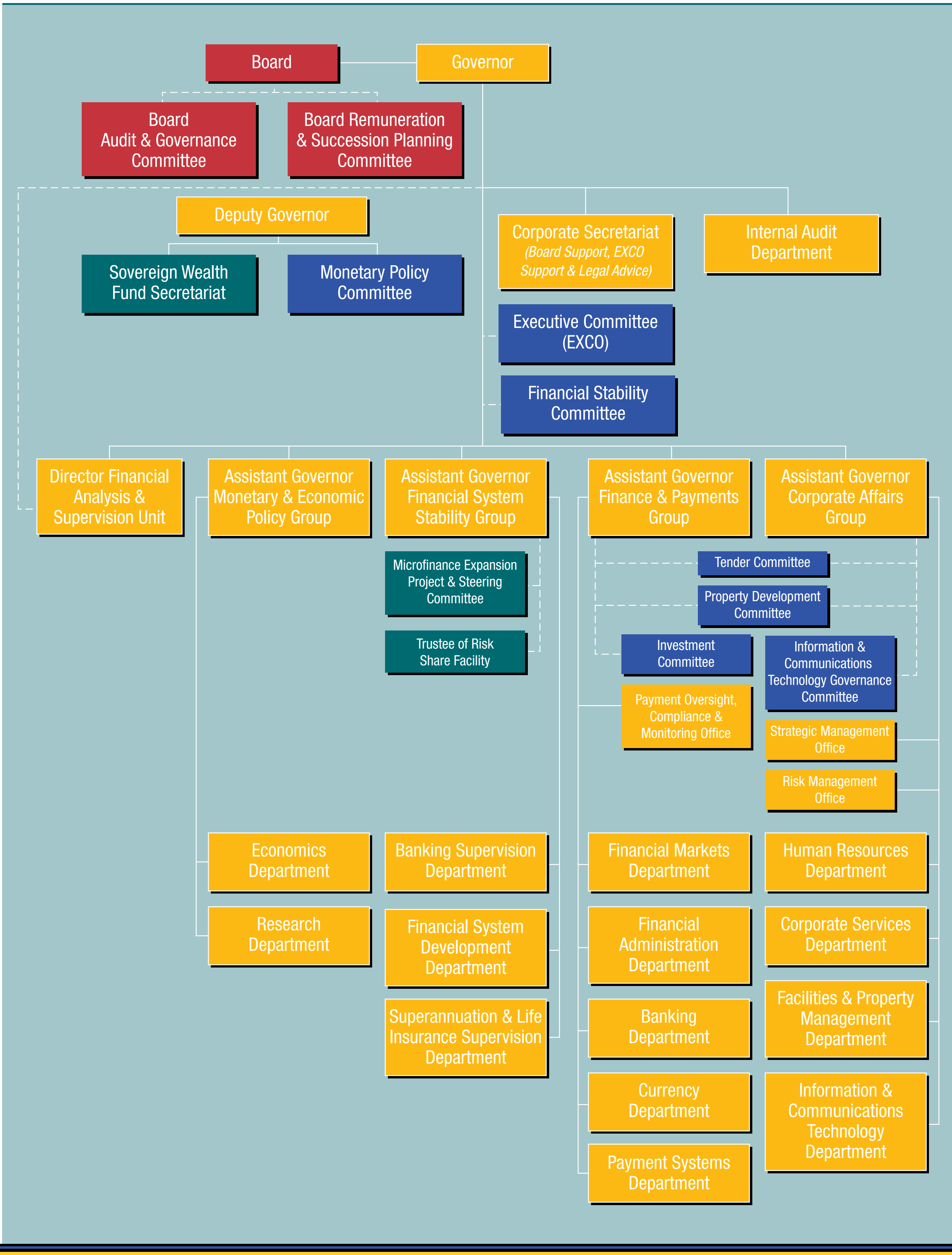
Over the course of the year the Bank sponsored employees to attend local and offshore training programs. These included workshops, conferences, short courses and long-term studies. The Bank was also successful in renewing the Reserve Bank of Australia Scholarship for another term of 6 years. The selected candidate will start studies in Australia in 2018.

The Bank recognises the benefit of continuous affiliation with professional bodies, to maintain its network and professional standing of its employees and encourages staff to hold memberships from relevant industry associations.

New recruits to the Bank of PNG participate in a comprehensive induction program.

Organisation Chart

31 December 2017



Institutional Support

Senior officers (31 December 2017)	
Governor	**Loi M. Bakani CMG**
Deputy Governor	Dr Gae Kauzi
Secretariat	
Corporate Secretary	Tau Vini
Internal Audit	
Department Manager	Benek Beriso
Financial Analysis and Supervision Unit	
Director	Benny Popoitai MBE
Deputy Director	Wilson Onea
Monetary & Economic Policy Group	
Assistant Governor	Vacant
Economics	
Department Manager	Sali David
Manager, Monetary Policy and Analysis	Wilson Jonathan
Manager, Balance of Payments	Thomas Jiki
Manager, Library	Polycarp Reu
Manager, International Transactions Monitoring	Elim Kiang
Research	
Department Manager	Jeffrey Yabom
Manager, Economic Analysis	Williamina Hubert
Manager, Projects	Boniface Aipi
Finance & Payments Group	
Assistant Governor	Joe Teria
Payments Oversight & Compliance	
Manager	Alfred Napun
Financial Markets	
Department Manager	Rowan Rupa (Acting)
Manager, Foreign Reserves	Rowan Rupa
Manager, Money Markets	Winnie Linken
Manager, Registry	Marie Martin
Manager, Middle Office	Ambrose Papis

Senior officers continued

Financial Administration	
Department Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Pala Tau (Acting)
Manager, Settlements	Soms Yankey
Banking	
Department Manager	Jason Tirime
Manager, Customer Services	So'on Drewei
Manager, Clearing Accounts	Aiva Aku
Manager, Government Accounts	Priscilla Ipu (Acting)
Currency	
Department Manager	David Lakatani
Manager, Control	John Yenas
Manager, Processing	Edward Kisaku
Payment Systems	
Department Manager	Gaona Gwaibo
Corporate Affairs Group	
Assistant Governor	Elizabeth Genia
Strategic Management	
Manager	Nathan Maire
Risk Management	
Manager	Ron Sikar
Human Resources	
Department Manager	Patrick Kwiwa
Manager, Strategy Planning and Development	Mairi Matthew
Manager, Administrative Support	Jennifer Tokome
Manager, Client Support	Vacant
Information Communications & Technology	
Chief Information Officer	Naime Kilamanu
Manager, Corporate Systems	Elvis Haoda
Manager, Operations	Manea Joseph
Manager, Projects Management Office	Aileen Watangia

Senior officers continued	
Corporate Services	
Department Manager	Jerome Peniasi
Manager, Media and E-Communications	Brian Semoso
Manager, General Services	William Tiki
Manager, Events, Marketing and Publications	Jon Kombeng
Facilities & Property Management	
Department Manager	Bruce Kitchen
Manager, Building	Gibson Param
Manager, Security	Slim Rupusina
Financial System Stability Group	
Assistant Governor	Ellison Pidik
Banking Supervision	
Department Manager	Sabina Deklin
Banks & Finance Companies	Boas Irima
Savings & Loans Societies	Nickson Kunjil
Superannuation & Life Insurance Supervision	
Department Manager	Elizabeth Gima
Superannuation	Tom Milamala
Life Insurance	Joseph Nukints
Employer Contributions Enforcement	Nonza Makip
Financial System Development	
Department Manager	George Awap
Macro-Prudential Supervision	Maria Kanari
Financial System Policy	Tanu Irau
Licensing and Compliance	Walio Gamini

INFORMATION AND COMMUNICATIONS TECHNOLOGY SERVICES

In 2017 the Bank completed or progressed several strategic projects related to information and communications technology services. Completed projects included:

- migrated the existing domestic markets system to a web-based platform
- implemented a business intelligence solution for monitoring the National Payments system
- completed implementation of an online reporting system to draw suspicious transactions to the attention of FASU
- enabled online access for quarterly reporting by supervised entities.
- progressed the development of the Bank's Blockchain research project.

The IDBox, successfully field trialled during 2017, needs no mains electricity, no Internet access nor Smartphone technology.

Projects commenced in 2017 and progressed during the year included the National Switch, next phase of reporting suspicious transactions, systems requirements relating to the Lae Currency Distribution Facility, currency inventory, Blockchain technology.

COMMUNICATIONS SERVICES

The Bank supports a range of communications activities and resources to facilitate the flow of information to the Bank's various audiences.

During 2017 the Bank commenced a strategic project related to communications. A working committee was convened to develop a comprehensive Bank-wide approach to consistent and effective communications.

INFRASTRUCTURE SERVICES AND SYSTEMS

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

COMMUNITY SUPPORT

The Bank supports a number of professional, cultural, educational, sporting and health related causes. During 2017 the Bank donated to 35 various causes.

The Bank continued to support fundraising for the Sir Buri Kidu Heart Foundation.

Other recipients of the support from the Bank included the Hanuabada Fire Appeal, the PNG Paralympic Committee, Cancer Foundation PNG, Port Moresby AFL Club and Cheshire disAbility Services.

Cancer Foundation PNG's Pinktober Breakfast, October 2017
Nawa Kai, Tamoa Aitsi and Priscilla Ipu.

BANK OF PAPUA NEW GUINEA

FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2017

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Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 December 2017

	Notes	2017 K'000	2016 K'000
Revenue from foreign currency investments			
Interest revenue	2	73,028	71,408
Realised gain/(loss) on financial assets		(11,788)	13,784
Foreign exchange gains and commissions		17,280	10,185
Total revenue from foreign currency investments		**78,520**	**95,377**
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(1,863)	(169)
Custodian and investment management fees		(5,856)	(6,350)
Total expenses from foreign currency investments		**(7,719)**	**(6,519)**
Net foreign currency income		**70,801**	**88,858**
Revenue from domestic operations			
Interest revenue	3	322,762	248,777
Other income	4	14,241	7,483
Total revenue from domestic operations		**337,003**	**256,260**
Expense on domestic liabilities			
Interest expense	5	(33,801)	(24,386)
Total expenses on domestic liabilities		(33,801)	(24,386)
Net domestic income		**303,202**	**231,874**
Total net operating income		**374,003**	**320,732**
Operating expenses			
General and administration expenses	6	(200,200)	(158,358)
Profit excluding unrealised income		**173,803**	**162,374**
Other unrealised income			
Fair value and foreign exchange revaluation gain on foreign currency investments		151,241	250,898
Fair value revaluation gain on domestic investments		41,886	8,731
Profit for the year		**366,930**	**422,003**
Other comprehensive income			
Items that may be subsequently reclassified to profit and loss			
Gain on gold asset revaluation		23,074	18,992
Items that will not be subsequently reclassified to profit and loss			
Gain on property valuation		-	163
Other comprehensive income for the year		**23,074**	**19,155**
Total comprehensive income for the year		**390,004**	**441,158**

The financial statements are to be read in conjunction with the notes on pages 46 to 72.

Statement of Financial Position

For the year ended 31 December 2017

	Notes	2017 K'000	2016 K'000
Assets			
Foreign currency financial assets			
Cash and cash equivalents	8	707,253	395,585
Financial assets at fair value	9	4,516,350	4,654,506
Assets held with IMF and other financial organisations	7	39,826	39,190
Accrued interest		18,858	18,158
Total foreign currency financial assets		**5,282,287**	**5,107,439**
Local currency financial assets			
Government of Papua New Guinea securities	10	3,264,954	3,787,129
Loans and advances	11	140,099	82,919
Accrued interest and other receivables		71,285	92,588
Total local currency financial assets		**3,476,338**	**3,962,636**
Total Financial Assets		**8,758,625**	**9,070,075**
Non-financial assets			
Gold		176,666	153,593
Property, plant & equipment	13	210,903	180,404
Investment properties	14	41,460	41,460
Other non-financial assets	12	51,628	39,738
Total non-financial assets		**480,657**	**415,195**
Total Assets		**9,239,282**	**9,485,270**
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF	7	581,857	539,722
Other financial liabilities	19	1,895	1,973
Total foreign currency financial liabilities		**583,752**	**541,695**
Local currency financial liabilities			
Deposits from banks and third parties	15	3,298,525	4,324,346
Deposits from Government and Government entities	16	460,259	711,738
Debt securities issued	17	2,089,739	1,358,923
Accrued interest payable on debt securities		1,677	1,574
Currency in circulation	18	2,073,747	2,114,210
Other financial liabilities	19	41,093	34,076
Total local currency financial liabilities		**7,965,040**	**8,544,867**
Total financial liabilities		**8,548,792**	**9,086,562**
Non-financial liabilities			
Provisions for employee entitlements	20	23,943	22,165
Total non-financial liabilities		**23,943**	**22,165**
Total Liabilities		**8,572,735**	**9,108,727**

Statement of Financial Position

	Notes	2017 K'000	2016 K'000
Equity			
Capital	21	145,540	145,540
Gold revaluation reserve	21	156,058	132,984
Property revaluation reserve	21	58,474	58,474
Unrealised loss reserve	21	(92,287)	(285,414)
Retained earnings	21	398,762	324,959
Total Equity		**666,547**	**376,543**
Total Liabilities and Equity		**9,239,282**	**9,485,270**

The financial statements are to be read in conjunction with the notes on pages 46 to 72.

Statement of Changes in Equity

For the year ended 31 December 2017

	Capital K'000	Gold Revaluation Reserve K'000	Property Revaluation Reserve K'000	Unrealised Loss Reserve K'000	Retained Earnings K'000	Total K'000
Balance at 1 January 2016	**145,540**	**113,992**	**93,452**	**(558,013)**	**240,414**	**35,385**
Profit for the year	-	-	-	259,629	162,374	422,003
Net transfers from unrealised profit/(loss) reserve to retained earnings				12,970	(12,970)	-
Other comprehensive income	-	18,992	-	-	-	18,992
Net transfers from property revaluation reserve to retain earnings	-	-	(35,141)	-	35,141	-
Dividend declared and paid					(100,000)	(100,000)
Asset Revaluation	-	-	163	-	-	163
Balance at 31 December 2016	**145,540**	**132,984**	**58,474**	**(285,414)**	**324,959**	**376,543**
Profit for the year	-	-	-	193,127	173,803	366,930
Net transfers from unrealised profit/(loss) reserve to retained earnings	-	-	-	-	-	-
Other comprehensive income	-	23,074	-	-	-	23,074
Dividend declared and paid	-	-	-	-	(100,000)	(100,000)
Balance at 31 December 2017	**145,540**	**156,058**	**58,474**	**(92,287)**	**398,762**	**666,547**

The realised profit for the year is K173.8 million. The unrealised loss reserve and net asset balance at 31 December 2017 are K92.29 million and K666.5 million 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 46 to 72.

Statement of Cash Flows

For the year ended
31 December 2017

	Notes	2017 K'000	2016 K'000
Cash Flows from Operating Activities			
Interest received on foreign investments		72,005	76,376
Interest received on domestic investments		344,389	215,228
Fees, commissions and other income received		31,521	17,669
Interest paid on IMF liabilities		-	(168)
Interest paid on domestic liabilities		(33,698)	(25,693)
Payments to employees		(62,499)	(54,460)
Payments to suppliers		(97,735)	(58,771)
Fees and commissions paid		(5,856)	(6,350)
Net proceeds from sale of foreign investments		317,246	513,747
Net payment for Government securities		564,061	(1,566,749)
Net loans repaid/(issued)		(57,180)	101,597
Net Cash Flow (used in)/provided by Operating Activities		**1,072,254**	**(787,574)**
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(18,128)	(12,781)
Payments for construction costs on capital projects		(55,705)	(46,112)
Proceeds from sale of property, plant and equipment		194	62
Net Cash Flow used in Investing Activities		**(73,639)**	**(58,831)**
Cash Flows from Financing Activities			
Net movement of currency in circulation		(40,463)	231,121
Net movement in debt securities issued		730,816	(207,970)
Distributions to the Government		(100,000)	(190,000)
Net movement in deposits from Government		(251,479)	(159,669)
Net movement in deposits from banks		(1,025,821)	1,112,573
Net Cash Flow provided by/(used in) Financing Activities		**(686,947)**	**786,055**
Net (Decrease)/Increase in Cash and Cash Equivalents		**311,668**	**(60,350)**
Cash and cash equivalents at 1 January		395,585	455,935
Cash and Cash Equivalents at 31 December	8	**707,253**	**395,585**

The financial statements are to be read in conjunction with the notes on pages 46 to 72.

Notes to the Financial Statements

For the year ended
31 December 2017

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

(a) Basis of preparation

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

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

Going concern

Although the Bank was exposed to significant valuation losses in its foreign currency assets as a result of appreciation of the PNG Kina against other major currencies in 2011 and 2012, the Kina has continued to depreciate since then. As a result, the Bank's unrealised losses have reduced considerably to PGK 100.4M (2016: PGK 293.5M).

Although in a net asset position of PGK 666.5M at 31 December 2017 (2016: net asset of PGK 376.5M). This steady improvement in the Bank's net asset position over the last three years is mainly driven by continued depreciation of the Kina and valuation gains in financial assets. This trend is expected to continue in the short to medium term further strengthening the Bank's financial position.

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 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 2017 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

(a) Note 23 (iv) – determination of the fair value of financial instruments with significant unobservable inputs;

(b) Note 14 – fair value of investment properties.

(ii) Accounting estimates

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

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

(d) New standards issued but not yet effective

Standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below, except for those standards which, in the opinion of the Board, will clearly not impact the Bank. The Bank intends to adopt the applicable standards when they become effective.

IFRS 9 Financial Instruments

This standard is effective for the Bank's annual reporting period beginning 1 January 2018. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss (ECL) model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39.

Based on the Bank's assessment, the adoption of IFRS 9 from 1 January 2018 will only have an immaterial impact as:

- No significant changes in the classification of the Bank's financial assets or financial liabilities with all significant categories classified as either amortised cost or fair value through profit or loss (FVPL)
- The Bank does not formally designate any relationships as hedges for accounting purposes; and
- Loans and advances, in particular loans and advances to staff, which is the main portfolio that will be affected by the new ECL model, is not material to the Bank's financial statements as a whole.

The Bank does not intend to restate comparative period financial information, as permitted by IFRS 9.

IFRS 15 Revenue from Contracts with Customers

This standard is effective for the Bank's annual reporting period beginning 1 January 2018. IFRS. IFRS 15 contains new requirements for the recognition of revenue and additional disclosures about revenue. The new standard is more prescriptive than the current requirements and provides more application guidance. Disclosure requirements will be more extensive.

Based on the Bank's assessment, the adoption of IFRS 15 from 1 January 2018 will only have an immaterial impact as:

- Many of the Bank's revenue streams do not fall within the scope of the standard; and
- The revenue recognition for the Bank's revenue streams that fall within the scope of the standard are materially consistent with the current treatment.

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. The standard requires lessees and lessors to make more extensive disclosures than under the current standard. The potential impact of this new standard is being assessed by the Bank.

(e) Financial assets and liabilities

Definition of financial instruments

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

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

(i) Domestic Government securities

The Bank holds inscribed stocks and Treasury bills with fixed coupon rates issued by the Government. Domestic Government securities are designated as 'fair value through profit or loss' under IAS 39. In accordance with this standard, the securities are accounted for on a fair value basis using the discounted present value model, with realised and unrealised gains and losses taken to profit. Interest earned on the securities is accrued over the term of the security and included as revenue in the statement of comprehensive income. Interest is received biannually at the coupon rate and the principal is received at maturity.

(ii) Foreign exchange holdings

Foreign exchange holdings are invested mainly in securities (issued by the Governments of Australia, the United Kingdom, United States of America, Germany, France and Japan) and bank deposits (with highly-rated international banks, Central banks and international agencies). These instruments are classified as 'financial assets held for trading' in accordance with IAS 39. Accordingly, these assets are measured at their fair value through profit and 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.

(iii) Foreign exchange translation

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

(iv) Foreign government securities

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

(v) Foreign deposits

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

(vi) 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 as they remain as part of the overall portfolio under the management of external fund managers. These forward contracts are accounted for on a fair value basis, with all changes in fair value being reflected in the statement of profit or loss and other comprehensive income in accordance with IAS 39. The fair values are determined with reference to prevailing exchange rates at balance date.

(vii) 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 IAS 39 as 'loans and advances' and valued 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.

(viii) Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilities under IAS 39. Deposit balances are shown at their amortised cost. 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.

(ix) 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.

(x) 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.

(xi) Assets and Liabilities with the International Monetary Fund (IMF)

As Papua New Guinea is an IMF member nation, special drawing rights (SDR) are periodically allocated. The Bank recognises the allocation as an asset. The IMF assets and liabilities are denominated in SDR which are based on the weighted average of four main trading currencies. These are translated to PGK using the SDR market rate at balance date. These assets and liabilities are accounted for on a fair value basis through profit or loss in accordance with IAS 39.

(xii) Currency in Circulation

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

(f) Determination of fair value

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

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

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs (for example, foreign exchange rates, volatilities and counterparty spreads) existing at the dates of the statement of financial position.

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

(g) Property, plant and equipment

Formal valuations of all the Bank's properties are conducted on a triennial basis. The properties are valued by local independent valuers. The most recent independent valuation of the properties was conducted during the year and the valuations reflected in the financial statements at 31 December 2016. In accordance with IAS 16 – Property, Plant and Equipment, properties are valued at fair value, which reflects observable prices and are based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Valuation gains and losses are transferred to the Property Revaluation Reserve. Management has assessed the fair value of all property and equipment as at year end and consider them to be appropriate.

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

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

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

(h) Computer Software

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

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

(i) Gold

Gold reserves placed on deposit with a financial institution are valued at the Kina equivalent of the prevailing exchange rate at balance date. On this basis, the underlying transaction means that the Bank holds a gold asset which is separately disclosed as gold. Gold is classified as a fixed asset, and accounted for under IAS 16 – Property, Plant and Equipment, Plant and Equipment, using revaluation model as it is a tangible item, held for use in the supply of services (stabilisation of the exchange rates for the good of entities operating in the jurisdiction) and can be expected to be used during more than one period. Unrealised gains and losses on gold are transferred to other comprehensive income.

(j) Investment properties

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

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

(k) Investment property rental income

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

(l) De-recognition

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

(m) Offsetting financial instruments

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

(n) Inventory – Notes & Coins

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

(o) Cash and cash equivalents

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

(p) Other receivables

Other receivables are stated at amortised cost.

(q) Employee benefits

(i) Pension Fund

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

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

(ii) Provision For Leave Entitlement

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

(r) Other liabilities

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

(s) Reserves

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

(i) Bank of Papua New Guinea Reserve Fund

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

(ii) Property Revaluation Reserve

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

(iii) Unrealised Profits Reserve

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

(iv) Distributable Profit Reserve

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

(v) Gold Revaluation Reserve

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

(t) Determination of distributable profit

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

(i) Section 50 (1) states that net profit arising from revaluation and foreign currency movements shall not be available to be distributed to the Government or paid into the Consolidated Revenue 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.

(u) Tax Exemption

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

(v) Comparatives

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

(w) Rounding

Financial information has been rounded to the nearest thousand Kina.

	2017 K'000	2016 K'000
Note 2: INTEREST REVENUE – FOREIGN CURRENCY INVESTMENTS		
Foreign securities and bank deposits	73,028	71,408
	73,028	**71,408**

Interest income on foreign investments includes interest earned on foreign bonds, Treasury bills, nostro accounts and other foreign investments. Income of K46.6 million (2016: K43.0 million) is in relation to investments managed by external fund managers and the remainder of K26.4 million (2016: K28.4 million) relates to investments managed by the Bank. Coupon rates during the year varied between 0.00% and 5.5% (2016: 0.05% and 6.5%) and yields varied between 0% and 3% (2016: 3% and 6.3%).

	2017 K'000	2016 K'000
Note 3: INTEREST REVENUE – DOMESTIC OPERATIONS		
Inscribed stock and other Government securities	318,602	241,337
Temporary advances to Government	3,882	4,988
Overnight lending to Commercial Banks	278	2,452
	322,762	**248,777**

Interest income earned on government inscribed stock amounted to K216.8 million (2016: K178.1 million) while K101.8 million was earned from Government Treasury bills (2016: K63.1 million). During the year coupon rates on inscribed stock varied between 9% and 12.5% (2016: 6% and 14%) while yields on Treasury bills varied between 2.4% and 7.7% (2016: 2.4% and 7.7%).

	2017 K'000	2016 K'000
Note 4: OTHER INCOME – DOMESTIC OPERATIONS		
Licensing and other fees	7,199	3,151
Numismatic currency	27	14
Property rent	3,923	3,526
Other	3,092	792
	14,241	**7,483**

	2017 K'000	2016 K'000
Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS		
Central Bank Bills issued	33,598	24,157
Other deposits held	203	229
	33,801	**24,386**

Interest on securities issued varied between 1.3% and 3.8% during the year (2016: 1.2% and 3.5%).

	2017 K'000	2016 K'000
Note 6: GENERAL AND ADMINISTRATION EXPENSES		
Staff costs	67,183	57,517
Premises and equipment	39,726	25,001
Revaluation decrease from property valuation	30,533	8,112
Other expenses	12,895	17,577
Depreciation of property, plant and equipment	12,609	6,843
Travel	10,414	8,468
Amortisation of notes and coins production expenses	10,001	15,081
Legal & consultancy fees	7,390	8,361
Staff training and development	5,365	4,913
Board & meeting expenses	1,688	1,202
Currency distribution expenses	1,313	935
Audit fee	1,083	1,698
Provisioning of staff and other loans	-	2,650
	200,200	**158,358**
Note 7: IMF AND OTHER FINANCIAL ORGANISATION RELATED ASSETS & LIABILITIES		
Assets		
IMF SDR holdings and deposits and other organisations	39,826	39,190
	39,826	**39,190**
Liabilities		
IMF number 1 and 2 loan accounts	5,931	5,931
SDR allocation	575,926	533,791
	581,857	**539,722**

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.

	2017 K'000	2016 K'000
Note 8: CASH & CASH EQUIVALENTS		
Foreign currency holdings – Nostro accounts	707,253	395,585
	707,253	**395,585**

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

	2017 K'000	2016 K'000
Note 9: FINANCIAL ASSETS AT FAIR VALUE		
Foreign investments	4,313,645	4,301500
Derivative assets	202,705	353,006
	4,516,350	**4,654,506**

Foreign investments include K3.6 billion (2016: K3.5 billion) of investments managed by external fund managers. The remainder of K1.3 billion (2016: K1.2 billion) is managed directly by the Bank. The investments comprise foreign bank debt securities, sovereign debt securities and over the counter derivative currency contracts.

	2017 K'000	2016 K'000
Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES		
Inscribed stock	2,096,677	1,856,994
Treasury bills	1,168,277	1,930,135
	3,264,954	**3,787,129**

	2017 K'000	2016 K'000
Note 11: LOANS AND ADVANCES		
Loans to PNG commercial banks	120,000	-
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	26,986	20,492
Allowance for doubtful loans	(8,273)	(8,273)
Temporary advances facility to PNG government	-	69,314
	140,099	**82,919**

As at 31 December 2017, K120m was issued to commercial banks (2016: there were no loans issued to PNG commercial banks. The Temporary Advance Facility is governed by the provisions of the *Central Banking Act 2000*. The interest rate charged is the 6 monthly treasure bills rate, approximately 4.7% p.a. The facility limit is PGK 200m.

	2017 K'000	2016 K'000
Note 12: OTHER NON FINANCIAL ASSETS		
Inventory notes and coins	47,344	36,219
Commemorative notes & coins and other receivables	(102)	594
Other non-financial assets	4,386	2,925
	51,628	**39,738**

	Land and Buildings at Fair Value K'000	Equipment K'000	Motor Vehicles K'000	Computer Equipment K'000	Computer Software K'000	Capital Working In-progress K'000	Total K'000
Note 13: PROPERTY, PLANT & EQUIPMENT							
At 31 December 2016							
Cost or fair value	89,959	15,813	3,001	9,389	41,959	38,000	198,121
Accumulated depreciation	-	(3,825)	(1,551)	(6,484)	(5,857)	-	(17,717)
Net Book Amount	**89,959**	**11,988**	**1,450**	**2,905**	**36,102**	**38,000**	**180,404**
Year ended 31 December 2017							
Opening net book amount	89,959	11,988	1,450	2,905	36,102	38,000	180,404
Additions	15,529	654	1,198	524	224	55,705	73,834
Disposals	-	-	(194)	-	-	-	(194)
Depreciation charges	(6,066)	(2,840)	(749)	(641)	(2,313)	-	(12,609)
Revaluation of building	-	-	-	-	-	(30,532)	(30,532)
Closing Book Amount	**99,422**	**9,802**	**1,705**	**2,788**	**34,013**	**63,173**	**210,903**
At 31 December 2017							
Cost or fair value	117,650	16,467	3,361	9,913	42,183	63,173	252,747
Accumulated depreciation	(18,228)	(6,665)	(1,656)	(7,125)	(8,170)	-	(41,844)
Net Book Amount	**99,422**	**9,802**	**1,705**	**2,788**	**34,013**	**63,173**	**210,903**

The Bank's increase in *Property, Plant and Equipment* during the year pertain primarily land and buildings and motor vehicle additions.

The increase in land and buildings and capital work in-progress assets are driven mainly by the development of the Lae currency distribution centre and improvements to ToRobert Haus.

There is a reclassification to distinguish capital working in progress in the current year 2017 Financial Statement to prior year mainly in our land and building assets.

	2017 K'000	2016 K'000
Note 14: INVESTMENT PROPERTIES		
Balance at 1 January	41,460	38,740
Acquisitions	-	-
Reclassification from property, plant and equipment	-	-
Change in fair value	-	2,720
Balance at 31 December	**41,460**	**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 and the last valuations were performed in 2016. 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 K3.7 million (2016: K3.5 million).

Note 15: DEPOSITS FROM BANKS & THIRD PARTIES

	2017 K'000	2016 K'000
Banks		
Exchange settlement accounts	1,169,371	2,190,931
Cash reserve requirement	2,117,549	2,124,963
Other Deposits	11,605	8,452
	3,298,525	**4,324,346**

Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES

	2017 K'000	2016 K'000
Deposits from Government and government entities	460,259	711,738
	460,259	**711,738**

Note 17: SECURITIES ISSUED

	2017 K'000	2016 K'000
Central bank bills issued	2,089,739	1,358,923
	2,089,739	**1,358,923**

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

Note 18: CURRENCY IN CIRCULATION

	2017 K'000	2016 K'000
Currency in Circulation	2,073,747	2,114,210
	2,073,747	**2,114,210**

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.

	2017 K'000	2016 K'000
Note 19: OTHER FINANCIAL LIABILITIES		
Foreign Currency		
Foreign currency deposits	1,895	1,973
	1,895	**1,973**
Local Currency		
Expense creditors	41,093	34,076
	41,093	**34,076**

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

	2017 K'000	2016 K'000
Provision for gratuity leave	1,355	2,375
Provision for annual leave	17,506	15,660
Provision for long service leave	5,082	4,130
	23,943	**22,165**
Reconciliation of leave provisions		
Balance at 1 January	22,165	19,108
Net charged to statement of comprehensive income	1,778	3,057
Balance at 31 December	**23,943**	**22,165**

Note 21: SHARE CAPITAL

At 31 December 2017, the authorised and subscribed capital of the Bank was Kina 145.5 million (2016: Kina 145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2017 K'000	2016 K'000
Capital		**Restated**
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	156,058	132,984
Property revaluation reserve	58,474	58,474
Unrealised loss reserve	(92,287)	(285,414)
Retained earnings	398,762	324,959
Total other reserves	**521,007**	**231,003**
Total owner's equity	**666,547**	**376,543**

Note 22: SEGMENT REPORTING

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

Note 23: RISK MANAGEMENT

Note 23(i): Financial Risk Management

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

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

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

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

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

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

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

Note 23(ii): CREDIT RISK

(a) Credit Risk Management

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

The Bank manages credit risk by employing the following strategies;

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

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

(b) Concentration of Credit Exposure

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

	2017 K'000	2016 K'000
Foreign governments, banks and financial organisations		
Nostro accounts	707,253	296,105
Foreign investments (note 9)	4,516,350	4,753,896
Assets held with IMF and other financial organisations	39,826	39,190
Accrued interest receivable	18,858	18,158
Papua New Guinea Government		
Government of Papua New Guinea securities (note 10)	3,264,954	3,787,129
Accrued interest receivable (note 11)	140,099	82,919
PNG commercial banks (note 11)	-	-
Temporary advance to PNG Government (note 11)	-	69,314
Bank staff and employees (note 11)	26,986	20,492
Other government institutions (note 11)	1,386	1,386
	8,715,712	**9,068,589**

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the statement of financial position. 15% (2016: 10%) of the total assets have a credit rating of A-1+ or above in short term investments and 26% (2016: 36%) 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 indicates the entity has an extremely strong capacity to pay interest and principal. AA is a high grade rating, indicating a very strong capacity. 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	2017 K'000	% of 2017 Financial Assets	2016 K'000	% of 2016 Financial Assets
Short term foreign investments				
A-1+	1,279,478	15	747,419	9
A-1	215,183	2	95,078	1
A-2	44,908	1	-	-
A-3	-	-	-	-
NR	165,876	2	485,749	6
	1,705,445	**20**	**1,328,246**	**16**
Long term foreign investments				
AAA	1,634,172	20	951,038	11
AA+	124,930	2	1,079,176	13
AA	537,765	7	386,476	5
AA-	10,037	-	189,319	2
A+	19,368	-	450,826	5
A	488,705	6	-	-
A-	-	-	12,290	-
BBB+	-	-	-	-
BBB	370,739	5	172,527	2
BBB-	-	-	184,088	2
	3,185,716	**40**	**3,425,740**	**40**
Total foreign investments	**4,891,161**	**60**	**4,753,986**	**56**
Short term domestic investments				
B	1,168,277	14	1,930,135	23
	1,168,277	**14**	**1,930,13**	**23**
Long term domestic investments				
B+	2,096,677	26	1,856,994	22
	2,096,677	**26**	**1,856,994**	**22**
Total domestic investments	**3,264,954**	**40**	**3,787,129**	**44**
Total investments	**8,156,115**	**100**	**8,541,115**	**100**

Note 23(iii): MARKET RISK

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate and currency products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads and foreign exchange rates.

(a) Foreign Exchange Risk

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

As at 31 December 2017 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

	CURRENCY OF DENOMINATION							
As at 31 December 2017	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	318,693	81,191	253,809	-	32,397	-	21,163	707,253
Investments	3,344,036	87,324	630,864	51,369	-	-	200,052	4,313,645
Derivative assets	202,705	-	-	-	-	-	-	202,705
Assets held with IMF	-	-	-	-	-	39,826	-	39,826
Accrued interest	12,251	4,472	934	1,201	-	-	-	18,858
	3,877,685	**172,987**	**885,607**	**52,570**	**32,397**	**39,826**	**221,215**	**5,282,287**
Foreign Currency Liabilities:								
Liabilities with IMF	-	-	-	-	-	581,857	-	581,857
Foreign currency liabilities	1,895	-	-	-	-	-	-	1,895
	1,895	**-**	**-**	**-**	**-**	**581,857**	**-**	**583,752**
Net Foreign Currency Exposure	**3,875,790**	**172,987**	**885,607**	**52,570**	**32,397**	**(542,031)**	**221,215**	**4,698,535**

As at 31 December 2016	CURRENCY OF DENOMINATION							
	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 assets:								
Foreign currency	131,380	53,783	146,253	-	45,154	-	19,014	395,584
Investments	2,072,975	798,686	708,053	126,489	457,782	-	137,516	4,301,501
Derivative assets	353,006	-	-	-	-	-	-	353,006
Assets held with IMF	-	-	-	-	-	39,190	-	39,190
Accrued interest	7,846	4,168	4,266	728	477	-	673	18,158
	2,565,207	**856,637**	**858,572**	**127,217**	**503,413**	**39,190**	**157,203**	**5,107,439**
Foreign Currency Liabilities:								
Liabilities with IMF	-	-	-	-	-	539,722	-	539,722
Foreign currency liabilities	1,973	-	-	-	-	-	-	1,973
	1,973	**-**	**-**	**-**	**-**	**539,722**	**-**	**541,695**
Net Foreign currency exposure	**2,563,234**	**856,637**	**858,572**	**127,217**	**503,413**	**(500,532)**	**157,203**	**4,565,744**

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 summarises the maturity profile of the Bank's financial liabilities based on the contractual repayment date, determined on the basis of the remaining period at the reporting date to the contractual maturity date.

As at 31 December 2017	Balance Total K'000	MATURITY PROFILE On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specified maturity K'000	Weighted average effective rate %
Assets								
Foreign Currency Financial Assets:								
Cash and cash equivalents	332,443	332,443	374,810	-	-	-	-	0.44%
Financial assets at fair value	4,891,160	-	265,952	724,173	3,153,473	372,752	-	1.87%
Assets held with IMF	39,826	-	-	-	-	-	39,826	0.03%
Accrued interest	18,858	-	15,111	3,747	-	-	-	na
	5,282,287	**332,443**	**655,873**	**727,920**	**3,153,473**	**372,752**	**39,826**	
Local Currency Financial Assets:								
Government of Papua New Guinea securities	3,264,954	-	8,388	1,159,887	736,372	1,360,307	-	6.32%
Loans and advances	140,099	-	120,000	-	-	20,099	-	0.02%
Accrued interest and receivables	71,285	-	-	26,554	14,495	30,236	-	na
	3,476,338	**-**	**128,388**	**1,186,441**	**750,867**	**1,410,642**	**-**	
Non-financial assets:								
Gold	176,666	-	-	-	-	-	176,666	na
Property, plant and equipment	210,903	-	-	-	-	-	210,903	na
Investment properties	41,460	-	-	-	-	-	41,460	na
Other non-financial assets	51,628	-	-	-	-	-	51,628	na
	480,657	**-**	**-**	**-**	**-**	**-**	**480,657**	
Total Assets	**9,239,282**	**332,443**	**784,261**	**1,914,361**	**3,904,340**	**1,783,394**	**520,483**	
Liabilities								
Foreign Currency Financial Liabilities:								
Liabilities with IMF	581,857	-	-	-	-	-	581,857	0.03%
Other financial liabilities	1,895	-	1,895	-	-	-	-	na
	583,752	**-**	**1,895**	**-**	**-**	**-**	**581,857**	
Local Currency Financial Liabilities:								
Deposits from bank and third parties	3,298,525	3,298,525	-	-	-	-	-	0.01%
Deposits from Government	460,259	460,259	-	-	-	-	-	0.01%
Securities issued	2,089,739	-	2,089,739	-	-	-	-	2.54%
Accrued interest payable	1,677	-	1,677	-	-	-	-	na
Currency in circulation	2,073,747	2,073,747	-	-	-	-	-	na
Other financial liabilities	41,093	-	41,093	-	-	-	-	na
	7,965,040	**5,832,531**	**2,132,509**	**-**	**-**	**-**	**-**	
Total Liabilities	**8,548,792**	**5,832,531**	**2,134,404**	**-**	**-**	**-**	**581,857**	

As at 31 December 2016	Balance Total K'000	MATURITY PROFILE On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specified maturity K'000	Weighted average effective rate %
Assets								
Foreign Currency								
Financial Assets:								
Cash and cash equivalents	296,105	296,105	99,480	-	-	-	-	0.44%
Financial assets at fair value	4,753,986	-	33,711	1,068,166	329,163	2,910,012	-	1.47%
Assets held with IMF	39,190	-	-	-	-	-	39,190	0.03%
Accrued interest	18,158	-	12,667	5,491	-	-	-	na
	5,107,439	**296,105**	**145,858**	**1,073,657**	**329,163**	**2,910,012**	**39,190**	
Local Currency								
Financial Assets:								
Government of Papua New Guineas securities	3,787,129	-	208,829	1,728,130	289,695	1,560,475	-	6.57%
Loans and advances	82,919	-	-	69,314	-	13,605	-	0.02%
Accrued interest	92,588	-	66,572	26,016	-	-	-	na
	3,962,636	**-**	**275,401**	**1,823,460**	**289,695**	**1,574,080**	**-**	
Non-financial assets:								
Gold	153,593	-	-	-	-	-	153,592	na
Property, plant and equipment	180,404	-	-	-	-	-	180,404	na
Investment properties	41,460	-	-	-	-	-	41,460	na
Other non-financial assets	39,738	-	-	-	-	-	39,738	na
	415,194	**-**	**-**	**-**	**-**	**-**	**415,194**	
Total Assets	**9,485,270**	**296,105**	**421,259**	**2,897,117**	**618,858**	**4,484,092**	**454,384**	
Liabilities								
Foreign Currency								
Financial Liabilities:								
Liabilities with IMF	539,722	-	-	-	-	-	539,722	0.03%
Other financial liabilities	1,973	-	1,973	-	-	-	-	na
	541,695	**-**	**1,973**	**-**	**-**	**-**	**539,722**	
Local Currency								
Financial Liabilities:								
Deposits from bank and third parties	4,324,346	4,324,346	-	-	-	-	-	0.01%
Deposits from Government	711,738	711,738	-	-	-	-	-	0.01%
Securities issued	1,358,923	-	1,358,923	-	-	-	-	2.54%
Accrued interest payable	1,574	-	1,574	-	-	-	-	na
Currency in circulation	2,114,210	2,114,210	-	-	-	-	-	na
Other financial liabilities	34,076	-	34,076	-	-	-	-	na
	8,544,867	**7,150,294**	**1,394,573**	**-**	**-**	**-**	**-**	
Total Liabilities	**9,086,562**	**7,150,294**	**1,396,546**	**-**	**-**	**-**	**539,722**	

Note 23(iv): FAIR VALUE

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

	2017 K'000	2016 K'000
Financial Assets		
Cash and cash equivalents	707,253	395,585
At fair value through profit/(loss)	7,821,130	8,480,825
Loans & receivables	230,242	193,665
	8,758,625	**9,070,075**
Financial Liabilities		
At fair value through profit/(loss)	583,752	541,695
At amortised cost	7,965,040	8,544,866
	8,548,792	**9,086,561**

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.

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.

	Level 1 K'000	Level 2 K'000	Level 3 K'000	Total K'000
31 December 2017				
Financial assets held at fair value through profit or loss				
Domestic Government securities – Inscribed stock and Treasury bills	-	-	3,264,954	3,264,954
Foreign Government and semi-Government bonds	-	869,486	-	869,486
Derivatives managed by external fund managers	-	202,705	-	202,705
Investments in bonds and other instruments managed by external fund managers	3,444,158	-	-	3,444,158
Assets held with IMF	-	39,826	-	39,826
Total assets at fair value through profit or loss	**3,444,158**	**1,112,017**	**3,264,954**	**7,821,129**
Non financial assets at fair value				
Gold	176,666	-	-	176,666
Property plant and equipment	-	-	210,903	210,903
Investment property	-	-	41,460	41,460
Total assets at fair value	**176,666**	**-**	**252,363**	**429,029**
Financial liabilities held at fair value through profit & loss				
Derivatives	-	1,895	-	1,895
Liabilities with IMF	-	581,857	-	581,857
Total liabilities at fair value through profit or loss	**-**	**583,752**	**-**	**583,752**
31 December 2016				
Financial assets held at fair value through profit or loss				
Domestic Government securities - Inscribed stock and Treasury bills	-	-	3,787,129	3,787,129
Foreign Government and semi-Government bonds	-	1,110,177	-	1,110,177
Derivatives managed by external fund managers	-	353,006	-	353,006
Investments in bonds and other instruments managed by external fund managers	3,191,323	-	-	3,191,323
Assets held with IMF	-	39,190	-	39,190
Total assets at fair value through profit or loss	**3,191,323**	**1,502,373**	**3,787,129**	**8,480,825**
Non financial assets at fair value				
Gold	153,592	-	-	153,592
Property, plant and equipment	-	-	180,404	180,404
Investment property	-	-	41,460	41,460
Total assets at fair value	**153,592**	**-**	**221,864**	**375,456**
Financial liabilities held at fair value through profit & loss				
Derivatives	-	1,973	-	1,973
Liabilities with IMF	-	539,722	-	539,722
Total liabilities at fair value through profit or loss	**-**	**541,695**	**-**	**541,695**

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2017:

	Level 3 K'000
Opening balance	3,787,129
Maturities, net of additional investment	(564,061)
Fair value revaluation gains/(losses) on Level 3 instruments	41,886
Closing balance	**3,264,954**
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.	**13,624**

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2016:

	Level 3 K'000
Opening balance	2,220,380
Additional investment, net of maturities	1,563,055
Fair value revaluation gains/(losses) on Level 3 instruments	3,694
Closing balance	**3,787,129**
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.	**3,694**

	Valuation Technique	Unobservable Input	Range of Inputs		Fair value movement due to change in unobservable Input	
			2017	2016	Increase	Decrease
Domestic Government securities – Inscribed stock and Treasury bills	Discounted cash flows present value method	Current market yield	9% to 12.5%	7.9% to 16%	Decrease	Increase
Investment property	Income capitalisation	Capitalisation rate	10% to 14%	10% to 14%	Decrease	Increase

Note 23(v): SENSITIVITY ANALYSIS

The sensitivity of the Bank's profit and equity to a movement of +/- 10 percent in the value of the Kina as at 31 December 2017 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2017 K'000	2016 K'000
Changes in profit/equity due to a 10 percent appreciation in the value of the Kina	(545,895)	(526,103)
Changes in profit/equity due to a 10 percent depreciation in the value of the Kina	545,895	654,475

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.

	2017 K'000	2016 K'000
Changes in profit/equity due to an increase of 1 percentage point	79,650	85,411
Changes in profit/equity due to a decrease of 1 percentage point	(79,650)	(85,411)

Note 24: EVENTS AFTER THE BALANCE DATE

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

Note 25: CONTINGENT LIABILITIES

The Bank had no contingent liabilities at 31 December 2017 (2016: nil) and there are no transactions or events that will have material impact on the financial report during the preparation of this report.

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

Note 26: CAPITAL COMMITMENTS

The Bank has no capital commitments.

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

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. This group comprises 29 in total (2016: 25), including the Governor, Deputy Governor, 4 Assistant Governors, 8 non-executive Board members and 15 senior staff. The Salaries and Remuneration Committee (SRC) and Salaries, Conditions & Monitoring Committee (SCMC) determine the terms and conditions on which the Governor and Deputy Governor hold office in accordance with the *Central Banking Act 2000*. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

	2017 K'000	2016 K'000
Short term benefits	12,639	10,135
Post employment benefits	831	735
Other long term benefits	4,403	3,788
	17,873	**14,658**

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

As at 31 December 2017 the loans owed by the key management personnel to the Bank were K4,218,012 (2016: K3,081,922).

Note 28: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,082,837 (2016: K1,698,871). This represents the total statutory audit fee paid to the Auditor General's Office and other auditors in relation to external fund manager operations. These transactions are performed at arm's length.

Note 29: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

The Bank of Papua New Guinea acts as the banker to the Government and its various government departments and controlled enterprises. The Government of Papua New Guinea is restricted under the *Central Banking Act 2000* from 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.

Declaration by Management

DECLARATION BY MANAGEMENT

In my opinion the foregoing Statement of Profit or Loss and other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows including the Notes to and forming part thereof, have been drawn up so as to give a true and fair view of the matters to which they relate for the year ended 31 December 2017.

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

Loi M Bakani CMG
Governor

Gae Kauzi (Dr)
Deputy Governor

4 July 2018

Report of the Auditor-General

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

PAPUA NEW GUINEA

Phone: (+675) 3012200 Fax: (+675) 325 2872 Email: agopng@ago.gov.pg Website: www.ago.gov.pg

INDEPENDENT AUDITOR'S REPORT ON THE ACCOUNTS OF
BANK OF PAPUA NEW GUINEA
FOR THE YEAR ENDED 31 DECEMBER 2017

To the Minister for Treasury

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2017** as set out on pages **2** to **27.** The financial statements comprise:

- Statement of Financial Position as at 31 December 2017;
- Statement of Profit or Loss and Other Comprehensive Income;
- Statement of Changes in Equity;
- Statement of Cash Flows for the year ended; and
- Summary of significant accounting policies and other explanatory notes.

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

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

Responsibility of the Auditor-General

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

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

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

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

AUDIT OPINION

In my opinion:

(a) the financial statements of Bank of Papua New Guinea for the year ended 31 December 2017:

- (i) give a true and fair view of the financial position of the Bank as at 31 December 2017 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.

GORDON KEGA, CPA
Acting Auditor-General

6 July, 2018

Notes


BANK OF PAPUA NEW GUINEA