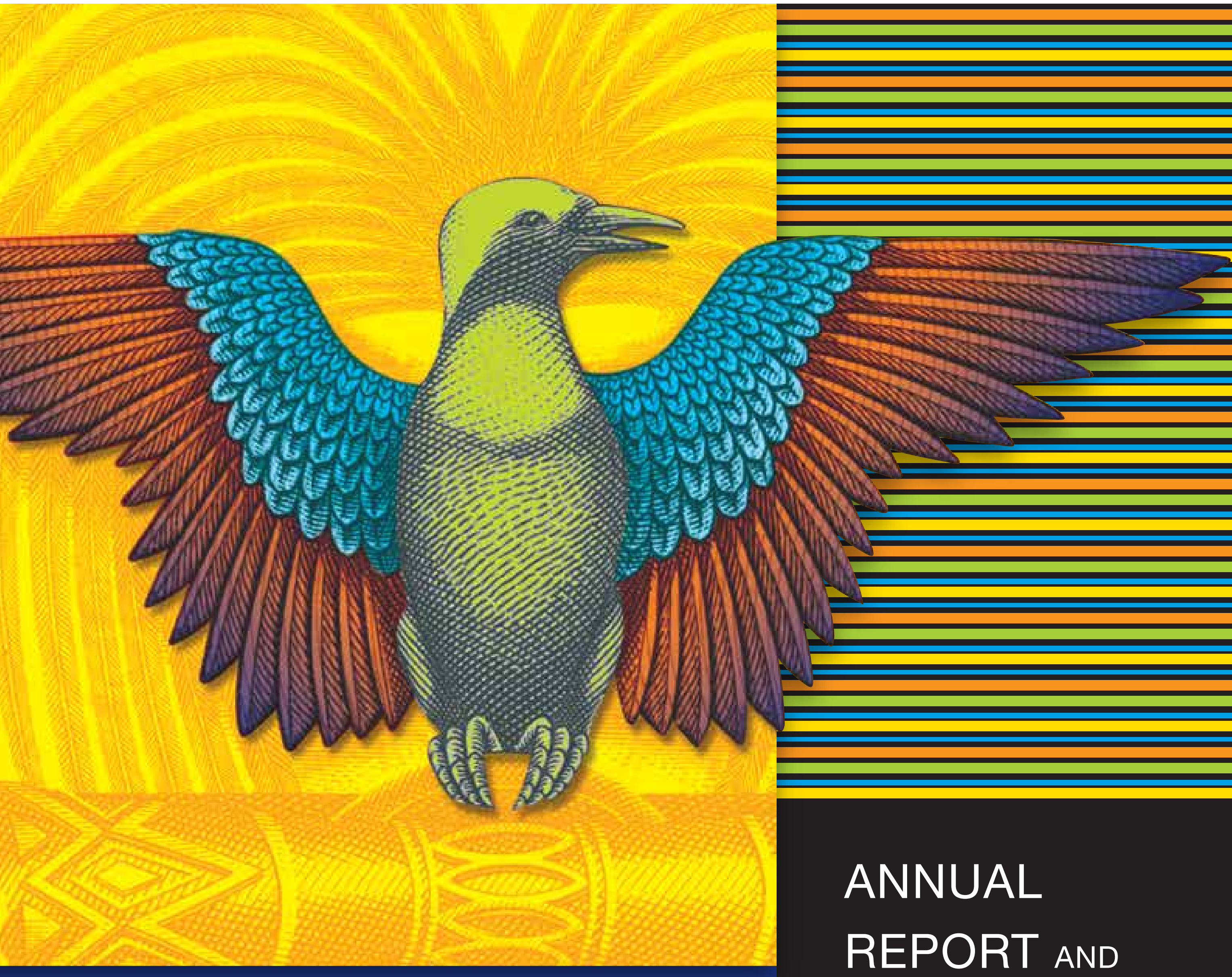
BANK OF PAPUA NEW GUINEA



ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2018

BANK OF PAPUA NEW GUINEA

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2018

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

In Memoriam

Late Dr Gae Yandabing Kauzi

Dr Gae Kauzi passed away on 9 June 2019 after a short illness.

Late Dr Kauzi was a career central banker, joining the Bank of Papua New Guinea in May 1993. He served in various capacities in the Economics Department and later as the head of the Research Department. In October 2011 he was appointed Assistant Governor for Monetary and Economic Policy Group. He was promoted to Deputy Governor in July 2016. He served with distinction in this role until his untimely passing.

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Governor's Foreword

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

From earthquake to APEC, 2018 was a year of challenges and achievements.

Economic growth of 0.3 percent was recorded for 2018. While this represented the seventeenth consecutive year of growth for PNG, the rate of growth was considerably lower than in 2017, largely due to the impact of the February earthquake on the oil and gas sector (which accounts for around 35 percent of GDP).

The external sector of the Papua New Guinea economy improved further over the course of the year, reflecting increased prices for some major commodities and higher export receipts from the mineral and agriculture, fishery and forestry sectors. On the whole the lower gas and oil export volume was more than offset by higher export prices as well as growth in other sectors, which resulted in increased export earnings for 2018.

Tax and dividend payments arising from increased earnings of mining, oil and gas companies, the proceeds of the inaugural sovereign bond, together with external borrowing by the Government to fund the national budget, also contributed to inflows of foreign exchange and higher reserves.

However, over the past several years revenue growth has not been able to meet the increase in Government expenditure, giving rise to significant budget deficits (2018: K2,048 million, representing 2.5 percent of GDP). By the end of 2018 the level of public debt had reached over 30 percent of GDP. The continued high budget deficits and debt level remain a cause of concern for fiscal sustainability and its impact on macroeconomic stability.

In recent years, given the saturation of the domestic debt market for further issuance of debt by the Government, the focus was towards accessing financing from the international capital market and direct budget support from international donor partners.

Annual headline domestic inflation for 2018 was an average of 4.5 percent, lower than the average of 5.4 percent in 2017 (December quarter 2018: 4.3 percent compared with December quarter 2017: 4.7 percent). The inflation rate was considered to be manageable in the context of price stability.

The challenges facing the Bank, including the ongoing issue of high liquidity in the banking system, also created opportunities to work on initiatives to carry out monetary policy implementation, financial system supervision improvement and provision of an effective national payments system.

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

A clear highlight of the year was the very successful outcome of the inaugural sovereign bond issue, which raised K1.57 billion by its conclusion date. The issue was over-subscribed by 600 percent, demonstrating the confidence the international investment market has in the future of PNG.

The final US$200 tranche of the Credit Suisse loan was drawn down in June. Along with the proceeds of the sovereign bond, it was used to retire short term domestic debt and provide funding for Government priority expenditure.

Managing foreign exchange demand continued to be a key focus for the Bank during the year. Through the improvements to inflow and increases in reserves, combined with interventions by the Bank, the market was able to clear a large proportion of the outstanding import orders, reducing the backlog to K445.4 million by the end of 2018 and shortening the average time taken for orders to be served to less than 3 months.

These improvements to reduce the backlog were important achievements. However, even with the higher export receipts and other inflows during the year, the demand for foreign currency continued to increase. The backlog would not have occurred at all if the LNG earnings were brought onshore instead of being held in foreign currency accounts held overseas.

An important milestone was reached at the end of the year, when the building contractors officially handed the Lae Currency Distribution Facility (CDF) building over to the Bank. The handover marked the end of the building's general construction phase, which had commenced in late 2015.

The Lae CDF is the Bank's first regional building, the first in the Bank's 44 year history to be built outside Port Moresby. It was purpose-designed and constructed to the Bank's specifications to play an integral role in the Bank's currency management responsibilities.

During the year the Bank announced further property activities. Tenders were issued for the construction of staff accommodation in Lae and Port Moresby and pre-planning activities were started for the Bank's proposed business resumption facility to be located in Port Moresby.

The Bank's currency reform program continued in 2018. All PNG currency banknotes have now been resized to aid identification, and sophisticated security features have been incorporated to provide built-in protection against counterfeiting.

The year's APEC activities were commemorated with the issuing of special limited edition currency for circulation, a K100 banknote and a coloured 50 toea coin, both featuring the APEC logo. In addition, the Bank launched a special K100 gold coin also featuring the APEC logo, intended for the numismatic market.

In addition to APEC-related activities during the year, the Bank's regional perspective in 2018 extended to capacity-building initiatives. Research capacity has been enhanced, such as through the Bank's collaboration with three other central banks in the Pacific and Griffith University, Australia, which culminated during the year with the presentation of a series of research papers in Suva, Fiji. As well, BPNG staff participated in a series of networking, knowledge transfer and cultural exchange activities with the Reserve Bank of Vanuatu and the Central Bank of the Solomon Islands during the year, an initiative of the governors of the Pacific nations' central banks.

Within PNG the Bank continued its strong focus on financial inclusion and financial education. A successful series of awareness seminars was conducted for members of the public in regional areas, on the topics of the benefits of KATS and investment opportunities.

I acknowledge the assistance and support we have received during 2018 from the International Monetary Fund (IMF), the Reserve Banks of Australia and of New Zealand, the World Bank including IFC, Asian Development Bank (ADB), the Pacific Financial Technical Assistance Centre (PFTAC), AUSTRAC, Pacific Financial Inclusion Programme (PFIP) and South East Asian Central Banks (SEACEN).

2018 has been a year of many successful events, significant achievements and progress towards meeting the challenges of operating a modern central bank. I 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 move into 2019, 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 our core functions and making a distinct and valuable contribution to the economic well-being of Papua New Guinea'.

Loi M. Bakani CMG

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

APEC Papua New Guinea 2018

APEC Haus

Oro Dancers

APEC 2018 Papua New Guinea

The Asia-Pacific Economic Cooperation (APEC) series of meetings during 2018 gave the Bank of Papua New Guinea a world stage to showcase a range of its developments and achievements, from digital financial services and financial education and literacy, through to launching a commemorative banknote and coins.

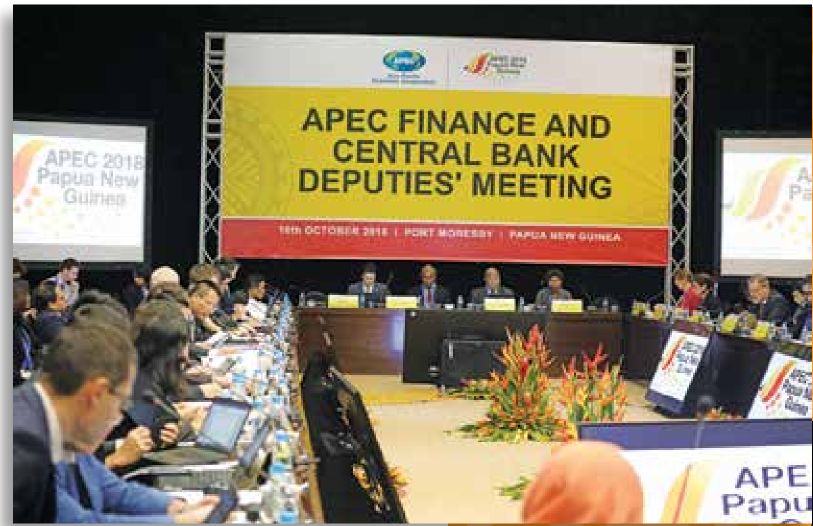
APEC is an inter-governmental forum, with twenty-one Pacific Rim member economies, that promotes free trade throughout the Asia-Pacific region.

During the series of APEC meetings Governor Loi M. Bakani CMG delivered a number of keynote addresses to forums and workshops. The focus of these presentations was providing secure financial services to all people in Papua New Guinea at a reasonable cost by harnessing digital technologies.

APEC Haus, located near Ela Beach in Port Moresby, was purpose-built for these meetings. Reflecting the traditionally-inspired architecture, the official opening of the APEC meeting series featured dancers from the Oro Province.

The APEC Finance and Central Bank Deputies Meeting provided an ideal opportunity for central bankers from around the region to share information, knowledge, experience and new developments in central banking.

The Bank was proud to launch the commemorative currency during the APEC meeting program.



APEC Finance and Central Bank Deputies Meeting

Senior officials from a range of PNG government departments and authorities participated in the APEC Finance and Central Bank Deputies Meeting.

Representatives from the Bank of Papua New Guinea attended the official launch of the APEC commemorative currency. L-R Assistant Governor Mrs Elizabeth Genia, Mrs Naomi Kedea and Ms Naime Kilamanu. (See page 29)

Highlights

BPNG and IFC mark strong working relationship

International Finance Corporation (IFC), a member of the World Bank Group, has had a long association with the Bank of Papua New Guinea. IFC and the Bank renewed their working relationship, here represented by the signing of the Amended and Restated Cooperation Agreement by Governor Loi M. Bakani CMG and IFC Vice-President Ms Nena Stolijkovic in August 2018.

With partnerships FASU builds strength against financial crime

For the Financial Analysis and Supervision Unit (FASU) 2018 was a year of strengthening key relationships and signing information sharing agreements.

FASU signed an information-sharing agreement with the PNG National Fisheries Authority during the year. Pictured front row L-R, Ms Rosa Banik, from FASU, Mr John Kasu, from PNG Fisheries and Mr Benny Popoitai MBE, Director of FASU. Back row: members of staff from the Bank and the National Fisheries Authority.

Mr Benny Popoitai MBE, Director of FASU, and Mr Alistair Sands, Director of International Technical Assistance & Training, Intelligence and International Division with AUSTRAC signed the terms of reference for the Analyst Exchange Program. The Program will enable FASU staff to build their technical skills through placement with AUSTRAC.

Also pictured, standing from L-R: Mr Brian Giffney, Principal Analytics Engineer, Innovation Information and Analytics Division, AUSTRAC, Mrs Rosa Banik, Manager, AML/CTF Supervision and Compliance Division, FASU, Mr Daniel Kelen, Manager, Intelligence, AUSTRAC, Mr Edric Ogomeni, Manager, Intelligence Management Division, FASU, Mr Alex Omilian, Director, Innovation Information and Analytics Division, AUSTRAC, Mr Stephen Munro, Manager, PNG Program, International Technical Assistance & Training, Intelligence and International Division, AUSTRAC.

Building investment awareness around the country

During the year BPNG conducted a successful series of seminars around PNG for members of the general public. During the sessions Bank staff explained the benefits of KATS as a safer alternative to cash and cheque transactions and raised the participants' awareness of investing in government securities. (See page 36)

Kokopo Business College in East New Britain hosted one of the Bank's awareness seminars.

Mr Wilson Jonathan (right) from BPNG speaking with a local participant at a seminar in East New Britain Province.

Pictured L-R, Governor Loi M. Bakani CMG with Mr Garima Tongia, acknowledges Mr Anil Paul's participation in the CEFI Working Group's progress review.

No more paper banknotes

One of the Bank of Papua New Guinea's key responsibilities is to ensure an adequate supply of quality currency in circulation. This also involves withdrawing damaged and soiled banknotes from circulation. Several years ago paper banknotes were de-monetarised and have been gradually removed from circulation, to be completely replaced by polymer banknotes. During the year the Bank conducted a campaign to remind the general public that paper banknotes are no longer accepted. Pictured is the information billboard erected in Vanimo, Sandaun Province in August 2018.

BPNG in the community

The Bank has been a strong supporter of professional, cultural, health and community causes for many years. In 2018 the Bank donated a power generator to the Magarida Station, Abau District, Central Province. Pictured as the presentation ceremony, L-R, Mr Cameron Cowley and Mr Micky Aeae, Barauoro Ward Members, Amazon Bay LLG, Margarida, Abau, and representatives of BPNG, Mr Tonga Albert, Deputy Governor Gae Kauzi and Assistant Governor, Corporate Affairs Group, Mrs Elizabeth Genia.

Financial inclusion activities continue to gain momentum

During the year the National Executive Council approved the National Financial Inclusion Policy. The Centre of Excellence for Financial Inclusion (CEFI), the apex organisation responsible for coordinating all financial inclusion activities in PNG, progressed a number of initiatives in 2018. This included establishing several working groups to support the implementation of the National Financial Inclusion Strategy 2016-2020 (NFIS 2). (See page 36)

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, issuing of the national currency 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.

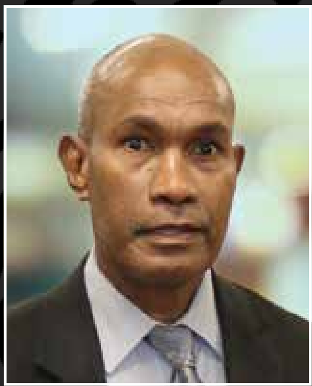
Through **ACCOUNTABILITY** we take responsibility for our decisions and actions.

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

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

Governance

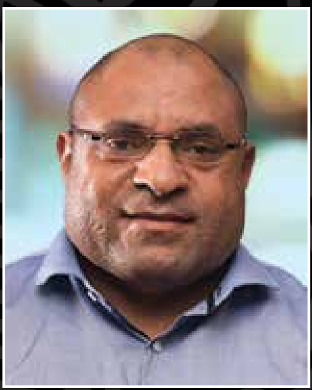
Governor Loi M. Bakani CMG



Dr Gae Kauzi

Mr John Leahy

Bishop Denny Bray Guka



Mr Richard Kuna

Mr Simon Tosali

Mr Alex Tongayu

Mr John Paska

Members of the Board of the Bank of Papua New Guinea

31 December 2018

The Bank of Papua New Guinea ('the Bank', 'BPNG' or the 'Central Bank') is one of the cornerstones of the PNG financial system. Like other central banks around the world, BPNG 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 in its commitment for continuous improvement, through the Board and its committees, effective organisational structures, enhanced 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 Governor is directly responsible for the formulation of monetary policy and regulation of the financial system. The Board's role is to determine the policy of the Bank in all other aspects of its functions.

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.

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 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 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 Chamber of Commerce and Industry and the President of the Papua New Guinea Trade Union Congress (PNGTUC).

Acting on advice from the NEC, 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.

The Corporate Secretariat, Internal Audit Department and Financial Analysis and Supervision Unit (FASU) 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, including financial independence from the Government, is essential to maintaining the integrity of its operation and policy decision-making. Under the CBA 2000, the Bank is a self-funding institution, with its own capital and reserves.

The Board

Governors

Governor and Chairman

Loi M. Bakani CMG

Mr 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 South East Asian Central Banks (SEACEN), the Alternative Governor for IMF Annual Meetings, Chairman of the Microfinance Expansion Project, Chairman of the Centre of Excellence for Financial Inclusion (CEFI), Chairman of the PNG Institute of Banking & Business Management (IBBM), Member of the PNG Institute of Directors (PNGID) and a Member of the Advisory Board of Port Moresby 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 an *ex officio* 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 Master's 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 the 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 Vice-Chairman of Anglicare PNG. He is also a member of the Release on License Committee and the Lawyers Statutory Committee, a Director of the Papua New Guinea Medical Board and the PNG Bible Society and Vice-Chairman of Coronation Primary School.

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

Mr 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 and is a qualified Certified Practising Accountant.

Mr Simon Tosali OBE

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

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 John Paska

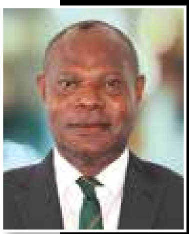
Mr John Paska was appointed President of the Papua New Guinea Trade Union Congress (PNGTUC) in September 2018 and by virtue of that appointment is an *ex officio* member of the Board. The Board welcomed the PNGTUC appointment, as it enabled the *ex officio* position, which had been vacant for some years, to be filled. Mr Paska is also a Member of the Board of the Security Industry Authority, the National Tripartite Consultative Council and the National Training Council. He lectures at the University of Papua New Guinea on labour market issues.

He holds a Bachelor of Laws from the University of Papua New Guinea, a Master's degree in Labour Studies from the University of Queensland, Australia, a Diploma in Trade Union Philosophy through the International Confederation of Free Trade Unions, New Delhi, India and a Board of Directors Certificate from the University of South Pacific. Mr Paska has also participated in tertiary studies in labour economics and labour relations at the George Meany Institute of Labor Studies, Washington DC, USA and the University of Hawaii, Honolulu USA.

Mr Alex Tongayu MBE

Mr Tongayu was appointed Chairman of the Securities Commission of Papua New Guinea in November 2018 and by virtue of that appointment is an *ex officio* member of the Board.

He holds a Bachelor of Laws degree from the University of Papua New Guinea, a Master's degree in Public Administration from the Divine Word University and Certification in Global Leadership in the Financial Markets from the Toronto Centre, Canada.



Mr Hnanguie was appointed an *ex officio* member of the Board in May 2017 in his capacity as Chairman of the Securities Commission of PNG. Mr Hnanguie's term as a member of the Bank's Board ended in November 2018 with the appointment of Mr Tongayu as Chairman of the Securities Commission.

The Bank thanks Mr Hnanguie for his valuable contribution during his term as a Board member.

Board Meetings

The Board meets at least once every three months. The March 2018 meeting was held in Buka in the Autonomous Region of Bougainville. Two meetings were held in Port Moresby (July and December 2018) and the October meeting was held in Lae, Morobe Province.

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	3
Bishop Denny Bray Guka	4	4
Mr Richard Kuna	4	1
Mr Simon Tosali	4	4
Mr Christopher Hnanguie	3	2
Mr Alex Tongayu MBE	1	1
Mr John Paska	1	1

Board Committees

Under the terms of the CBA 2000, the Board may appoint Committees from time to time 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 2018.

Board Audit & Governance Committee

The Committee's role is to provide oversight 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.

The Board Audit & Governance Committee comprised non-executive directors. Mr Richard Kuna chaired the Committee during 2018, with Mr John Leahy and Mr Christopher Hnanguie as members. Mr Alex Tongayu replaced outgoing member Mr Hnanguie for the December meeting.

During the year the Committee's activities included working closely with the external auditors on the finalisation of the 2018 accounts, considering the review of the Bank's corporate governance framework and overseeing the internal audit program.

Board Remuneration & Succession Planning Committee

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 twice a year and otherwise as required.

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

In 2018 the Committee was involved in oversight of the recruitment process for senior Bank positions.

Other Governance Measures

Internal Management Committees

The Executive Committee (EXCO) is chaired by the Governor and attended by the Deputy Governor and the Assistant Governors. EXCO is convened fortnightly to consider reports from the management committees.

The management committees, Monetary Policy Committee, the Investment Committee, the Financial Stability Committee, the Tender Committee, the Property Development Committee and the Information Communications Technology Governance Committee, report to EXCO. Each committee has specific roles and responsibilities, set out in individual charters.

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 2018 the focus of internal audit was on several significant reviews along with an ongoing program of routine audits.

Risk management

During 2018 the Bank continued its program of establishing an effective risk management policy and framework. Risk management activities undertaken included a full review of business impact assessments across the Bank, business continuity planning during the APEC meeting period, site inspections, assessments and risk profiling for the proposed business resumption site and risk assessments for currency distribution centres.

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 Salaries and Remuneration Commission.

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.

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 2018 was K406.6 million, a decrease of K9.9 million from K415.15 million in 2017. Revenue from foreign currency investments increased by K8.8 million over the previous year, as a result of increased interest and foreign exchange gains and commissions. However, this increase was more than offset by a K18.7 million decrease in interest revenue on domestic investments, due to a reduced level of government securities.

Operating Expenditure

Total operating expenditure, comprising interest expense and general administration costs, was K218.4 million, K23.3 million lower than the 2017 level of K241.7 million. General administration expenses decreased by K39.1 million, due to property revaluation gain, while interest expenses rose by K15.8 million as a result of increased holdings in Central Bank Bills.

Net Operating Profit

The Bank recorded a net operating profit of K187.2 million for 2018, compared with K173.8 million for 2017.

Unrealised Gain/(Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K155.3 million for 2018, which was transferred to the Unrealised Gain/(Loss) Reserve. This resulted from the depreciation of the kina against major currencies during the financial year. Gold valuation gain of K5.0 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) as dividend.

However, the Board can decide that no amount is to be paid into the CRF 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.

Furthermore, under the terms of Section 50(1) of the CBA 2000, net profit arising from revaluation of the Bank's assets and/or liabilities and/or from foreign exchange movements shall not be available to be distributed as a dividend to the Government or paid into the CRF.

Distribution of Profit

	2014 K'm	2015 K'm	2016 K'm	2017 K'm	2018 K'm
Total Comprehensive Income/(Loss)	139.5	680.7	441.2	390.0*	372.3
Unrealised profit/(loss)	49.8	541.2	270.7	216.2*	185.1
DISTRIBUTABLE PROFIT/(LOSS)	**89.7**	**139.5**	**170.5**	**173.8**	**187.2**
ALLOCATIONS MADE					
Currency Movement Reserve	-	-	-	-	-
Property Revaluation Reserve	-	-	0.2	-	24.8
Unrealised Profits Reserve	42.2	536.4	251.5	193.1	155.3
Gold Reserve	7.6	4.8	19.0	23.1	5.0
Building Reserve					73.8
Retained Profit/(Loss)	89.7	139.5	70.5	73.8	13.4
Consolidated Revenue Fund (Government)	-	90.0	100.0	100.0	100.0†

** These figures differ from those reported in the 2017 Annual Report. (Refer p47)*

† In consultation with the Minister for Treasury, the Bank paid a dividend of K100 million to the Government in 2019 out of the retained profits for the 2018 financial year.

2018 Budget

	Actual 2018 K'm	Actual 2017 K'm
Operating Income		
Interest received – overseas	59.9	61.2
Interest received – domestic	308.4	322.8
International trading/foreign exchange fees	27.3	17.2
Other income	10.0	14.2
TOTAL INCOME	**405.6**	**415.4**
Operating Income		
Interest expenses – domestic operations	48.2	33.8
Financial markets & external fund manager expenses	9.1	7.7
Staff costs	75.4	67.1
Staff training and development	6.1	5.4
Premises and equipment	49.4	39.7
Depreciation of property, plant and equipment	13.4	12.6
Amortisation of notes and coins production	16.3	10.0
Currency distribution expenses	1.2	1.3
Audit fee	1.4	1.1
Travel	11.6	10.4
Legal and consultancy fees	9.9	7.4
Board fees and meeting expenses	1.3	1.7
Information & communication technology	0.0	0.0
Special projects	0.0	0.0
Revaluation decrease from property valuation	-38.6	30.5
Other expenses	13.7	12.9
TOTAL PAYMENTS	**218.4**	**241.6**
NET OPERATING PROFIT/LOSS	**187.2**	**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 2018 the Bank released two monetary policy statements as required by the Act, on 31 March and 30 September. (The MPS are available on the Bank's website www.bankpng.gov.pg)

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, are 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 2018 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, especially the National and Supplementary budgets.

Inflation was significantly lower in 2018, compared with the 2017 average of 5.4 percent. In both the March and June 2018 quarters, inflation was 4.5 percent, in the September quarter 4.8 percent, and in the December quarter 4.3 percent. These inflation levels were considered manageable and within the Bank's 2018 forecast.

The reduction in the inflation rate was attributed to a drop in the cost of seasonable items from their 2017 prices, including fruit, vegetables and betelnut.

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 2018.

Improvement in Monetary Policy Framework

In 2018 the Bank continued to refine monetary policy through the reserve money framework, aiming to improve the transmission of the policy rate to market interest rates. As part of this development, the Bank introduced the Intra-Day Liquidity Facility and refined the Repo Facility so that borrowings by the banks could be collateralised. Work to implement the recommendations by the International Monetary Fund to improve the transmission process continued through the year.

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.

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 2018.

FOREIGN EXCHANGE

By 31 December the Kina had depreciated by 4.04 percent to US$0.2970. During the year foreign exchange flows in the domestic market were dominated by outflows, mainly from the Petroleum and Retail sectors. Foreign exchange outflows in 2018 totalled K686 million, compared to inflows of K668 million.

The Bank's interventions in the foreign exchange market offset the net outflows. During the first three quarters of 2018 the Bank focused its interventions on sectors with national and strategic importance, targeting the Petroleum, Communications and Retail sectors. This intervention strategy ceased during the final quarter of 2018 as foreign exchange inflows improved.

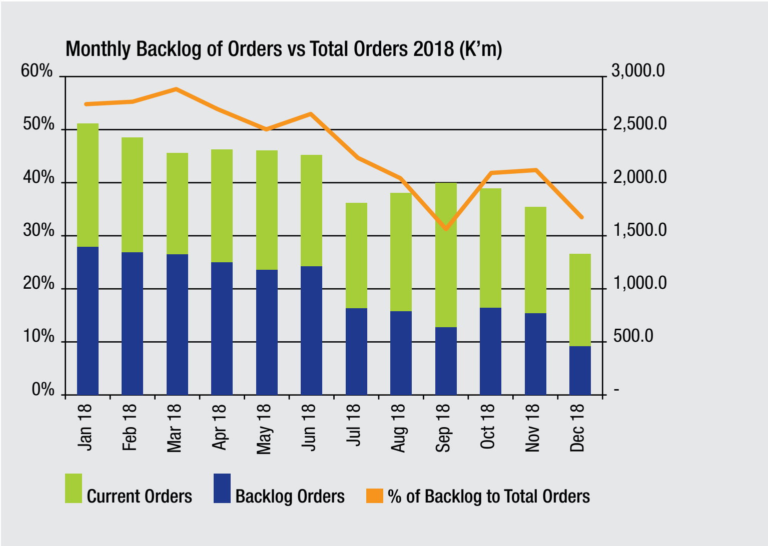
Over the course of the year foreign currency inflows declined by 1.2% compared to a 1.0% decline in outflows. The Mining, Agriculture and Forestry sectors were the main supplier of foreign currency into the domestic market. Outflows were mainly attributed to the Finance & Business, Retail and Petroleum sectors, as shown in the table below.

Major Sector Contributions to Foreign Exchange Flows

	2017 K'm	2018 K'm	Change
Inflows			
Mining	4,737.0	4,637.1	-2.1%
Agriculture	2,206.5	2,430.0	10.1%
Finance & Business	2,184.3	2,128.4	-2.6%
Forestry	893.7	1,255.9	40.5%
Petroleum	1055.2	1,009.3	-4.4%
Total Inflows	**13,753.9**	**13,586.6**	**-1.2%**
Outflows			
Finance & Business	3,199.3	3,105.7	-2.9%
Retail	2,379.1	2,203.0	-7.4%
Small Transactions	2,458.2	1,884.4	-23.3%
Manufacturing	1,771.4	1,781.8	0.6%
Petroleum	1,707.7	1,331.1	-22.1%
Total Outflows	**14,421.8**	**14,272.6**	**-1.0%**

Kina trading

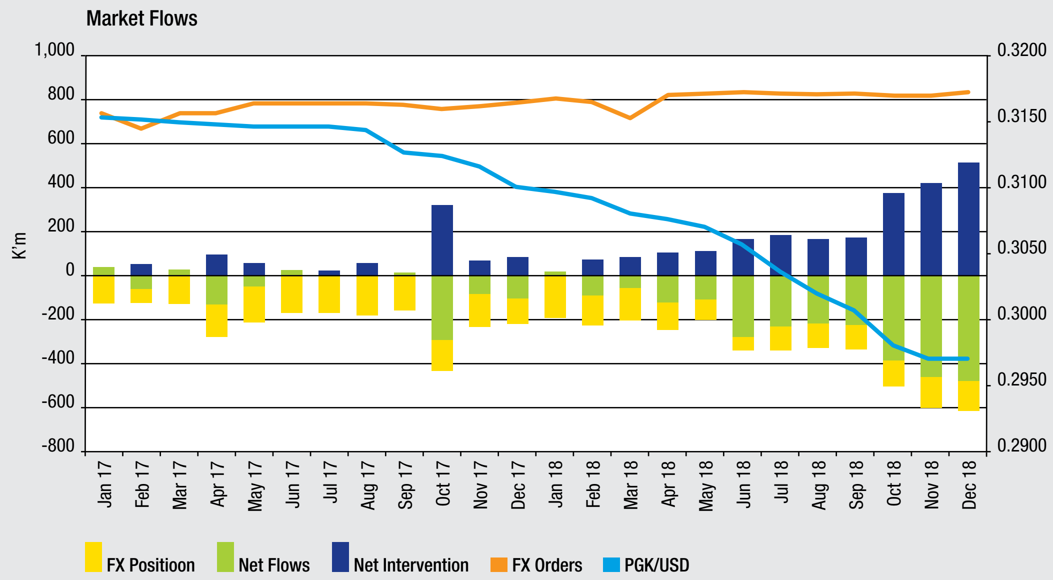
Total outstanding sell kina orders brought into the market by Authorised Foreign Exchange Dealers (AFEDs) declined to K1.3 billion at the end of 2018, from K2.5 billion a year earlier. As a consequence, the total amount of overdue foreign exchange orders declined to K0.4 billion from K1.4 billion over the same period. This reflected a gradual normalisation of activity in the domestic foreign exchange market. There was also an improvement in the time taken by the AFEDs in clearing orders to less than three months.



Intervention

In 2018 the Bank sold US$695.4 million (K2,314.0 million) in the domestic foreign exchange market to correct the mismatch in foreign currency flows (2017: K226.7 million). The higher amount was a consequence of using the foreign exchange inflows to reduce the backlog of foreign exchange orders.

The total market turnover in 2018 was K31.9 billion (2017: K28.2 billion).



Exchange Rates

	End of Dec 2017	End of Dec 2018	YTD (% Change)
PGK/USD	0.3095	0.2970	-4.04%
PGK/AUD	0.3967	0.4208	6.08%
PGK/EUR	0.2590	0.2599	0.35%
PGK/GBP	0.2299	0.2341	1.83%
PGK/JPY	34.90	32.78	-6.07%
PGK TWI	29.49	29.60	0.44%

During 2018 the Kina (PGK) appreciated against the Australian Dollar (AUD), Great Britain Pound (GBP) and the Euro (EUR), but was weaker against the Japanese Yen (JPY). The appreciation against AUD, GBP and EUR mainly reflected a stronger USD, which supported positive domestic economic conditions. The PGK depreciated against JPY as a result of that currency strengthening against the USD, as a flight to quality was spurred by global geo-political risks.

Foreign currency and interest rates risks

In 2018 a pickup in global manufacturing and trade supported the global economy. This was further aided by a combination of favourable financial conditions, more supportive fiscal policies and low inflation.

However, geo-political events (such as Brexit and various European elections) and the continued trade tensions between the US and China provided resistance to global economic activity towards the end of the year.

Economic growth in the United States remained firm, supported by lower personal income taxes and strong labour market conditions. During the first half of the year a decline in corporate tax rates contributed to increased business investment. By the third quarter business investment had slowed as trade tensions between the US and China resulted in a decline in US exports to China. These tensions remain a risk for the US economy going forward.

In China economic activity eased slightly during 2018. The slowing in economic growth was mainly due to a tightening of financial conditions initiated by the government in the first half of the year. The decline in government spending, especially on infrastructure, reduced activity in the manufacturing sector. In spite of this slowdown, growth is expected to remain resilient, supported by the services sector.

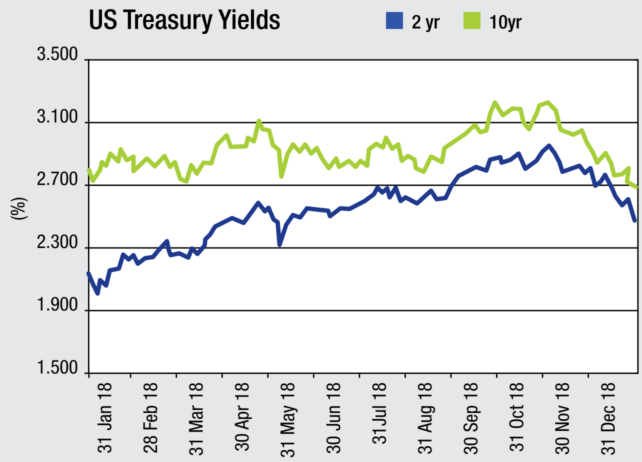
Eurozone economic growth slowed in 2018. The decline was felt across most economies and over most expenditure components of GDP. The main expenditure component was in the external sector, which saw demand fall, particularly with China. As a consequence, consumer and business sentiment were also low.

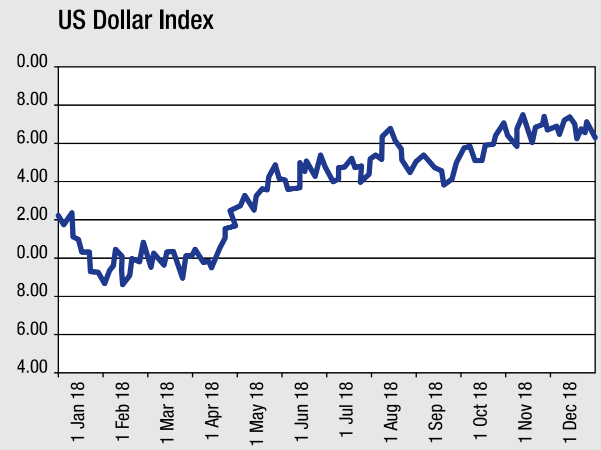
Emerging economies generally did well in 2018. Despite a weak external sector, most Asian economies continued to grow at a reasonable pace. In Eastern Europe weaker growth in Turkey and Russia, coupled with slower growth in the Eurozone, dampened activity. Growth continued slowly in Latin America, as a result of weak economic activity in several key countries within the region. In contrast, the expansion in Sub-Saharan Africa strengthened, due to improved economic growth in Nigeria and South Africa supported by strong agricultural production.

Interest rates in the US continued to rise throughout the year. The US Federal Open Market Committee (FOMC) increased its federal funds rate on four occasions in 2018 to end the year at 2.5 percent. Other major central banks remained mixed in terms of their respective interest rate targets, with some gradually becoming less accommodative,such as the Bank of England. Others, including the European Central Bank and Bank of Japan, expected to maintain their accommodative monetary policy stance.

Given the divergence in monetary policy stances, US bond market yields generally increased throughout the year and in turn provided support for the US dollar.

In response to these market developments, the Bank of Papua New Guinea maintained an accommodative portfolio duration and currency exposure strategy throughout 2018.





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:

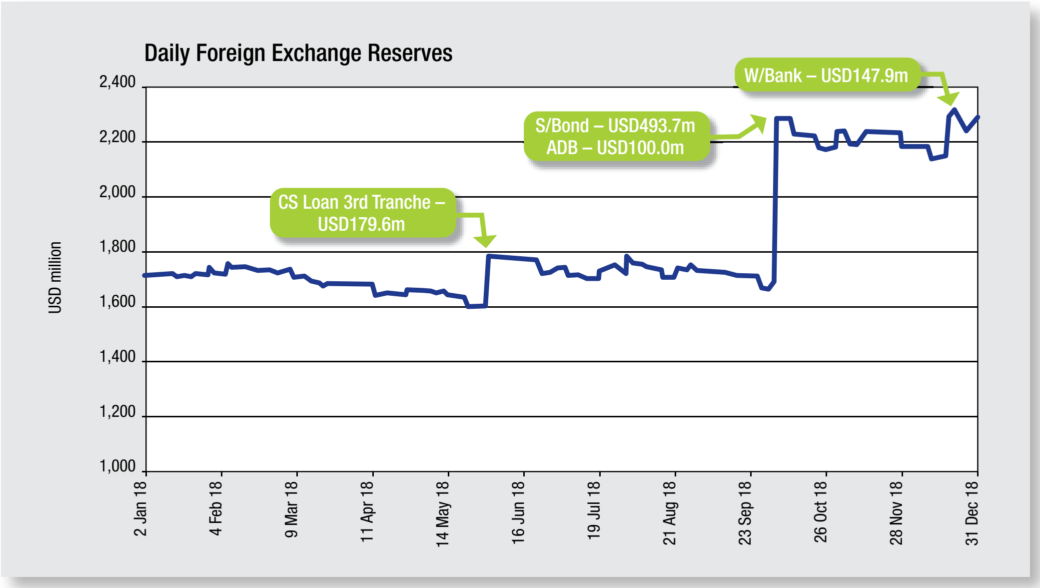
- support price stability (a core objective of the Bank's monetary policy)
- service the State's foreign debt
- minimise the impact of external shocks on the domestic economy.

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

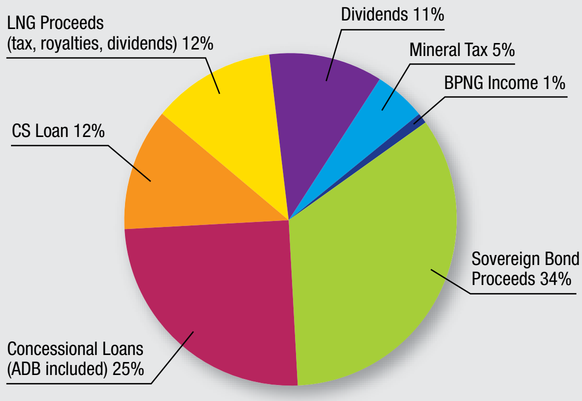
- preserve the capital value of the foreign exchange reserves
- maintain adequate foreign currency liquidity
- manage credit risk conservatively
- earn an acceptable rate of return on the investment of reserves.

The Bank's foreign exchange reserves increased from US$1.718 billion (K5.468 billion) to US$2.296 (K7.603 billion) by the end of December 2018.

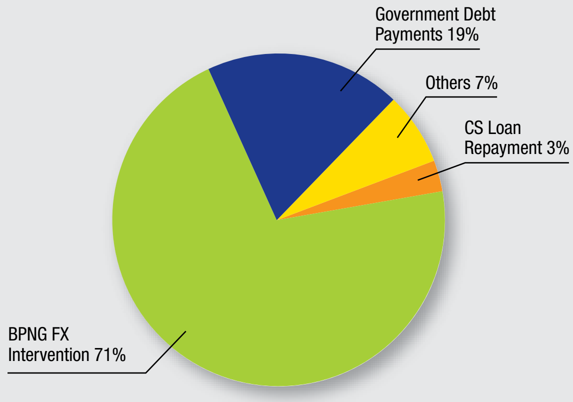
The increase in foreign reserves was mainly attributed to inflows from the drawdown of the 3rd tranche of the Credit Suisse loan, proceeds of the Sovereign Bond issue and budget support loans from ADB and World Bank.



Foreign Exchange Inflows 2018



Foreign Exchange Outflows 2018



Foreign reserve inflows for the year totalled US$1,471.3 million, compared to outflows of US$970.3 million. Foreign exchange reserve inflows mainly comprised US$493.7 million from the proceeds of the Sovereign Bond, concessional loans of US$371.5 million, Credit Suisse loan proceeds of US$179.6 million, LNG proceeds (including tax, royalties and dividends) of US$176.4 million, dividends of US$160.2 million and income from foreign investments totalling US$11.3 million.

Outflows mainly comprised the Bank's intervention in the foreign exchange market of US$695.4 million, government debt service payments of US$182.4 million, Credit Suisse loan repayments of US$26.0 million and others of US$66.5 million.

Fund Performance

In-house Managed Funds

The Bank's in-house managed reserves generated portfolio returns of 2.19 percent over the year to 31 December 2018, compared to 1.66 percent for the 2017 year. During the year to December 2018, the in-house portfolio outperformed the benchmark by 13 basis points. The result was attributed to high yields generated by the Australian dollar portfolio.

Outsourced Funds

The outsourced funds generated a return of 1.97 percent in 2018, compared to 1.18 percent in the previous year. The outsourced component of the Bank's foreign reserves has grown by 17.5 percent (US$174.48 million) since the inception of the outsourcing program. The total at December 2018 was US$1,174.48 million.

Average Annual Return (%)

Source	2018	2017	2016
In house funds management	2.19	1.66	1.20
Outsourced funds	1.97	1.18	1.59
Benchmark FTSE Russell Government Bond Index 1 – 3 years USD Hedged*	2.06	0.92	1.18

** This benchmark was formerly known as Citi Group World Government Bond 1-3 year USD Hedged.*

Composition of Foreign Exchange Reserves 2018

	In-house Managed Reserves	Externally Managed Reserves	Gold	Total Invested Foreign Exchange Reserves	IBRD	Total Foreign Exchange Reserves
Date	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)/PKG ('m)
31 Dec 2018	1,066.10	1,174.48	54.90	2,295.48	0.30	2,295.70 (7,062.80)
31 Dec 2017	509.97	1,151.69	55.63	1,717.29	0.30	1,718.31 (5,461.20)
Change	556.13	22.79	-0.73	578.19	0.00	2,141.60
Change (%)	109.05%	1.98%	-1.31%	33.67%	0%	39.21%

International Transactions Monitoring

Foreign Exchange Control Directives

All authorised dealers complied with the directives over the course of 2018.

Foreign Currency Accounts

Opening and operating a domestic foreign currency account (FCA) requires the Bank's approval. During the year the Bank received 17 applications for new FCAs. The Bank approved 8 applications and declined 9.

During the year the Bank introduced a system to monitor approved FCAs, in which monthly balances are checked against the three months transaction forecast to determine net credit or net debit.

Gold Export Licences

The Bank allows residents and non-residents to buy and sell gold freely within PNG. However companies must obtain a gold export licence from the Bank to export gold. Subject to complying with the conditions of the licence in each year, a new licence is granted to the licence-holder for the following year.

Applications received in 2018	20
Existing licenses approved	10
• Italpreziosi South Pacific limited • Golden Valley Enterprises Limited • Issac Lete Lumbu Gold Buyers Limited • Vertic Limited • Niella AU Limited • Meekom Minerals Limited • Aviga Impex Limited • Bougainville Gold Exchange Limited • Mi-Do Gold Buyers & Exporters Limited • Simberi Gold Company Limited	
New applications approved • MNK Jewellers PNG Limited • Soi Gold Exports Limited • BullionScope Limited • JIA Gold Holdings Limited • Armstrong Precious Metals Limited	5
Applications declined	4
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 2018	11
Value of transactions	K825.2 million (US$245.1 million)

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 2018	8
Applications approved	8

Removal of Physical Cash from 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 assessed in 2018	5
Applications approved	5
Value of approved transactions	K455,290.0
Value of physical cash	NIL
Value of approved numismatic notes exported	K455,290.0

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 2018	31 Dec 2017
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	13	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)	5	4
Life insurance brokers (LIBs)	5	4
Authorised money changers	9	8
Money remitter	2	1
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operator	1	1
Total assets (K billion)	**51.2**	**50.2**
Banking industry (%)	74.2	74.7
Authorised Trustees (ASFs) (%)	25.4	24.4
LICs (%)	0.4	0.9
Total deposits (K billion)	**27.7**	**28.2**
Commercial banks (%)	94.2	94.4
LFIs (%)	2.7	2.8
SLSs (%)	2.4	2.1
Micro-banks (%)	0.7	0.7
Total loans outstanding (K billion)	19.9	18.5

REGULATION AND SUPERVISION

Licences and Approvals

In 2018 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 4 licences, refused 1 application, 5 applications in progress)
- granted 4 branch openings, 1 branch closure and 2 relocations.

In June 2018 Kina Bank Limited (KBL) announced that its major shareholder Fu Shan Investments Limited (Fu Shan), had sold its entire shareholding in Kina Securities Limited (KSL), the holding company of KBL. With the reduction of Fu Shan's shareholding, KBL met the final condition of its banking licence.

Also in June the Bank consented to KBL's proposal to purchase the retail portfolio of ANZ Bank Limited, subject to the completion of the conditional sale and purchase agreement and a full assessment by the Bank of Papua New Guinea.

In July Police & State Services Savings and Loans Society (POLSAV) and Teachers Savings and Loans Society completed their merger, with Teachers SLS taking over the management of POLSAV.

In November the Bank granted a full life insurance licence to BSP, authorising BSP Life Limited (BSPL) to operate as a Licensed Insurance Company in PNG.

Pictured below is the official presentation of the licence by Deputy Governor Dr Gae Kauzi and Assistant Governor Mr Ellison Pidik to BSP's Chief Executive Officer, Mr Robin Fleming.

Supervisory Enforcement Actions

Reviews

The Bank conducts prudential reviews or examinations of regulated institutions as part of its supervisory role in strengthening the risk management systems and compliance capacity.

During 2018 the Bank conducted 20 on-site prudential reviews or examinations on the 4 commercial banks (1 bank was visited twice), 6 licensed financial institutions, 6 savings and loan societies, 2 licensed trustees and 1 licensed investment manager.

The Bank also held 12 prudential consultations with 6 licensed financial institutions, 1 licensed trustee, 2 licensed investment managers and 2 life insurance companies.

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 August 2018 the Bank participated in a supervisory college with BSP in Vanuatu, in which the Governor and Deputy Governor of the Reserve Bank of Vanuatu also participated.

Employee superannuation contribution enforcement

In October the Bank commenced a program of onsite visits to 225 employers around PNG identified as not complying with the superannuation rules. The visits to the provinces included meetings with the key stakeholders, the provincial administrators and the ASF branches.

Statutory Administration, Management and Liquidation Activities

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

Regulation and Supervision Development

Online reporting

The Bank continued to encourage authorised institutions to report online. By the end of 2018 the majority of institutions in the financial system had moved to online reporting, including the 4 commercial banks, 13 LFIs, the 4 ASFs, 3 LICs and 6 SLSs.

Directors pipeline project

In November 2018 the Bank and the University of Papua New Guinea (UPNG) signed a Memorandum of Agreement to confirm the funding arrangements for the proposed post-graduate diploma program on governance.

The diploma program is the first part of the arrangement established between the Bank, the PNG Institute of Directors (PNGID) and UPNG, to establish a framework through which aspiring company directors can achieve relevant qualifications.

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, focuses on raising understanding of good governance and building capability in its practice. 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

The program did not continue in 2018. Having provided reports to the ASFs in 2017, the Bank encouraged them to undertake the recommended Board reviews.

Financial Sector Development Strategy

The National Executive Council approved the Financial Sector Development Strategy (FSDS) in August 2018. The strategic responsibilities of the FSDS include:

- framing PNG's financial sector regulatory and supervisory arrangements
- developing PNG's government bond and capital markets
- continuing development of the national payments system
- continuing implementation work in financial inclusion.

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.

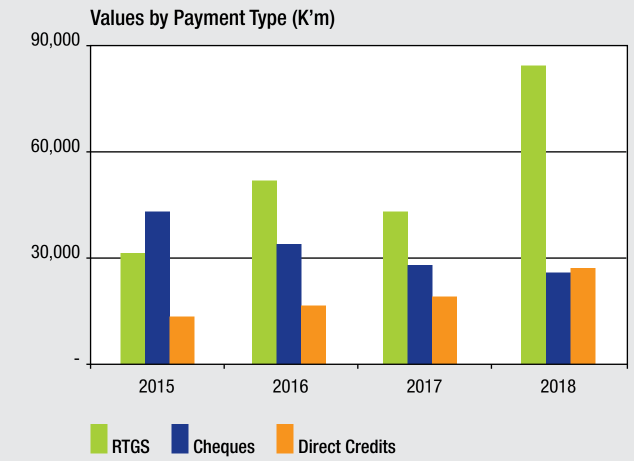
Over the course of the year the Bank continued to enhance and improve the NPS.

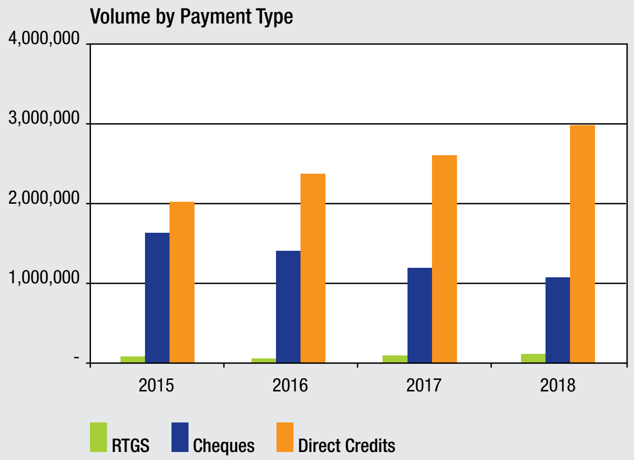
The Bank's other NPS responsibilities include currency management and government banking and agency services.

KATS

With KATS enabling a considerable increase in the number of electronic payments, the number of cheques processed continued to decline during 2018. The increase in electronic payments included high value payments associated with an increase in interbank lending and borrowing, active trading in the repurchase agreement facility, the increase in intervention by the Bank and direct credit arrangements offered by financial institutions.

The Bank continued to implement the payments facility to enable Government Departments make digital payments faster and more secure. During the year the Department of Finance went live with electronic file transfer payments, thereby enabling Government payments to be uploaded through their own systems for remittance through KATS. This was a significant contribution to the increase in real time gross settlements (RTGS) during the year.





Retail Electronic Payments System (REPS)

Over the course of 2018 the Bank worked on the legal, commercial, operational and technical frameworks for a retail payment system with the necessary compatibility to give access to all providers.

The REPS will be phased in with the National Switch (the system that will enable the REPS).

When in full operation, the REPS will enable all providers, including mobile banking service providers, to exchange and use information across the National Payment System.

AML Compliance enabled through KATS

In 2018 the Bank further enhanced the Anti-Money Laundering (AML) module in KATS to strengthen compliance. The module screens domestic RTGS payments processed through KATS against an international sanction list.

National Payments Council

During the year the National Payments Council was established under the terms of the *NPS Act 2013*. The Council is an advisory body to provide governance oversight of the REPS project and serve as a forum to discuss other strategic payments matters.

Resized K100 Banknote – 150mm x 70mm

Resized K2 Banknote – 125mm x 70mm

Resized K50 Banknote – 145mm x 70mm

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.

Currency Distribution

The Bank distributes cash from its head office in Port Moresby and from the Cash Distribution Centres (CDCs) in Lae, Morobe province and in Kokopo, East New Britain province.

Modernisation

Over the course of 2018 the Bank continued to improve the NPS by ensuring an adequate supply of currency and maintaining a higher quality of currency in the economy. To this end, the Bank undertook a major refurbishment of the currency operations area in Head Office, Port Moresby and installed new currency processing systems in Port Moresby and in Lae.

Lae Currency Distribution Facility

The handover of the Lae CDF building occurred in November, marking the completion of the general building construction and the finalising of the vault design.

Currency Development

APEC commemorative note and coins

In November the Bank launched a limited supply of a special K100 banknote into circulation to commemorate the APEC meetings held in PNG during the year. As shown in the picture above left, the note features the APEC logo. The Bank also launched a special coloured 50 toea coin for circulation (pictured above left), as well as a K100 gold coin and a K5 silver platinum coin intended as numismatic items, all featuring the APEC logo.

Re-sized banknotes released

Timed to coincide with the APEC meeting activities, the Bank released re-sized K2 and K50 banknotes in November. The Bank undertook the resizing of the notes as part of the banknote reform program, so each denomination can be differentiated readily by size. Both banknotes maintain their original design and security features (with the addition of an extra security feature on the K50), but the new banknotes are slightly smaller than the previous notes.

Clean Bannote 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 in Circulation

Total currency in circulation increased to K2,155.1 million by the end of 2018 (2017: K2,076.2 million). The value of the coins in circulation at 31 December 2018 was K87.8 million (2017: K84.7 million). The value of banknotes in circulation at the end of the year was K2,067.3 million (2017: K1,991.5 million).

The Bank recorded an increase in demand for K100 and K50 denominations by the commercial banks and a slight increase in demand for 20 and 10 toea and K1 coins.

Notes and Coins in Circulation

Notes Denomination	Value K'm 2018	Value K'm 2017	Value K'm 2016	Value K'm 2015
K2	58.2	56.1	56.2	52.7
K5	29.7	57.7	59.1	52.4
K10	86.8	84.1	85.1	72.6
K20	194.7	192.2	210.2	185.0
K50	518.1	488.7	491.1	407.2
K100	1,149.8	1,112.7	1,132.4	969.0
Sub Total	**2,067.3**	**1,991.5**	**2,034.1**	**1,738.9**
Coins Denomination				
K2	0.2	0.2	0.2	0.2
K1	28.4	26.8	25.4	24.3
50 Toea	7.7	7.5	7.1	6.8
20 Toea	22.1	21.6	20.9	20.1
10 Toea	22.5	21.9	21.1	20.1
05 Toea	6.9	6.7	6.6	6.4
Sub Total	**87.8**	**84.7**	**81.3**	**77.9**
Total	**2,155.1**	**2,076.2**	**2,115.4**	**1,816.8**

In August the Bank's information team visited Vanimo, Sandaun Province.

New Notes and Coins

During 2018 the Bank issued new notes and coins amounting to K519.25 million (2017: K3.43 million). The Bank recorded an increase in demand for K100, K50 and K20 banknotes by commercial banks and a slight increase in demand for coins to cater for the temporary closure of the Bank's Port Moresby facility during the refurbishment.

New Notes and Coins issued in 2018

Notes Denomination	Value K'm 2018	Value K'm 2017	Value K'm 2016	Value K'm 2015
K2	21.7	21.8	21.3	21.7
K5	25.0	23.3	25.6	24.9
K10	27.0	25.9	37.7	34.5
K20	60.2	51.2	93.7	74.8
K50	168.0	154.3	171.8	142.5
K100	214.0	101.0	256.8	215.0
Sub Total	**515.9**	**377.4**	**606.9**	**513.4**
Coins Denomination				
K1	1.48	1.4	1.0	1.2
50 Toea	0.27	0.37	0.34	0.40
20 Toea	0.68	0.70	0.59	0.14
10 Toea	0.74	0.84	0.86	0.83
05 Toea	0.18	0.12	0.2	0.28
Sub Total	**3.35**	**3.43**	**2.99**	**2.85**
Total	**519.25**	**380.83**	**609.89**	**516.25**

Destruction of Soiled Banknotes

	VALUE OF SOILED NOTES DESTROYED			
Notes Denomination	K'm 2018	K'm 2017	K'm 2016	K'm 2015
K2	11.7	20.1	19.7	16.9
K5	13.8	24.1	18.5	22.7
K10	13.0	26.3	23.6	31.7
K20	27.6	54.7	67.9	99.5
K50	100.4	112.1	109.8	152.5
K100	126.4	125.9	142.7	157.5
Total	**292.9**	**363.3**	**382.2**	**480.8**

Numismatic Items

The Bank sells commemorative items to the public and currency collectors worldwide. Total value of sales was K0.8 million in 2018 (2017: K0.6 million), reflecting the popularity of the new notes and coins released to commemorate the APEC meetings.

As well as the 2018 APEC K5 and K100 gold coin sets and the new re-sized K2, K5 and K100 banknotes, the most popular items purchased during the year were the 1998 50 toea coin set, the 35th Anniversary K2 coin pack, the 2012 K50 silver coin, the 2015 UPNG coin sets and the South Pacific Games coin sets.

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 Government maintained 42 drawing accounts for national departments and 93 trust accounts with the Bank during 2018. The balance of the trust accounts at 31 December 2018 was K732 million (2017: K333 million).

In line with the National Government's roll-out of the Integrated Financial Management System (IFMS) to the Provinces and Districts, 104 new drawing accounts were opened at the Bank, 21 for provincial treasury drawing accounts and 83 district treasury drawing accounts. By the end of 2018 only one province was yet to participate in IFMS.

The largest Government transactions the Bank processed during the year continued to be for the Provincial and District Services Improvement projects, Provincial and District grants, Tuition Fee Free Education, APEC, Autonomous Bougainville Government Grants, Medical Supplies and Infrastructure Development Projects co-ordinated by the Department of Works.

By the end of 2018 the Bank had provided access to IRC, Customs and the Department of Finance to the Banking Services System, enabling these Departments to view balances and run statements and customer designed reports from terminals installed at their offices. The Department of Finance also implemented the Electronic Files Transfer (EFT) function. As a result, all cash fund certificate related payments, including provincial and district grants, development grants to the provinces, statutory bodies' transfers and grants to hospitals are now disbursed through EFT.

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.

In 2018 the TAF limit remained at K200 million. The Government used the facility frequently to meet temporary mismatches in its cashflow across the course of the year.

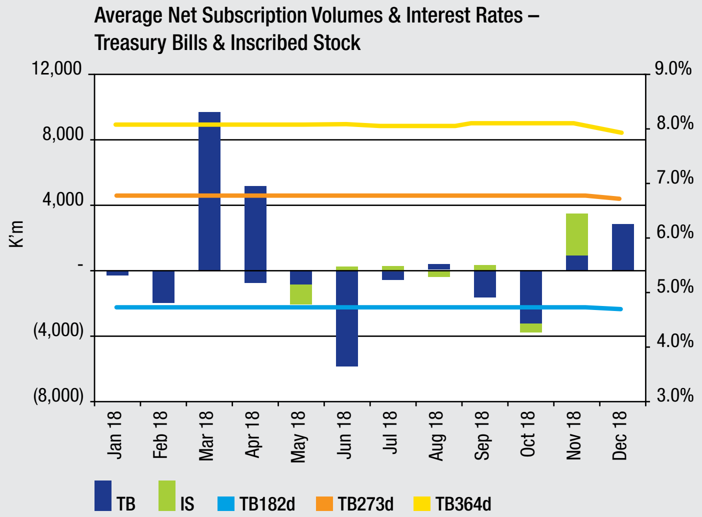
Government Agent Operations

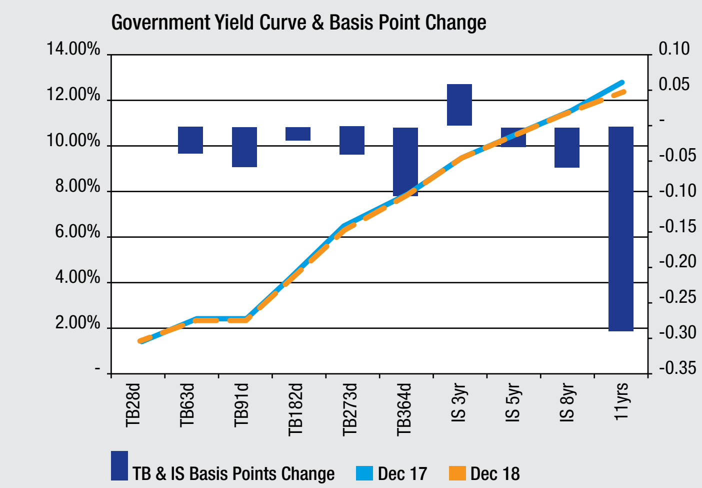
The Bank of Papua New Guinea is the agent for the National Government as an authorised issuer, registrar and paying agent for Government securities.

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 2018 the Government issued its Treasury bills in 91, 182, 273 and 364 day terms. Treasury bonds were issued monthly in the 3, 5, 8 and 11 year terms.

The interest rates for most Treasury bills and bonds remained steady in 2018. However, in November investor demand improved as the market reinvested proceeds from a significant Treasury bond coupon and maturity payment.

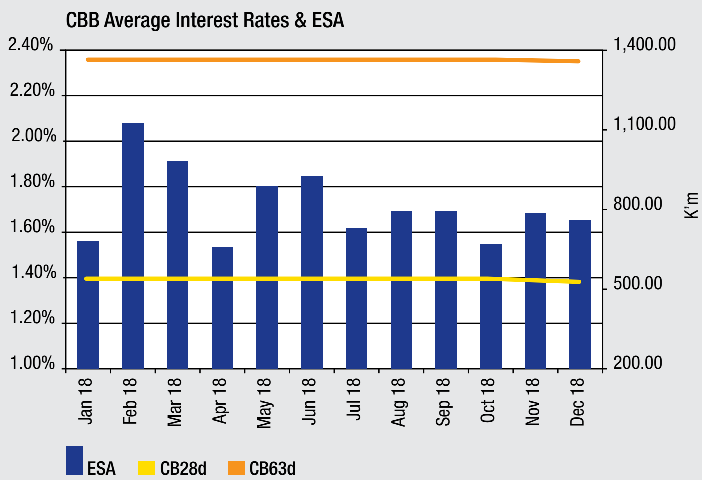


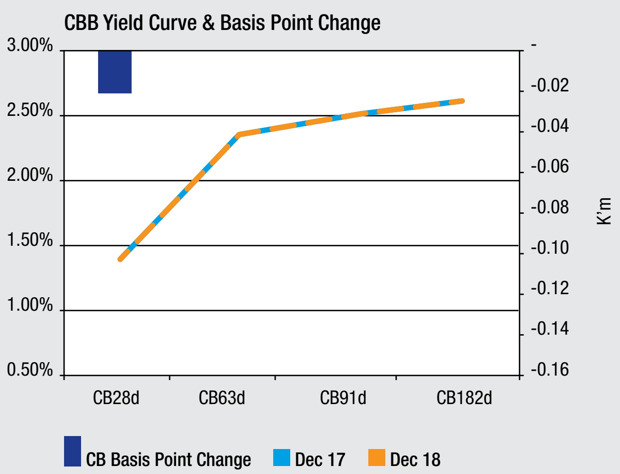


Central Bank Bills

The Bank issued its Central Bank Bills (CBB) mainly in the shorter-dated terms of 28 and 63 days to implement monetary policy. In 2018 CBB interest rates remained stable in spite of good demand by investors.

Banking system liquidity, as measured by the Exchange Settlement Account (ESA) balances, remained elevated around the K900.0 million level. The high ESA level reflected the retirement of domestic market investments by investors to meet their exposure limits, coupled with increased Government spending.

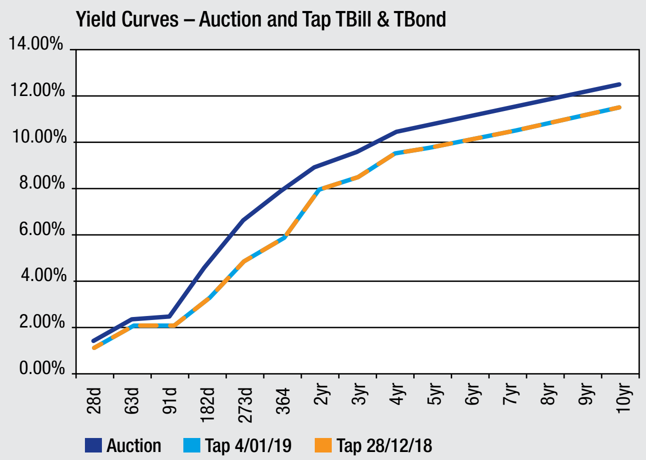




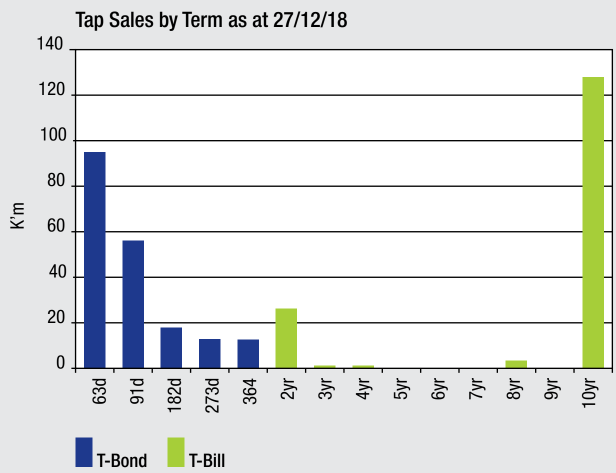
Tap Facility

The CBB Tap facility aims to encourage investment by individuals, to help develop a savings culture within PNG society. It provides an opportunity for individuals and small businesses, ineligible to participate at the primary auctions, to invest in government securities.

Under the facility T bills were issued in the 63, 91, 182, 273 and 364 day terms and T bonds issued in the 2, 4, 8 and 10 year terms.



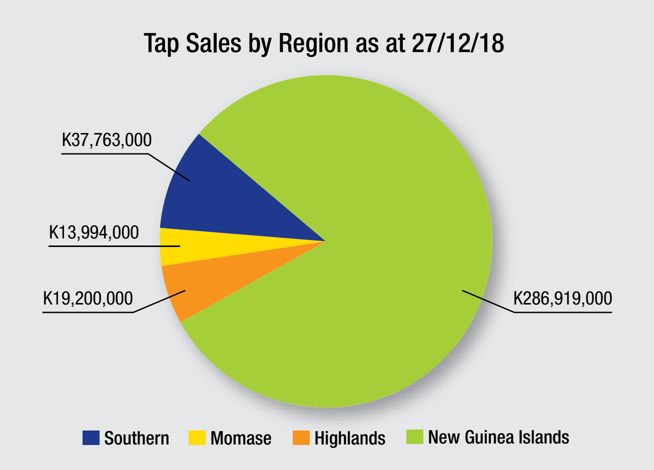
At the end of 2018 the total outstanding Tap stock was K242 million, a substantial increase from the 2017 level of K82.7 million.

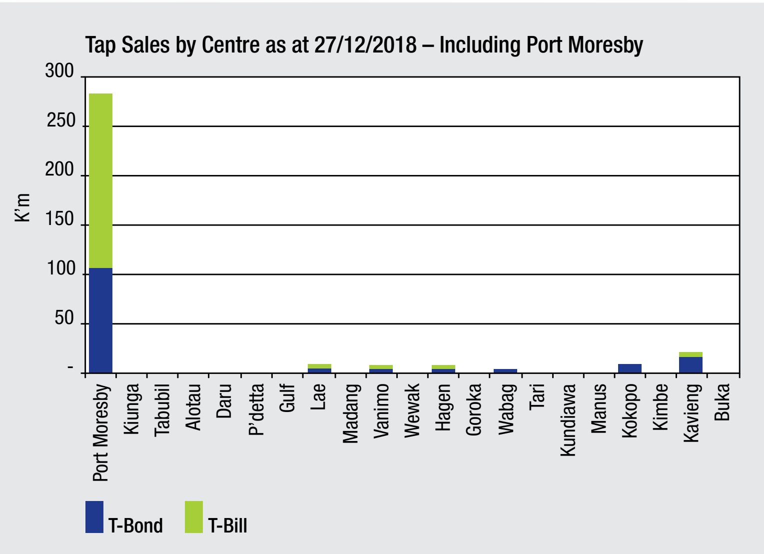


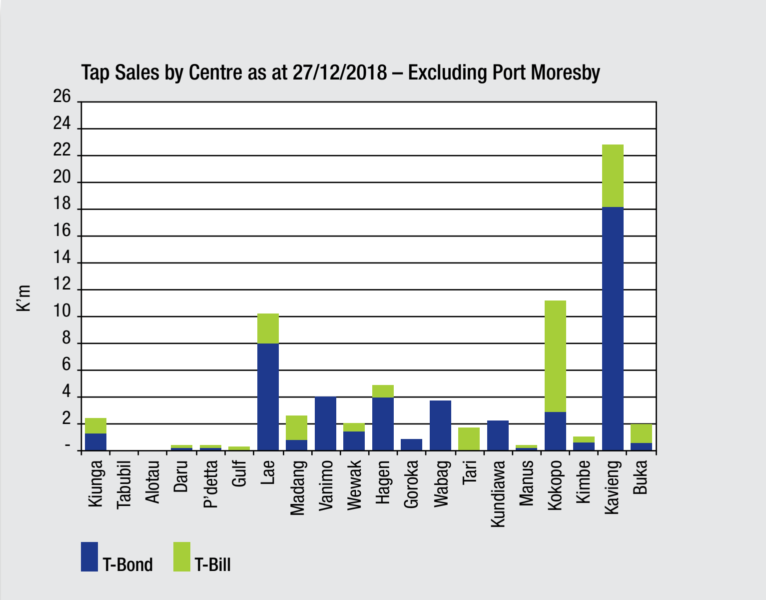
Tap Investment Awareness Program

For a number of years the Bank has conducted awareness presentations around the nation. The sessions, designed for the general public, usually include information about the role of the Bank of Papua New Guinea as the country's central bank, the investment opportunities available in the domestic market, as well as warnings about scams and fast money-making schemes. During 2018 the Bank presented a series of sessions in the New Guinea Islands region, with the major focus on Tap investments, KATS, currency matters and other key functions of the Bank.

The success of the awareness program in 2018 was reflected in substantial growth in Tap investments during the year and in the positive feedback received from seminar attendees.







'Slack' Arrangement

Based on an agreement between the Department of Treasury and the Bank, in previous years the Bank took up the under-subscription of T bills at the weekly auctions ('slack'), to enable the Government to finance priority government expenditure, such as health, education and key infrastructure. In turn, the Bank sterilised the injection of liquidity resulting from the take-up of the slack, by on-selling the securities to the public through the Tap facility and the issuance of CBBs.

At the end of 2018 the outstanding balance of slack stood at K630.3 million (2017: K1,230.7 million). The reduction in the slack holding reflected the conclusion of the agreement with the Department of Treasury and retirement of T bills from the proceeds of foreign loans.

Repurchase Agreements

The unsecured Repurchase Agreement ("Repo") market was active throughout 2018, with the commercial banks using both overnight and term Repos to fund shortfalls in their Exchange Settlement Accounts. The Bank offered Repos at the Kina Facility Rate (KFR) plus a 1.00% margin.

The Bank completed a master agreement and operational policy in 2018 to facilitate collateralised repurchase agreements.

Government Debt

In 2018 the Government's issuance strategy was to lengthen the duration of its debt profile by redeeming Treasury bills and re-issuing as Inscribed stock (Treasury bonds). The aim was to reduce roller risk in T bills and minimise the cost of debt.

At the end of the year total borrowing by the Government from the public amounted to K17.0 billion, a decrease of K0.2 billion from the end of 2017.

The borrowing comprised K8.3 billion Inscribed stock (2017: K8.0 billion) and K8.7 billion in T bills (2017: K9.2 billion).

Treasury bonds

	K'm
Issued in 2018	999
Maturities in 2018	656
Net Issuance	344
Outstanding at 31 December 2018	8,322
Outstanding at 31 December 2017	7,979
Increase in balance	344
BPNG holdings 31 December 2018	2,063
BPNG holdings 31 December 2017	2,098
Net decrease in BPNG holdings	-0.36

Treasury bills

	K'm
Outstanding as at 31 Dec 2017	9,194
Issued in 2018	10,047
Slack issued in 2018	1,130
Maturities in 2018	9,968
Slack maturities in 2018	1,727
Net issuance	79
Outstanding as at 31 Dec 2018	8,677

Central Bank Bills

	K'm
Outstanding as at 31 Dec 2017	2,012
Issued in 2018	22,200
Slack issued in 2018	11,920
Maturities in 2018	22,046
Slack maturities in 2018	12,319
Net issuance	154
Outstanding as at 31 Dec 2018	2,166

BPNG Bill Tap facility

	K'm
Outstanding as at 31 Dec 2017	31
Issued in 2018	124.4
Maturities in 2018	69
Net issuance	56
Outstanding at 31 December 2018	87

BPNG Bond Tap facility

	K'm
Outstanding at 31 December 2017	52
Issued in 2018	109
Maturities in 2018	6.2
Net Issuance	103
Outstanding at 31 December 2018	155

Secondary Market Development

Having an active domestic secondary market for government securities is important for any economy. One of the Bank's strategic goals is to enable and promote better functionality of this market.

Over the course of 2018 the Bank continued to use the Registry and Money Market System (RMS) to facilitate secondary market transactions. Due to the lack of liquidity in the secondary market, primary market investors are unable to sell their Government securities 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 of the effect on monetary policy as a result of policy of the Government.

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 2018. Papers ready for publication included:

- Equilibrium Real Exchange Rate and its Misalignment in PNG
- The Monetary Policy in PNG, a SVAR Approach
- Estimating Excess Liquidity Demand Model for PNG.

Strategic Research Activities

Macroeconomic and Fiscal Framework development

The development of the Bank's Macroeconomic and Fiscal Framework (MFF) progressed rapidly through 2018. The MFF, a financial programming and policies tool designed to deepen the Bank's understanding about the links between the different sectors of the economy and the potential impact of shocks on the sectors, is a collaboration between the Bank and the IMF's Pacific Financial Technical Assistant Centre (PFTAC).

In July the MFF featured as a case study during a regional macroeconomics workshop held in the Solomon Islands, attended by technical staff from Pacific Island central banks and government agencies.

Collaboration with Griffith University

In collaboration with Griffith University, Australia in 2018 the Bank produced several research papers:

- Foreign Exchange Shortage in PNG – Is Devaluation an Option?
- Determinants of Private Sector Credit in PNG
- Exchange Rate Volatility and its Impact on Trade in PNG
- PNG Money Multiplier
- Advancing Financial Inclusion Using Digital Technology in PNG.

The research papers were presented at the Central Bank conference held in Suva, Fiji during the year.

Collaborative research with SEACEN

The Bank took part in two SEACEN collaborative research projects, producing two papers:

- Cross-Border Interbank Risk Analysis
- Price-setting and Inflation Dynamics in Papua New Guinea.

Surveys

Business Liaison and Employment surveys

In 2018 the Bank updated its Business Register to reflect the results of the resampling exercise conducted over the previous year. The resampling project involved selecting a final sample of 390 companies from over 3,000 registered companies, to participate in regular surveys. Reported in the Bank's Quarterly Economic Bulletin (QEB), responses to the regular Business Liaison and Employment surveys are key to the Bank's understanding of the economy's performance.

During the year the Bank began surveying all companies on the Business Register on a quarterly basis. Previously large companies were surveyed each quarter, but small to medium enterprises were surveyed annually. The change in survey frequency reflected the Bank's recognition of the increasing demand for up-to-date information.

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 (NFIS 2), in particular through its close working relationship with the Centre of Excellence for Financial Inclusion (CEFI).

Financial inclusion and financial literacy

Key results in 2018	End 2018	End 2017
Total deposit accounts	3,203,882	3,066,133
Number of access points	16,509	15,391
Number of branches	216	211
Number of ATMs	463	463
Number of EFTPOS merchants	15,379	14,308
Number of agents	475	409
Number of mobile financial service accounts	600,881	509,033

The Centre for Excellence in Financial Inclusion (CEFI)

CEFI is the apex organisation responsible for coordinating all financial inclusion activities in PNG, including the implementation of the National Financial Inclusion Strategy 2016-2020 (NFIS 2), the nation's second financial inclusion strategy.

The Strategy identifies 9 priority areas for support to expand financial inclusion:

1. Digital Financial Services
2. Inclusive insurance
3. Financial Literacy and Financial Education
4. Financial Consumer Protection
5. Informal Economy and Agricultural Finance
6. SME Finance
7. Resources Sector Engagement (mining areas)
8. Data Collection and Dissemination
9. Government Engagement

Financial Inclusion Policy approved by National Government

In September the National Executive Council approved the National Financial Inclusion Policy, firmly positioning financial inclusion as a policy priority and recognising financial inclusion as a key driver for PNG's economic and social development. The Policy provides a framework through which all government agencies support financial inclusion efforts.

Strategy rollout

The rollout of NFIS 2 continued through the year, assisted by the formation of 7 working groups representing industry leaders from Government and the private sector, who met regularly to review the progress of the implementation.

The focus of the second Strategy is 'usage', noting that 'access' and 'quality' are prerequisites for effective usage. NFIS 2 also notes that 'financial literacy' and 'consumer awareness' must be strengthened to drive usage.

The Strategy also confirms the commitment of PNG and the Bank to the Maya Declaration, originally signed in 2013. In September 2018, at a meeting in Russia, BPNG renewed the commitment by pledging to reach an additional 2 million currently unbanked low income people, half of which number to be women. The Strategy reflected this commitment by setting a target of 2 million additional accounts by the end of 2020, 50% of which are to be owned by women.

Strategic alliances

Partnership with Department of Agriculture

In October 2018 CEFI and the Department of Agriculture launched the design for the "Market for Villagers" project. CEFI is the implementation partner for financial inclusion activities for the US$38 million project, funded by the International Fund for Agricultural Development (IFAD), an agency of the United Nations.

Partnership with MIX Market

CEFI's partnership with the international microfinance information exchange, MIX Market, enables operational and financial performance information about PNG's microfinance institutions to be compiled and published for a global audience. Nine PNG institutions provided information through CEFI to MIX Market's latest reports, including the Annual Benchmark Report for Papua New Guinea.

Projects

Financial inclusion activities rollout pilot program

In 2018 CEFI selected four provinces, Milne Bay, East New Britain, Eastern Highlands and Madang Provinces, to take part in a pilot program of financial inclusion activities. The first steps in the project are

- conduct awareness workshops
- generate a list of financial inclusion activities to be rolled out in those provinces
- determine the appropriate governance structure for the pilot program.

Mobile banking feasibility study

During the year CEFI conducted a feasibility study in the Namatanai District of New Ireland Province to establish the current status of banking services in the district and to gauge the viability of banking and mobile banking services. The study found that the market was ripe to launch banking services through a super-agent with its own agent network model. As a result, the MiBank Super Agent operation in Namatanai was opened in November.

Data mapping

Recognising the particular challenge presented by geography to the delivery of financial services within PNG, CEFI and BPNG commenced a project to map the spatial dimension of financial access points across the country. The project aims to use this data to provide policymakers, regulators, financial services providers and customers with interactive information. During 2018 CEFI and BPNG conducted a number of workshops and training sessions for financial institutions participating in the pilot program.

Information flow

Throughout the year CEFI continued to collect, verify and consolidate financial inclusion data on a quarterly basis from all the regulated financial institutions. This information is published on the AFI and CEFI websites.

As well as its quarterly newsletter, CEFI Nius, CEFI provides information online through the official website (www.thecefi.org). During 2018 CEFI expanded its online presence to social media, establishing Facebook, twitter and LinkedIn pages.

Microfinance Expansion Project

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

In 2018 the following activities took place:

Financial education

212,691 people, including 100,972 women (47% of total), participated in financial education and training, exceeding project targets.

12,338 people attended business development training, including 7,434 women. 3,836 women were trained by women.

Products

Partner Financial Institutions (PFIs) successfully trialled and introduced eighteen new products into the market.

Industry capacity development

Work to build the accounting capacity and ICT infrastructure of PFIs commenced, including core banking and operational system upgrades.

PFI staff participated in 3.5 thousand person days of training.

Management of the Risk Share Facility (RSF) was handed over to the Bank, with oversight provided by an independent Board comprised of key industry partners. Four risk share agreements were signed with lending financial institutions. The number of transactions covered by RSF grew over the course of the year, with 1,886 loans covered.

The total value of loans covered by RSF was K23.5 million at the end of 2018. Around 90 percent of this total, 1,716 loans amounting to K7.5 million, were made to women or SMEs.

Industry supervision

The Microfinance Industry standards were issued to the PFIs.

BPNG strengthened the regulatory and oversight mechanisms for MFIs and Savings and Loans Societies.

FINANCIAL INTELLIGENCE MONITORING

The Financial Analysis and Supervision Unit (FASU) is Papua New Guinea's Financial Intelligence Unit. FASU is an operationally independent unit, established by legislation. Its role is to coordinate efforts to protect PNG and the integrity of the PNG financial system against money laundering and terrorist financing (AML/CTF) and other serious financial crime.

AML/CTF activities conducted by FASU throughout 2018 included signing information-sharing agreements with 5 other international FIUs and 2 domestic agencies.

In October FASU received a second 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 2018 included:

- The National Executive Council (NEC) endorsed the PNG National Risk Assessment report on AML/CTF risks in Papua New Guinea and the National AML/CTF Strategic Plan 2017-2022.
- Completion of a new database to improve financial intelligence capabilities. AusAID provided funding support and AUSTRAC supplied technical assistance.
- Participation in several international training programs and information exchange opportunities, including financial investigations and prosecutions relating to forestry crime, with assistance from INTERPOL.
- Provision of technical assistance for reporting entities to develop best practice due diligence guidelines, with support from ADB.
- Conduct of awareness and education forums on the roles and responsibilities of the FASU and the obligations of the reporting entities in Goroka, Kavieng, Kimbe, Kokopo, Lae, Madang, Port Moresby and Vanimo.
- Conduct onsite visits to 3 commercial banks.

Participants in the financial investigations training program conducted by BPNG and Interpol in April. The training focussed on forestry crime, land use and other related crimes.

Institutional Support

STRATEGIC AND OPERATIONAL MANAGEMENT

During 2018 the Bank conducted a mid-term evaluation of the Strategic Plan 2016-2020, to review progress and confirm the remaining implementation priorities.

The Bank reviewed the business continuity plan to consider the potential impact of the APEC activities on the Bank's operations and incorporated the results of the review into the development planning for the Bank's business resumption site.

Key achievements in 2018 included:

- Establishment of the Sogeri Accord, a document of commitment signed by members of the Bank's management, arising from the Sogeri management workshop
- Improvements to monitoring and reporting strategic initiatives, programs and projects
- Rationalisation of strategic activities as a result of portfolio review and project reprioritisation
- Progress towards strengthening the Bank's institutional governance framework
- Further alignment of budgeting to strategic plans.

With the half-way point of the Bank's Strategic Plan 2016-2020 reached during the year, senior management participated in a workshop to review and measure progress against the Plan's objectives. An important outcome from the workshop was the establishment of the Sogeri Accord, a restatement of commitment from members of the management team.

From left: Aileen Watangia, Augustine Birie, Jerome Peniasi, Moses Kiriat and Romney Tabara participated in the Sogeri workshop.

HUMAN RESOURCES MANAGEMENT

Staff Numbers

Staff Category	2018	2017	2016
Non-management level staff	417	388	350
Management	59	57	57
Executive	6	5	5
Total	482	450	412

Staffing

The Bank continued its focus on attracting, retaining and equipping its staff to achieve the Bank's functional objectives. In 2018 the staff complement increased by 32, mainly as a result of expanding functions and workloads, recruitment for the Lae office and strengthening capacity across the Bank.

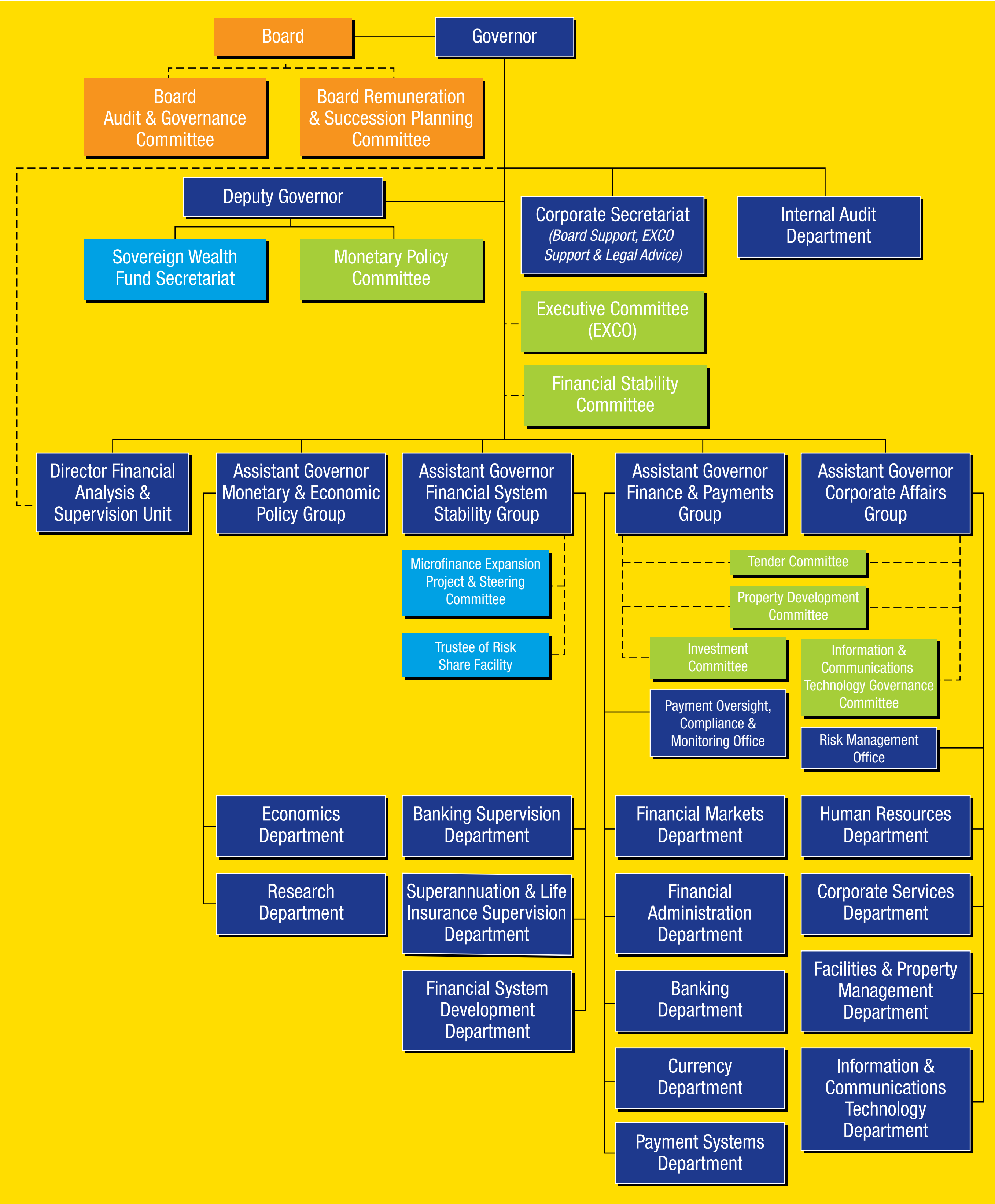
Employee Capacity Development

As in previous years, the Bank sponsored employees to attend local and offshore training programs and other development opportunities. These included workshops, conferences, short courses and more long-term formal studies. Twenty-seven staff members were engaged in studying various business and finance related programs, from diploma level to post-graduate qualifications. Five employees returned to resume their duties with the Bank, after successfully completing their programs of study, 3 with overseas post-graduate qualifications and 2 with local bachelor degrees.

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

Over the course of 2018 the Bank also rolled out structured capacity development programs for staff, including employee engagement workshops and opportunities to participate in activities to help build leadership and communication skills.

Organisation Chart (31 December 2018)



Senior officers (31 December 2018)	
Governor	**Loi M. Bakani CMG**
Deputy Governor	Dr Gae Kauzi
Secretariat	
Corporate Secretary	Tau Vini
Internal Audit	
Manager	Benek Beriso
Manager, Operations Audit	Frieda Kamakom
Manager, IT Audit	Justin Wohuinangu
Financial Analysis and Supervision Unit	
Director	Benny Popoitai MBE
Deputy Director	Wilson Onea
Manager, Supervision & Compliance Division	Rosa Bank
Manager, Intelligence Management Division	Edric Ogomeni
Monetary & Economic Policy Group	
Assistant Governor	Vacant
Economics	
Department Manager	Thomas Jiki (Acting)
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
Financial System Stability Group	
Assistant Governor	Ellison Pidik
Banking Supervision	
Department Manager	Sabina Deklin
Manager, Banks & Finance Companies	Boas Irima
Manager, Savings & Loan Societies	Nickson Kunjil

Senior officers (31 December 2018)	
Superannuation & Life Insurance Supervision	
Department Manager	Elizabeth Gima
Manager, Superannuation	Tom Milamala
Manager, Life Insurance	Joseph Nukints
Manager, Employer Contributions Enforcement	Nonza Makip
Financial System Development	
Department Manager	George Awap
Manager, Macro-Prudential Supervision	Maria Kanari
Manager, Financial System Policy	Tanu Irau
Manager, Licensing and Compliance	Walio Gamini
Finance & Payments Group	
Assistant Governor	Joe Teria
Payments Oversight & Compliance Office	
Manager	Alfred Napun
Manager, Monitoring & Analytics	Francis Poko
Financial Markets	
Department Manager	Rowan Rupa (Acting)
Manager, Foreign Reserves	Rowan Rupa
Manager, Money Markets Operation	Winnie Linken
Manager, Registry	Marie Martin
Manager, Middle Office	Ambrose Papis
Financial Administration	
Department Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Pala Tau
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)

Senior officers (31 December 2018)	
Currency	
Department Manager	David Lakatani
Manager, Control	John Yenas
Manager, Processing	Edward Kisakau
Payment System	
Department Manager	Gaona Gwaibo
Manager, Switch Operations & Support	Stephen Pouru
Corporate Affairs Group	
Assistant Governor	Elizabeth Genia
Strategic Management Office	
Manager	Nathan Maire
Risk Management Office	
Manager	Vacant
Human Resources	
Department Manager	Patrick Kwiwa
Manager, Strategy Planning and Development	Mairi Matthew
Manager, Administrative Support	Jennifer Tokome
Manager, Client Support	Hitolo Galamo
Officer, Projects	Romney Tabara
Information Communications & Technology	
Chief Information Officer	Naime Kilamanu
Manager, Corporate Systems	Elvis Haoda
Manager, Operations	Manea Joseph
Manager, Projects Management Office	Aileen Watangia
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	Varo Kapigeno

INFORMATION AND COMMUNICATIONS TECHNOLOGY SERVICES

The Information and Communications Technology (ICT) function within the Bank provides oversight, management and delivery of enterprise-wide ICT services.

In 2018 the Bank completed or progressed several strategic projects across the activities of the Bank, including updating and upgrading key systems, facilitating human resourcing through completion of the time & attendance system, enhancing security and business recovery systems and processes, and preparing for the operation of the Lae CDF.

Several strategic projects commenced during the year, including the National Switch and the Retail Electronic Payments System, and systems requirements relating to the Lae CDF.

With a strong focus on cyber security, during the year the Bank undertook staff awareness training, conducted penetration and vulnerability testing and implemented monitoring of security incidents.

Blockchain Development

In 2018 the Bank again sponsored and were judges at London Blockchain Week and Hackathon and delivered the final keynote address.

During the year the Bank visited Bangko Sentral ng Pilipinas, the central bank of the Republic of the Phillipines, to study their “Learn & Grow” environment as a basis for the development of a ‘regulatory sandbox’ for Papua New Guinea.

Work progressed on the development of an Identity Trust Framework. The aim of the Framework is to provide the financial sector with a consistent view of what constitutes an 'identity' and ways in which identities can be universally authenticated and verified across all institutions.

ADB and the Australian Government provided support for the Blockchain Project during 2018.

COMMUNICATIONS AND EVENTS COORDINATION

During 2018 the Bank’s communications and events staff were involved in a wide range of activities to support the Bank’s performance of its key functions and promote public awareness of the role of the central bank.

These included coordinating significant events, such as the official launch of the APEC currency and other APEC-related functions, organising the Bank’s participation in formal announcements, staging the investment information seminars held around PNG, participating in London Blockchain Week and blockchain awareness-raising activities in PNG, arranging financial inclusion activities and facilitating community support events and presentations.

As well as major events, the Bank produced and conducted the public launch of the two Monetary Policy Statements, issued a range of public information, including the Quarterly Economic Bulletin, participated as a guest speaker at a number of significant conferences and continued public information campaigns.

COMMUNITY SUPPORT

The Bank supports a number of professional, cultural, educational, sporting and health related causes. During 2018 the Bank donated to 36 various causes.

BPNG staff members conducted fund raising activities to support victims of the Highlands earthquake.

The Bank actively encourages staff to participate in Transparency International's annual Walk Against Corruption. Well over 30 Bank employees, proudly wearing their BPNG polo shirts, joined the 2018 Walk.

The community of the Magarida Station, Abu District, Central Province was delighted to receive the Bank's donation of a power generator.

BANK OF PAPUA NEW GUINEA

FINANCIAL STATEMENTS
FOR THE YEAR ENDING
31 DECEMBER 2018

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Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 December 2018

	Notes	2018 K'000	2017 K'000
Revenue from foreign currency investments			
Interest revenue	2	94,854	73,028
Realised gain/(loss) on financial assets		(34,896)	(11,788)
Foreign exchange gains and commissions		27,347	17,280
Total revenue from foreign currency investments		87,305	78,520
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(2,533)	(1,863)
Custodian and investment management fees		(6,604)	(5,856)
Total expenses from foreign currency investments		**(9,137)**	**(7,719)**
Net foreign currency income		**78,168**	**70,801**
Revenue from domestic operations			
Interest revenue	3	308,354	322,762
Other income	4	9,968	14,241
Total revenue from domestic operations		**318,322**	**337,003**
Expense on domestic liabilities			
Interest expense	5	(48,245)	(33,801)
Total expenses on domestic liabilities		**(48,245)**	**(33,801)**
Net domestic income		**270,077**	**303,202**
Total net operating income		**348,245**	**374,003**
Operating expenses			
General and administration expenses	6	(161,055)	(200,200)
Profit excluding unrealised income		**187,190**	**173,803**
Other unrealised income			
Fair value and foreign exchange revaluation gain on foreign currency investments		150,044	151,241
Fair value revaluation gain on domestic investments		5,273	41,886
Profit for the year		**342,507**	**366,930**
Other comprehensive income			
Items that may be subsequently reclassified to profit and loss			
Gain on gold asset revaluation		5,050	23,074
Items that will not be subsequently reclassified to profit and loss			
Gain on property valuation		24,760	-
Other comprehensive income for the year		**29,810**	**23,074**
Total comprehensive income for the year		**372,317**	**390,004**

The financial statements are to be read in conjunction with the notes on pages 51 to 82.

Statement of Financial Position

For the year ended 31 December 2018

	Notes	2018 K'000	2017 K'000
Assets			
Cash and cash equivalents	8	1,640,037	707,253
Financial assets at fair value through profit or loss	9	5,564,449	4,516,350
Assets held with IMF and other financial organisations			
at fair value through profit or loss	7	37,187	39,826
Accrued interest		19,462	18,858
Total foreign currency financial assets		**7,261,135**	**5,282,287**
Government of Papua New Guinea securities at fair value through profit or loss	10	2,660,968	3,264,954
Loans and advances	11	149,025	140,099
Accrued interest and other receivables		63,434	71,285
Total local currency financial assets		**2,873,427**	**3,476,338**
Total Financial Assets		**10,134,562**	**8,758,625**
Non-financial assets			
Gold		181,716	176,666
Property, plant & equipment	13	361,831	210,903
Investment properties	14	41,460	41,460
Other non-financial assets	12	70,678	51,628
Total non-financial assets		**655,685**	**480,657**
Total Assets		**10,790,247**	**9,239,282**
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF at fair value through profit or loss	7	593,735	581,857
Other financial liabilities	19	13,644	1,895
Total foreign currency financial liabilities		**607,379**	**583,752**
Local currency financial liabilities			
Deposits from banks and third parties	15	3,116,735	3,298,525
Deposits from Government and Government entities	16	1,505,423	460,259
Debt securities issued	17	2,402,654	2,089,739
Accrued interest payable on debt securities		1,751	1,677
Currency in circulation	18	2,151,993	2,073,747
Other financial liabilities	19	37,487	41,093
Total local currency financial liabilities		**9,216,043**	**7,965,040**
Total financial liabilities		**9,823,422**	**8,548,792**
Non-financial liabilities			
Provisions for employee entitlements	20	27,961	23,943
Total non-financial liabilities		**27,961**	**23,943**
Total Liabilities		**9,851,383**	**8,572,735**

	Notes	2018 K'000	2017 K'000
Equity			
Capital	21	145,540	145,540
Gold revaluation reserve	21	161,108	156,058
Property revaluation reserve	21	83,234	58,474
Unrealised gain/(loss) reserve	21	63,030	(92,287)
Building reserve	21	73,800	-
Retained earnings	21	412,152	398,762
Total Equity		**938,864**	**666,547**
Total Liabilities and Equity		**10,790,247**	**9,239,282**

The financial statements are to be read in conjunction with the notes on pages 51 to 82.

Statement of Changes in Equity

For the year ended 31 December 2018

	Capital K'000	Gold Revaluation Reserve K'000	Property Revaluation Reserve K'000	Unrealised Loss Reserve K'000	Building Reserve K'000	Retained Earnings K'000	Total K'000
Balance at 1 January 2017	**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**
Net transfers from retain earnings to building reserve	-	-	-	-	-	-	**-**
Dividend declared and paid					-	(100,000)	**(100,000)**
Asset Revaluation	-	-	-	-	-	-	**-**
Balance at 31 December 2017	**145,540**	**156,058**	**58,474**	**(92,287)**	**-**	**398,762**	**666,547**
Profit for the year	-	-	-	155,317	-	187,190	**342,507**
Net transfers from unrealised profit/(loss) reserve to retained earnings	-	-	-	-	-	-	**-**
Other comprehensive income	-	5,050	-	-	-	-	**5,050**
Net transfers from retain earnings to building reserve	-	-	-	-	73,800	(73,800)	**-**
Revaluation of PPE			24,760				**24,760**
Dividend declared and paid	-	-	-	-	-	(100,000)	**(100,000)**
Balance at 31 December 2018	**145,540**	**161,108**	**83,234**	**63,030**	**73,800**	**412,152**	**938,864**

The realised profit for the year is K187.2 million. The unrealised gain/(loss) reserve and net asset balance at 31 December 2018 are K63.03 million and K938.9 million, respectively. Board has approved and transferred the remaining 2017 Audited Profit of K73.8m to a Building Reserve Account. 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 51 to 82.

Statement of Cash Flows

For the year ended 31 December 2018

	Notes	2018 K'000	2017 K'000
Cash Flows from Operating Activities			
Interest received on foreign investments		94,250	72,005
Interest received on domestic investments		316,205	344,389
Fees, commissions and other income received		37,315	31,521
Interest paid on IMF liabilities		-	-
Interest paid on domestic liabilities		(48,171)	(33,698)
Payments to employees		(71,427)	(62,499)
Payments to suppliers		(94,578)	(97,735)
Fees and commissions paid		(6,604)	(5,856)
Net proceeds from sale of foreign investments		(920,968)	317,246
Net payment for Government Securities		584,259	564,061
Net loans repaid/(issued)		(11,078)	(57,180)
Net Cash Flow (used in) / provided by Operating Activities		**(120,797)**	**1,072,254**
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(29,493)	(18,128)
Payments for construction costs on capital projects		(71,499)	(55,705)
Proceeds from sale of property, plant and equipment		38	194
Net Cash Flow used in Investing Activities		**(100,954)**	**(73,639)**
Cash Flows from Financing Activities			
Net movement of currency in circulation		78,246	(40,463)
Net movement in debt securities issued		312,915	730,816
Distributions to the government		(100,000)	(100,000)
Net movement in deposits from government		1,045,164	(251,479)
Net movement in deposits from banks		(181,790)	(1,025,821)
Net Cash Flow provided / (used in) by Financing Activities		**1,154,535**	**(686,947)**
Net (Decrease)/Increase in Cash and Cash Equivalents		**932,784**	**311,668**
Cash and cash equivalents at 1 January		707,253	395,585
Cash and Cash Equivalents at 31 December	8	**1,640,037**	**707,253**

The financial statements are to be read in conjunction with the notes on pages 51 to 82.

Notes to the Financial Statements

For the year ended
31 December 2018

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 (CBA) 2000* (the "Act"). In the event of any conflict between the requirements of the Act and the Accounting Standards, the Bank is required to comply with the Act.

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

Going concern

The financial statements continue to be prepared on a going concern basis. The Bank recorded a net asset position of K938.9 million at 31 December 2018 (2017: net asset of K666.5 million). 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 increased investments in Government of Papua New Guinea securities.

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 2018 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 standard 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 16 Leases

This standard is effective for the Bank's annual reporting period beginning on 1 January 2019. IFRS 16 requires a lessee to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. Under the standard, the Bank will reflect in the Statement of Financial Position the right-of-use assets and lease liabilities in respect of the lease agreements. The impact on the Statement of Financial Position and the Statement of Comprehensive Income is being assessed by the Bank. The standard will not be adopted early and does not apply to the Bank until the period beginning on 1 January 2019.

There are no other standards that are not yet effective that would be expected to have a material impact on the Bank in the current or future reporting periods and on foreseeable future transactions. Other amendments made to existing standards that are not yet effective are not expected to result in a material impact on the Bank's financial report.

(e) Adoption of IFRS 15 Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers which replaces all existing revenue requirements and related interpretations and is effective for annual periods beginning on 1 January 2018. IFRS 15 redefined the principles for recognising revenue and is applicable to all contracts with customers other than contracts in the scope of other standards (e.g., interest and fee income integral to financial instruments which would be in the scope of IFRS 9 and lease income). Certain requirements in IFRS 15 are also relevant for the recognition and measurement of gains or losses on disposal of non-financial assets that are not in the ordinary course of business.

IFRS 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled to in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgement, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract. In addition, the standard requires extensive disclosures.

The Bank adopted IFRS 15 using the full retrospective method of adoption which requires it to restate comparative figures. Many of the Bank's revenue streams (e.g., interest income, gains and losses on financial instruments) are outside the scope of IFRS 15 and, therefore, accounting for those streams did not change as a result of the adoption of IFRS 15. The Bank's main revenue streams that are within the scope of IFRS 15 are commission income and licensing and other fees, which to were not materially affected by the requirements of IFRS 15.

(e) Adoption of IFRS 15 Revenue from Contracts with Customers

Commission income is charged to customers at the point in time when service is provided. The previous accounting policy was consistent with the requirements under IFRS 15 so no adjustments were required on transition.

The performance obligations related to licencing and other fees are satisfied over time as the related activity is being provided on the basis of passage of time, rather than at a specific point in time. The Bank previously recognised the licensing and other fees allocated to such a performance obligation over the period of time. This is materially in line with the requirements under IFRS 15 so no adjustments were required on transition.

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

(f) Adoption of IFRS 9 Financial Instruments

The Bank adopted IFRS 9 as of 1 January 2018. In accordance with the transition provisions of IFRS 9, comparative figures have not been restated.

Certain accounting policies were changed to comply with IFRS 9 which replaces the provisions of IAS 39 *Financial Instruments: Measurement and Recognition* that relate to the recognition, classification and measurement of financial assets and liabilities, hedge accounting and impairment of financial assets. IFRS 9 also amended other standards dealing with financial instruments, such as IFRS 7 *Financial Instruments: Disclosures* which resulted in additional disclosures included in the notes to the financial statements.

The impact of adoption of IFRS 9 to the Bank's Financial Statements is summaried below.

Classification and measurement of financial instruments

The Bank classified its financial assets as subsequently measured at either amortised cost or fair value depending on the business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective:

- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)

The expected frequency, value and timing of sales are also important aspects of the Bank's assessment. The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

A financial asset is measured at amortised cost only if the both of the following conditions are met:

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

In respect of financial liabilities, most IAS 39 requirements have been carried forward to IFRS 9, including the criteria for using the fair value option and the requirements related to the separation of embedded derivatives from hybrid contracts. One change introduced by IFRS 9 in respect of financial liabilities is related to liabilities designated at fair value through profit or loss (FVTPL) using the fair value option. The other change is the clarification that modifications to financial liabilities that do not result in derecognition, require a modification gain or loss to be recognised in profit or loss at the date of modification.

The adoption of IFRS 9 had 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 FVTPL, with the exception of loans and advances to staff.

The following table summarises the impact of classification and measurement to the Bank's financial assets and financial liabilities on 1 January 2018:

Financial Instruments	Assets	Original classification and measurement category under IAS 39	New classification and measurement category under IFRS 9	Original carrying amount under IAS 39 K'000	New Carrying amount under IFSR 9 K'000
Financial Assets					
Cash and cash equivalent	• Cash and short-term deposits	Cash and cash equivalent	Amortised cost	707,253	707,253
Loans and advances	• Loans to PNG commercial banks and agricultural export commodity support loans	Loans and receivables	Amortised cost	121,386	121,386
	• Loans and advances to staff – ex-staff	Loans and receivables	Amortised cost	789	789
	• Loans and advances to staff – current staff	Loans and receivables	Loans and receivables	26,197	26,197
Accrued interest and other receivables	• Other receivables	Loan and receivables	Amortised cost	71,285	71,285
Financial assets at fair value	• Foreign investments • Derivatives	FVTPL	FVTPL	4,516,350	4,516,350
Assets held with IMF and other financial organisations	• IMF SDR holdings and deposits and other organisations	FVTPL	FVTPL	39,826	39,826
Government of PNG Securities	• Government inscribed stocks • Treasury bills	FVTPL	FVTPL	3,264,954	3,264,954
Financial Liabilities					
Deposits from banks and third parties	• Deposit liabilities	Amortised cost	Amortised cost	3,298,525	3,298,525
Deposits from Government and Government entities	• Deposit liabilities	Amortised cost	Amortised cost	460,259	460,259
Accrued interest payable on debt security	• Interest payable	Amortised cost	Amortised cost	1,895	1,895
Other financial liabilities	• Foreign currency deposits • Expenses creditor	Amortised cost	Amortised cost	41,093	41,093
Debt securities issued	• Central bank bills	FVTPL	FVTPL	2,089,739	2,089,739
Currency in circulation	• Currency in circulation	FVTPL	FVTPL	2,073,747	2,073,747
Liabilities to IMF	• IMF loan accounts • SDR allocation	FVTPL	FVTPL	581,857	581,857

The following table is a reconciliation of the carrying amount in Bank's balance sheet from IAS 39 to IFRS 9 as at 1 January 2018.

Financial Instruments	Carrying amount under IAS 39 K'000	Reclassification	Remeasurement	Carrying amount under IFSR 9 K'000	Retained profit impact as at 1 January 2018
Financial Assets					
Cash and cash equivalent	707,253	-	-	707,253	-
Loans and advances, net of allowance for doubtful loans	140,099	-	-	140,000	-
Accrued interest and other receivables	71,285	-	-	71,285	-
Financial assets at fair value	4,516,350	-	-	4,516,350	-
Assets held with IMF and other financial organisations	39,826	-	-	39,826	-
Government of PNG Securities	3,264,954	-	-	3,264,954	-
Total financial Assets	**8,739,767**	**-**	**-**	**8,739,767**	**-**
Financial Liabilities					
Deposits from banks and third parties	3,298,525	-	-	3,298,525	-
Deposits from Government and Government entities	460,259	-	-	460,259	-
Accrued interest payable on debt security	1,895	-	-	1,895	-
Other financial liabilities	41,093	-	-	41,093	-
Debt securities issued	2,089,739	-	-	2,089,739	-
Currency in circulation	2,073,747	-	-	2,073,747	-
Liabilities to IMF	581,857	-	-	581,857	-
Total financial Liabilities	**8,547,115**	**-**	**-**	**8,547,115**	**-**

The Bank classifies and measures its derivatives and any assets held for trading at FVTPL. The Bank may designate financial instruments at FVTPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies, Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVTPL when they are held for trading and derivative instruments or the fair value designation is applied.

Financial assets and financial liabilities at FVTPL are those that are not held for trading and have been either designated by management upon initial recognition or are mandatorily required to be measured at fair value under IFRS 9. Management only designates an instrument at FVPL upon initial recognition when one of the following criteria are met. Such designation is determined on an instrument-by-instrument basis:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or

- The liabilities (and assets until 1 January 2018 under IAS 39) are part of a group of financial liabilities (or financial assets, or both under IAS 39), which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The liabilities (and assets until 1 January 2018 under IAS 39) contain one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited.

Changes to impairment of financial assets

The IFRS 9 impairment requirements are based on an expected credit loss model, replacing loss methodology model under IAS 9. Key changes in the Bank's accounting policy for impairment of financial assets are listed below.

The Bank applies a three-stage approach to measuring expected credit loss (ECL) on the loans and advances. At each reporting date, management assesses the credit risk of exposures in comparison to the risk at initial recognition. Debt instruments migrate through the following three stages:

- If no significant increase in credit risk is observed, 12-month ECL measurement applies to the debt instrument. (Stage 1)
- Lifetime ECL – not impaired measurement applies if the credit risk of a debt instrument at the reporting date has increased significantly since its initial recognition. (Stage 2)
- Lifetime ECL – impaired applies when the debt instrument becomes impaired. (Stage 3)

Exposures of credit risks are assessed on a collective basis in each stage where the loans and advances are grouped on the basis of shared credit risk characteristics, for which it takes into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry, geographical location of the borrower and other relevant factors, including forward looking macroeconomic factors. The exposure is assessed on an individual basis when there is sufficient evidence that one or more events associated with an exposure could have a detrimental impact on estimated future cash flows.

To assess the credit risk exposures, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort and that is relevant for an individual financial instrument, a portfolio, portion of a portfolio, and groups of portfolios. The information applied includes quantitative and qualitative information as well as forward looking analysis. The Bank also considers historical loss experience and adjusts for current observable data. The importance and relevance of each specific factor will depend on the type of product, characteristics of the financial instruments and the borrowers as well as the geographical region.

For loans and advances, judgement is required by management in the estimation of the amount and timing of future cash flows when determining an impairment loss for loans and advances. In estimating the cash flows, the Bank makes judgement about the borrower's financial situation and the net realisable value of collateral. Estimates are based on assumptions in relation to a number of factors.

The amount of ECL is measured at the probability-weighted present value of all cash shortfalls over the expected life of a debt instrument discounted at the original effective interest rate.

If the credit risk on that financial instrument deteriorates significantly since the initial recognition, at each reporting date the Bank measures the loss allowance for a loan or advances at an amount equal to the lifetime expected credit losses. The amount of shortfall is recognised as a provision for doubtful debts account. The cash shortfall is the difference between all contractual cash flows of the loans and advances due to the Bank and all the cash flows it expects to receive.

The interest recognition requirements are required on whether the loans and advances should be either originated as credit impaired or have been classified as credit impaired at the reporting date (i.e. in stage 3). For originated credit impaired assets (i.e. loans and advances) the credit adjusted effective interest rate must applied to the amortised cost of the asset from origination, and for credit impaired assets interest must only be recognised on the net carrying amount of the asset.

In the subsequent reporting period, the credit quality improves and reverses any previously assessed increases in credit risk since origination, the provision of doubtful debts reverts from lifetime ECL to 12 months ECL. The amount of expected credit loss is recognised as an impairment gain or loss in profit or loss.

The impact of changes in impairment requirements under IFRS 9 are not material to the Bank as the majority of financial assets are measured as at FVTPL, which are not subject to the impairment requirements.

Changes to hedge accounting

The Bank does not formally designate any relationships as hedges for accounting purposes. The adoption of IFRS 9 has no impact on the Bank in relation to the hedge accounting.

(g) 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 IFRS 9 and reports these instruments under IFRS 7 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. Interest is received biannually at the coupon rate and the principal is received at maturity. The securities are managed by the Bank on a fair value basis, and are held to implement monetary policy and may be sold or lent, typically for short terms, under repurchase agreements, thus they are designated as FVTPL under IFRS 9. In accordance with this standard, the securities are accounted for on a fair value basis using the discounted present value model, with realised and unrealised gains and losses taken to profit.

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

(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). They are available to be traded in managing the portfolio of foreign exchange reserves. In accordance with IFRS 9, these assets are designated as 'fair value through profit or loss'. External fund managers engaged by the Bank also enter into forward exchange contracts to hedge the returns of portfolios under their management to the US Dollar. No PNG Kina forward contracts are entered into.

(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. They are available to be traded in managing the portfolio of foreign exchange reserves and are managed by the Bank on a fair value basis, thus they are designated as FVTPL under IFRS 9. In accordance with this standard, these securities are valued at market bid prices on balance date. Realised and unrealised gains or losses are taken to profit; only realised gains and losses are available for distribution in accordance with the *Central Banking Act 2000*. Interest earned on securities is accrued as revenue in the Statement of Profit or Loss and Other Comprehensive Income.

(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 and recorded in a separate equity reserve as such gains and losses are not available for distribution. These forward contracts are accounted for on a fair value basis, with all changes in fair value being reflected in the statement of profit or loss and other comprehensive income in accordance with IFRS 9. The fair values are determined with reference to prevailing exchange rates at balance date.

(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 IFRS 9 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 IFRS 9. Deposit balances are shown at their amortised cost. Interest is accrued over the term of the deposits and paid periodically or at maturity. Interest accrued but not yet paid and the deposit liabilities are included in Note 15.

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

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

(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.

(h) 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.

(i) 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 2018. 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. Reflecting their specialised nature, the Bank's head office at ToRobert Haus and the Lae currency distribution facility are valued at depreciated replacement cost. Valuation gains and losses are transferred to the Property Revaluation Reserve. Management has assessed the fair value of all property and equipment as at year end and consider them to be appropriate.

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

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

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

(j) Computer Software

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

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

(k) Gold

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

(l) 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.

(m) 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.

(n) De-recognition

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

(o) 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.

(p) 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.

(q) 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.

(r) Other receivables

Other receivables are stated at amortised cost.

(s) 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.

(t) Other liabilities

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

(u) 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.

(v) 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.

(w) Tax Exemption

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

(x) Comparatives

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

(y) Rounding

Financial information has been rounded to the nearest thousand Kina.

	2018 K'000	2017 K'000

Note 2: INTEREST REVENUE – FOREIGN CURRENCY INVESTMENTS

	2018 K'000	2017 K'000
Foreign securities and bank deposits	94,854	73,028
	94,854	**73,028**

Interest income on foreign investments includes interest earned on foreign bonds, treasury bills, nostro accounts and other foreign investments. Income of K56.5 million (2017: K46.6 million) is in relation to investments managed by external fund managers and the remainder of K38.4 million (2017: K26.4 million) relates to investments managed by the Bank. Coupon rates during the year varied between 0.0% and 8.0% (2017: 0.0% and 5.5%) and yields varied between 0% and 4% (2017: 0% and 3%).

Note 3: INTEREST REVENUE – DOMESTIC OPERATIONS

	2018 K'000	2017 K'000
Inscribed stock and other Government securities	293,423	318,602
Temporary advances to Government	3,975	3,882
Overnight lending to Commercial Banks	10,956	278
	308,354	**322,762**

Interest income earned on government inscribed stock amounted to K227.5 million (2017: K216.8 million) while K65.8 million was earned from government treasury bills (2017: K101.8 million). During the year coupon rates on inscribed stock varied between 9% and 12.5% (2017: 9% and 12.5%) while yields on treasury bills varied between 2.4% and 8.1% (2017: 2.4% and 7.7%).

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

	2018 K'000	2017 K'000
Licensing and other fees	4,757	7,199
Numismatic currency	86	27
Property rent	4,405	3,923
Other	720	3,092
	9,968	**14,241**

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2018 K'000	2017 K'000
Central Bank bills issued	47,999	33,598
Other deposit held	246	203
	48,245	**33,801**

Interest on securities issued varied between 1.4% and 2.4% during the year (2017: 1.3% and 3.8%)

	2018 K'000	2017 K'000
Note 6: GENERAL AND ADMINISTRATION EXPENSES		
Staff costs	75,445	67,183
Premises and equipment	49,446	39,726
Property impairment/(Reversal of impairment)	(38,644)	30,533
Other expenses	13,658	12,895
Depreciation of property, plant and equipment	13,430	12,609
Travel	11,557	10,414
Amortisation of notes and coins production expenses	16,270	10,001
Legal & consultancy fees	9,933	7,390
Staff training and development	6,083	5,365
Board & meeting expenses	1,294	1,688
Currency distribution expenses	1,153	1,313
Audit fee	1,430	1,083
	161,055	**200,200**
Note 7: IMF AND OTHER FINANCIAL ORGANISATION RELATED ASSETS & LIABILITIES		
Assets – mandatorily measured at FVTPL		
IMF SDR holdings and deposits and other organisations	37,187	39,826
	37,187	**39,826**
Liabilities – mandatorily measured at FVTPL		
IMF number 1 and 2 loan accounts	5,939	5,931
SDR allocation	587,796	575,926
	593,735	**581,857**

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.

	2018 K'000	2017 K'000
Note 8: CASH & CASH EQUIVALENTS		
Foreign currency holdings - Nostro accounts	1,640,037	707,253
	1,640,037	**707,253**

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

	2018 K'000	2017 K'000
Note 9: FINANCIAL ASSETS AT FAIR VALUE		
Foreign investments – designated as FVTPL	5,420,914	4,313,645
Derivative assets – mandatorily measured at FVTPL	143,535	202,705
	5,564,449	**4,516,350**

Foreign investments include K3.7 billion (2017: K3.6billion) of investments managed by external fund managers. The remainder of K1.7 billion (2017: K1.3 billion) is managed directly by the Bank. The investments comprise of foreign bank debt securities, sovereign debt securities and over the counter derivative currency contracts.

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES		
Inscribed stock – designated as FVTPL	2,067,450	2,096,677
Treasury bills – designated as FVTPL	593,518	1,168,277
	2,660,968	**3,264,954**

Note 11: LOANS AND ADVANCES		
Loans to PNG commercial banks	25,000	120,000
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	3,328	26,986
Allowance for doubtful loans	(4,714)	(8,273)
Temporary advances facility to PNG government	124,025	-
	149,025	**140,099**

As at 31 December 2018, K25m was issued to commercial banks (2017: K120m). 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.

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

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

The loans and advances measured at amortised cost, excluding those to the PNG government, and related allowance for doubtful loans immaterial. Accordingly detailed disclosure regarding impairment has not been made.

	2018 K'000	2017 K'000
Note 12: OTHER NON FINANCIAL ASSETS		
Inventory notes and coins	38,118	47,344
Commemorative notes & coins and other receivables	(112)	(102)
Prepaid employee benefits	27,152	-
Other non-financial assets	5,520	4,386
	70,678	**51,628**

	Land and Buildings at Fair Value K'000	Equipment K'000	Motor Vehicles K'000	Computer Equipment K'000	Computer Software K'000	Capital Work-In-Progress K'000	Total K'000
Note 13: PROPERTY, PLANT & EQUIPMENT							
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**
Year ended 31 December 2018							
Opening net book amount	99,422	9,802	1,705	2,788	34,013	63,173	210,903
Additions	13,613	8,909	2,013	4,500	458	71,499	100,992
Revaluation	24,223	39,181	63,404				
Disposals	-	-	(38)	-	-	-	(38)
Depreciation charges	(6,511)	(1,285)	(909)	(767)	(3,958)	-	(13,430)
Closing Book Amount	**130,747**	**17,426**	**2,771**	**6,521**	**30,513**	**173,853**	**361,831**
At 31 December 2018							
Cost or fair value	153,226	25,376	4,439	14,414	42,641	173,853	413,949
Accumulated depreciation	(22,479)	(7,950)	(1,668)	(7,893)	(12,128)	-	(52,118)
Net Book Amount	**130,747**	**17,426**	**2,771**	**6,521**	**30,513**	**173,853**	**361,831**

The Bank's increase in *Property, Plant and Equipment* during the year pertains primarily to land and buildings, capital work in-progress and equipment additions.

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

	2018 K'000	2017 K'000
Note 14: INVESTMENT PROPERTIES		
Balance at 1 January	41,460	41,460
Acquisitions	-	-
Reclassification from property, plant and equipment	-	-
Change in fair value	-	-
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 K4.3 million (2017: K3.7 million).

	2018 K'000	2017 K'000
Note 15: DEPOSITS FROM BANKS & THIRD PARTIES		
Banks		
Exchange settlement accounts	1,057,612	1,169,371
Cash reserve requirement	2,048,705	2,117,549
Other Deposits	10,418	11,605
	3,116,735	**3,298,525**
Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES		
Deposits from government and government entities	1,505,423	460,259
	1,505,423	**460,259**
Note 17: SECURITIES ISSUED		
Central bank bills issued	2,402,654	2,089,739
	2,402,654	**2,089,739**

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.

	2018 K'000	2017 K'000
Note 18: CURRENCY IN CIRCULATION		
Currency in Circulation	2,151,993	2,073,747
	2,151,993	**2,073,747**

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.

	2018 K'000	2017 K'000
Note 19: OTHER FINANCIAL LIABILITIES		
Foreign Currency		
Foreign currency deposits	13,644	1,895
	13,644	**1,895**
Local Currency		
Expense creditors	37,487	41,093
	37,487	**41,093**

Expense creditors include cheques or warrants issued by the bank but not yet presented for clearance and subsequent encashment by government departments, investors and suppliers.

	2018 K'000	2017 K'000
Note 20: PROVISIONS FOR EMPLOYEE ENTITLEMENTS		
Provision for gratuity leave	3,407	1,355
Provision for long service leave	20,890	17,506
Provision for annual leave	3,664	5,082
	27,961	**23,943**
Reconciliation of leave provisions		
Balance at 1 January	23,943	22,165
Net charged to statement of comprehensive income	4,018	1,778
Balance at 31 December	**27,961**	**23,943**

Note 21: SHARE CAPITAL

At 31 December 2018, the authorised and subscribed capital of the Bank was K145.5 million (2017: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2018 K'000	2017 K'000
Capital		
At the beginning of the year	145,540	145,540
At the end of the year	**145,540**	**145,540**
Other Reserves		
Gold revaluation reserve	161,108	156,058
Property revaluation reserve	83,234	58,474
Unrealised gain/(loss) reserve	63,030	(92,287)
Building reserve	73,800	-
Retained earnings	412,152	398,762
Total other reserves	**793,324**	**521,007**
Total owner's equity	**938,864**	**666,547**

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 staffs conduct the Bank's local currency, foreign currency reserves management, and foreign exchange dealing operations in accordance with a clearly defined risk management framework, including delegated authority limits as set by the Governor.

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

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

Note 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:

	2018 K'000	2017 K'000
Foreign Governments, Banks & Financial Organisations		
Nostro accounts	1,640,037	707,253
Foreign investments (note 9)	5,564,449	4,516,350
Assets held with IMF and other financial organisations	37,187	39,826
Accrued interest receivable	19,462	18,858
Papua New Guinea Government		
Government of Papua New Guinea securities (note 10)	2,660,968	3,264,954
Temporary advance to PNG government (note 11)	124,025	-
Accrued interest receivable (note 11)	-	-
PNG commercial banks (note 11)	25,000	120,000
Bank staff and employees (note 11)	-	18,713
Other Government Institutions (note 11)	1,386	1,386
	10,072,514	**8,687,340**

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the statement of financial position. 16% (2017: 16%) of the total assets have a credit rating of A-1+ or above in short term investments and 31% (2017: 28%) of long term investments have a credit of A+ or above.

(c) Credit Exposure by Credit Rating

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

Investment in Financial Assets	2018 K'000	% of 2018 Financial Assets	2017 K'000	% of 2017 Financial Assets
Short term foreign investments				
A-1+	1,328,791	16	1,279,478	16
A-1	521,558	7	215,183	3
A-2	93,720	1	44,908	1
A-3	-		-	-
NR	158,513	2	165,876	2
	2,102,582	**26**	**1,705,445**	**22**
Long term foreign investments				
AAA	1,793,893	22	1,634,172	21
AA+	157,848	2	124,930	2
AA	527,593	7	350,360	5
AA-	23,839	-	10,037	-
A+	24,060	-	19,368	-
A	492,083	6	301,299	4
A-	-	-	-	-
BBB+	-	-	-	-
BBB	442,551	5	370,739	5
BBB-	-	-	-	-
	3,461,867	**42**	**2,810,905**	**37**
Total foreign investments	**5,564,449**	**68**	**4,516,350**	**59**
Short term domestic investments				
B	593,518	7	1,168,277	15
	593,518	**7**	**1,168,277**	**15**
Long term domestic investments				
B+	2,067,450	25	2,096,677	26
	2,067,450	**25**	**2,096,677**	**26**
Total domestic investments	**2,660,968**	**32**	**3,264,954**	**44**
Total investments	**8,225,417**	**100**	**7,781,304**	**100**

As the majority of financial assets are designated at FVTPL and the loans and advances measured at amortised cost, excluding loans to the PNG government, are immaterial, no quantitative disclosure of ECL have been made. No financial assets designated at FVTLP have been reclassified to amortised cost.

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 2018 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

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

	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**

The functional currency of all operations is Kina.

(b) Interest Rate Risk

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

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

(c) Liquidity Risk

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

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

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

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.

		MATURITY PROFILE						
As at 31 December 2018	Balance Total K'000	On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specified maturity K'000	Weighted average effective rate %
Assets								
Foreign Currency Financial Assets:								
Cash and cash equivalents	1,640,037	1,056,844	583,193	-	-	-	-	0.40%
Financial Assets at fair value	5,564,449	-	1,194,186	800,283	3,211,393	358,587	-	2.50%
Assets held with IMF	37,187	-	-	-	-	-	37,187	0.03%
Accrued interest	19,462	-	15,627	3,835	-	-	-	na
	7,261,135	**1,056,844**	**1,793,006**	**804,118**	**3,211,393**	**358,587**	**37,187**	
Local Currency Financial Assets:								
Government of Papua New Guinea securities	2,660,968	-	232,362	598,774	946,574	883,258	-	7.57%
Loans and advances	149,025	-	149,025	-	-	-	-	0.02%
Accrued interest and receivables	63,434	-	7,967	13,979	25,615	15,873	-	na
	2,873,427	**-**	**389,354**	**612,753**	**972,189**	**899,131**	**-**	
Non-financial assets:								
Gold	181,716	-	-	-	-	-	181,716	na
Property, plant and equipment	361,831	-	-	-	-	-	361,831	na
Investment properties	41,460	-	-	-	-	-	41,460	na
Other non-financial assets	70,678	-	-	-	-	-	70,678	na
	655,685	**-**	**-**	**-**	**-**	**-**	**655,685**	
Total Assets	**10,790,247**	**1,056,844**	**2,182,360**	**1,416,871**	**4,183,582**	**1,257,718**	**692,872**	
Liabilities								
Foreign Currency Financial Liabilities:								
Liabilities with IMF	593,735	-	-	-	-	-	593,735	0.03%
Other financial liabilities	13,644	-	13,644	-	-	-	-	na
	607,379	**-**	**13,644**	**-**	**-**	**-**	**593,735**	
Local Currency Financial Liabilities:								
Deposits from bank and third parties	3,116,735	3,116,735	-	-	-	-	-	0.01%
Deposits from Government	1,505,423	1,505,423	-	-	-	-	-	0.01%
Securities issued	2,402,654	-	2,161,297	108,845	4,899	127,613	-	1.61%
Accrued interest payable	1,751	-	1,751	-	-	-	-	na
Currency in Circulation	2,151,993	2,151,993	-	-	-	-	-	na
Other financial liabilities	37,487	-	37,487	-	-	-	-	na
	9,216,043	**6,774,151**	**2,200,535**	**108,845**	**4,899**	**127,613**	**-**	
Total Liabilities	**9,823,422**	**6,774,151**	**2,214,179**	**108,845**	**4,899**	**127,613**	**593,735**	

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	707,253	332,443	374,810	-	-	-	-	0.44%
Financial Assets at fair value	4,516,350	-	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 Guineas 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	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**	

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.

	2018 K'000	2017 K'000
Financial Assets		
Cash and cash equivalents	1,640,037	707,253
At fair value through profit/(loss)	8,262,604	7,821,130
Loans & receivables	259,073	230,242
	10,161,714	**8,758,625**
Financial Liabilities		
At fair value through profit/(loss)	607,379	583,752
At amortised cost	9,216,043	7,965,040
	9,823,422	**8,548,792**

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 2018				
Financial assets held at fair value through profit or loss				
Domestic Government securities – Inscribed stock and Treasury bills	-	-	2,660,968	2,660,968
Foreign Government and semi-Government bonds	-	1,691,076	-	1,691,076
Derivatives managed by external fund managers	-	143,535	-	143,535
Investments in bonds and other instruments managed by external fund managers	3,729,838	-	-	3,729,838
Assets held with IMF	-	37,187	-	37,187
Total assets at fair value through profit or loss	**3,729,838**	**1,871,798**	**2,660,968**	**8,262,604**
Non financial assets at fair value				
Gold	181,716	-	-	181,716
Property, plant, and equipment	-	-	361,831	361,831
Investment property	-	-	41,460	41,460
Total assets at fair value	**181,716**	**-**	**339,887**	**521,603**
Financial liabilities held at fair value through profit & loss				
Derivatives	-	13,644	-	13,644
Liabilities with IMF	-	593,735	-	593,735
Total liabilities at fair value through profit or loss	**-**	**607,379**	**-**	**607,379**
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**

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

	Level 3 K'000
Opening balance	3,264,954
Maturities, net of additional investment	(609,259)
Fair value revaluation gains/(losses) on Level 3 instruments	5,273
Closing balance	**2,660,968**
Total gains and losses for the period included in the profit or loss for Level 3 assets held at the end of the reporting period.	**5,273**

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
Additional investment, net of maturities	(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**

	Valuation Technique	Unobservable Input	Range of Inputs		Fair value movement due to change in unobservable Input	
			2018	2017	Increase	Decrease
Domestic Government securities – Inscribed stock and Treasury bills	Discounted cash flows present value method	Current market yield	9% to 12.6%	9% to 12.5%	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 per cent in the value of the Kina as at 31 December 2018 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2018 K'000	2017 K'000
Changes in profit/equity due to a 10 per cent appreciation in the value of the Kina	(744,285)	(545,895)
Changes in profit/equity due to a 10 per cent depreciation in the value of the Kina	744,285	545,895

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.

	2018 K'000	2017 K'000
Changes in profit/equity due to an increase of 1 percentage point	92,160	79,650
Changes in profit/equity due to a decrease of 1 percentage point	(92,160)	(79,650)

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 2018 (2017: 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 28 in total (2017: 29), including the Governor, 2 Deputy Governors, 2 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

	2018 K'000	2017 K'000
Short term benefits	13,244	12,639
Post employment benefits	831	831
Other long term benefits	5,101	4,403
	19,176	**17,873**

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

As at 31 December 2018, the loans owed by the key management personnel to the Bank were K5,431,930 (2017: K4,218,012)

Note 28: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,430,162 (2017: K1,082,837). This represents the total statutory audit fee paid to the Auditor General's Office and other auditors in relation to external fund manager operations. These transactions are performed at arm's length.

Note 29: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

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

(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 our opinion the foregoing Statement of Profit or Loss and other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows 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 2018.

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

Loi Martin Bakani CMG
Governor

Joseph Michael Teria
Deputy Governor

28 June 2019

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

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INDEPENDENT AUDITOR'S REPORT ON THE ACCOUNTS OF
BANK OF PAPUA NEW GUINEA
FOR THE YEAR ENDED 31 DECEMBER 2018

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, 2018** as set out on pages **2** to **31.** The financial statements comprise:

- Statement of Financial Position as at 31 December 2018;
- 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 2018:

- (i) give a true and fair view of the financial position of the Bank as at 31 December 2018 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 MBA, CPA
Acting Auditor-General

28 June, 2019

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Notes

Notes


BANK OF PAPUA NEW GUINEA