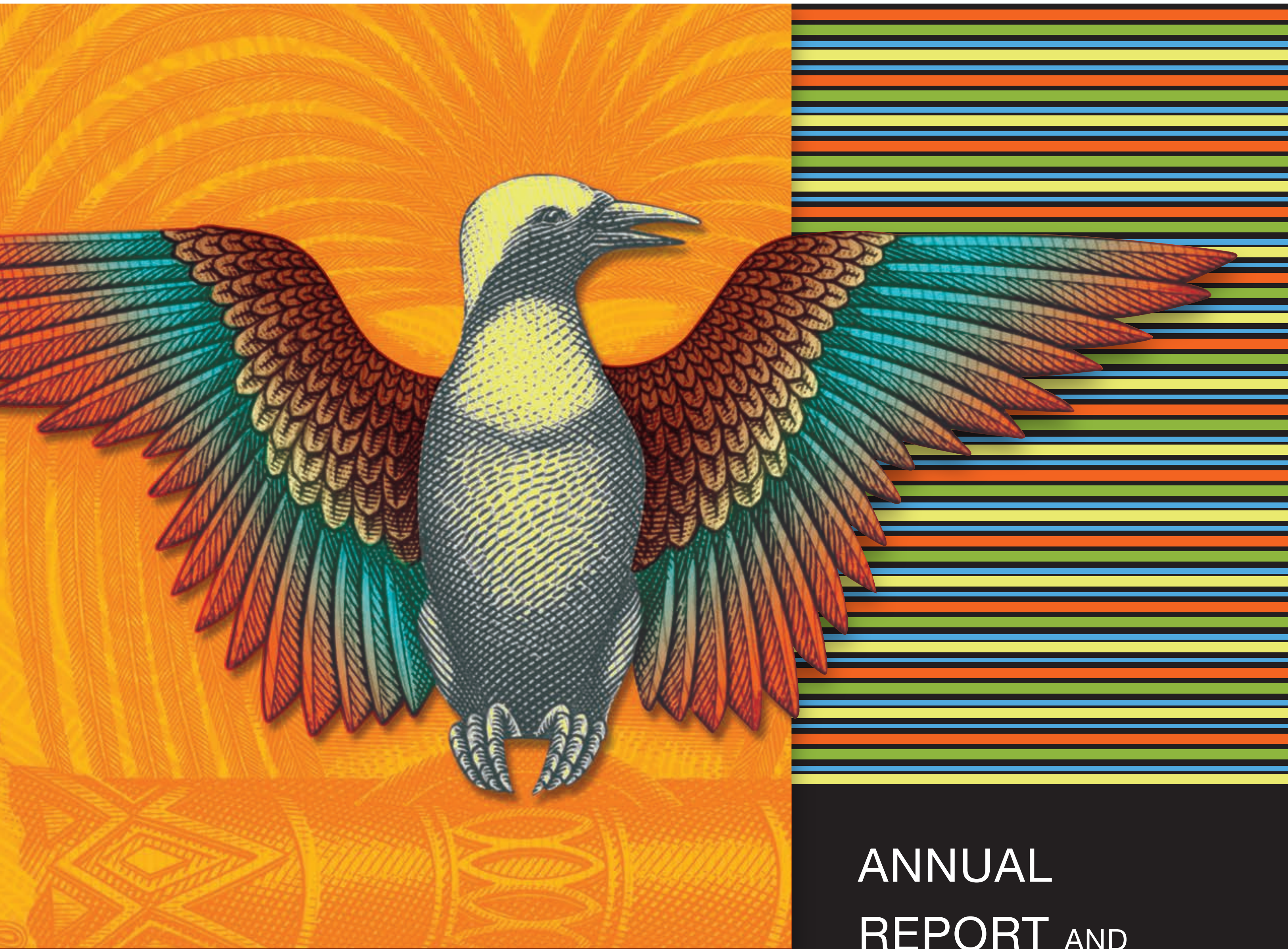
BANK OF PAPUA NEW GUINEA



ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2019

BANK OF PAPUA NEW GUINEA

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2019

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

BANK OF PAPUA NEW GUINEA

ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2019

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Governor's Foreword

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

In 2019 Papua New Guinea recorded higher economic growth, while the Bank made substantial progress in financial inclusion, celebrated the official opening of the Currency Processing Facility in Lae, achieved significant efficiencies in foreign exchange operations and took major steps towards broadening access to electronic payments.

The strong economic activity during the year in PNG was largely driven by a full year of production and export in the oil and gas and mining sectors, recovering from the shutdown caused by the impact of the 2018 earthquake. During the year these sectors achieved both higher production and increased exports of crude oil, liquified natural gas (LNG) and gold. Favourable international prices and production of some export commodities also contributed to improved inflows to the domestic foreign exchange market, which was supported by interventions from the Central Bank. Higher inflows to the foreign exchange market from exports resulted in a current account surplus, which more than offset a net outflow in financial and capital account. This resulted in a surplus in the overall balance of payments for the year.

The economic growth rate was estimated at 5.0 percent in 2019, the eighteenth consecutive year of growth for PNG and significantly higher than the lower rate of 0.3 percent in 2018.

Annual headline inflation gradually declined, from 4.8 percent at the end of 2018 to 4.5 percent in March 2019 and to 2.7 percent at the end of the year. The downward trend resulted from lower imported inflation, stability in the kina exchange rate, cheaper sources of imports and lower prices of seasonal produce combined with improvement in the domestic supply chain and price competition.

The fall in inflation prompted the Bank to ease its monetary policy stance in the second half of 2019, by reducing the Kina Facility Rate from 6.25 percent to 5.0 percent, with the aim of stimulating economic activity by encouraging lending to the private sector.

During the year the Bank continued to implement the 2016-2020 Strategic Plan, attaining a number of significant milestones in 2019. This Annual Report includes a summary of our activities and achievements as the Central Bank of PNG.

The Bank stepped into the national and international spotlights with a number of significant achievements during the year.

The official opening in March of the Bank of PNG Currency Processing Facility in Lae represented a very successful completion and realisation of years of planning and construction. I am very honoured to be recognised in its name, the Bakani Andu Kanom Sega, as the building stands for the Bank's commitment to financial inclusion and national access to financial services, which have been important goals throughout the years of my governorship.

Continuing the roll-out of the financial inclusion program, the launch of the Regulatory Sandbox, the first of its kind in the Pacific Island region, and the pilot testing of our world-first digital identity solution confirm that we are well on the way to enabling practical access to meaningful financial services to residents wherever they live in PNG.

Communicating the role of the Bank of PNG and how it relates to all members of PNG society has become an even greater priority for the Bank as we work towards achieving full financial inclusion. During the year the Bank conducted a number of awareness seminars and took part in financial education activities around the country. These programs have resulted in a growing number of individuals with a basic understanding of personal finance, and small business operators with a better knowledge of their financial rights and responsibilities, and with an appreciation for access to services.

Also on the topic of accessibility, the launch of the Retail Electronic Payments System (REPS) and the subsequent signing up to the system by most of PNG's leading financial institutions brings to consumers the convenience, security and efficiencies of direct payments.

Moving to another of our core functions, monetary policy, a key focus for the Bank during the year was streamlining foreign exchange operations. Foreign exchange inflows were relatively strong over the course of 2019, reflecting budget financing from external sources and increased inflows from the mining sector.

Combined with intervention by the Bank, foreign exchange inflows were used to reduce the backlog of outstanding import orders and to meet current orders within a reasonable timeframe. This action resulted in a lower average waiting period for foreign exchange orders and a significant decrease in the number of outstanding orders.

By the end of the year the average waiting period for foreign exchange orders of over K3.0 million was halved to less than 3 months, down from an average waiting period of 6 months in 2018. While total orders in the foreign exchange market remained elevated during the year, as the number of new orders grew these achievements represented a substantial step forward in meeting the foreign exchange needs of the private sector.

On the international front, the Bank is responsible for facilitating PNG's commitment to the global action against money laundering and terrorist financing. During the year this commitment took significant steps forward. Apart from the signing of agreements with a number of international and domestic financial intelligence agencies, PNG was admitted to the membership of the global network Egmont Group and also participated in training provided by INTERPOL.

Closer to home, the Bank introduced a Gender Equality & Social Inclusion (GESI) Policy, underpinning the importance we place on fairness in the workplace and respect for our staff. This commitment builds on the Bank's long-term plan of providing equal opportunities for all staff to reach their potential, through professional development and other capacity building activities.

Over the course of the year the Bank has received assistance and support from the International Monetary Fund (IMF), the Reserve Banks of Australia and of New Zealand, the World Bank and its subsidiary IFC, the Asian Development Bank (ADB), the Pacific Financial Technical Assistance Centre (PFTAC) and the South East Asian Central Banks (SEACEN) training centre. The Bank acknowledges and appreciates all this support.

I extend my sincere gratitude to my fellow Board members, Deputy Governors, Assistant Governors, the senior management team and staff of the Bank for their commitment and support during the year. In particular, I acknowledge with special thanks the enormous contribution former Deputy Governor, the Late Dr Gae Kauzi, made to the Bank of Papua New Guinea during the course of his long career.

As this Report attests, 2019 has been a year of focusing on our role as PNG's Central Bank, recognising that the role is not a static one. It requires of us to continue building our capacities, mastering new skills and working to improve the way we perform our core functions so we can keep making positive advances for the benefit of the people of Papua New Guinea.

Loi M. Bakani CMG
Governor and Chairman of the Board and Registrar of Savings and Loan Societies

Papua New Guinea Currency Processing Facility Launch

2014	Concept design approved
2015	Early site development works started
2016	Foundations laid
2017	Structural phase substantially completed
2018	General construction finalised, building handed over to the Bank
2019	Official opening

Currency Processing Facility opens for business

The Bank of Papua New Guinea's new state of the art Currency Processing Facility (CPF) was officially opened in March 2019. The CPF, named the Bakani Andu Kanom Sêga, is the Bank's first building located outside of Port Moresby and the first building constructed by the Bank in 20 years. The decision to locate it in Lae, the gateway to the Momase, Highlands and New Guinea Islands regions, was in line with the Bank's commitment to expand central banking services.

The key functions of the Lae CPF are to improve efficiency and cost-effectiveness in issuing and distributing PNG notes and coins and to monitor and maintain the quality of the currency in circulation. It will also enable the Bank to extend its financial inclusion activities, including financial education and awareness programs.

The high security Lae CPF was constructed at a cost of K120 million. It will be staffed by 60 to 70 employees, who will live and work in Lae. The butterfly motif on the building represents the Queen Alexandra Birdwing Butterfly, which appeared on the de-monetised 1 toea coin.

Highlights

National Government, with BPNG, launches key financial policies

The Financial Sector Development Strategy and the National Financial Inclusion Policy were launched in January 2019. Positioned as priority policies, the National Government acknowledged their importance in forming the framework for development of PNG's economy and social and financial equity.

A number of Government ministers, members of parliament, members of the diplomatic corps, provincial governors, heads of Government departments and senior representatives of the commercial banks and other licensed financial institutions attended the launch event. L-R: Governor Loi M. Bakani CMG receives the policies from Deputy Prime Minister Hon. Charles Abel MP.

BPNG hosts PFTAC meeting

The Bank hosted PFTAC's annual Steering Committee meeting in March. Welcomed by the Deputy Prime Minister and Treasurer Hon. Charles Abel MP, the 64 delegates to the meeting included representatives from 13 of the 16 PFTAC member countries, 4 donors (ADB, Australia, EU and New Zealand), as well as observers from the World Bank, IMF and other supporting institutions.

The Pacific Financial Technical Assistance Centre (PFTAC) was established by the United Nations and the International Monetary Fund in 1993 to help Pacific Island nations build their capacity to implement sound economic and financial policies, by providing technical assistance and training.

PFTAC delivers tailored training program to PNG

In April the Bank co-hosted a five-day course on Macroeconomic Policy for Stabilisation and Growth, delivered by the IMF, PFTAC and the Singapore Training Institute. By the end of the course the 33 participants, representing BPNG, the Department of Treasury, the Internal Revenue Commission, the National Statistical Office and PNG Customs, had worked with PNG accounting and relationships data to develop a financial programming baseline designed to meet PNG's specific requirements.

Highlights

Village plays key role in developing technology for financial inclusion

The Vesulogo Village community played a significant role in the development of the Bank's blockchain technology.

Vesulogo, which is near Sogeri, Central Province, was involved in the pilot testing of the proposed digital identity solution. The community provided the team from ADB and Bank of PNG with valuable information about the unique conditions the solution would need to address to operate in remote and rural locations, and insights into how any digital identity solution might be received by rural communities. (see page 45)

BPNG launches Regulatory Sandbox

The first of its kind in the Pacific Island region, the Regulatory Sandbox was designed to provide a controlled environment for financial institutions to test new technologies. The aim is to create new products and services that could be used to enhance financial inclusion.

L-R: Elizabeth Genia, Assistant Governor, Governor Loi M. Bakani CMG, Ellison Pidik, Assistant Governor.

BPNG introduces GESI Policy

In December the Bank introduced the Gender Equity & Social Inclusion (GESI) Policy (see page x), setting a clear direction for the Bank as a fair workplace for all staff.

L-R: Brenda Koan, Naomi Kedea and Angesula Jogamup.

INTERPOL training supports FASU's financial crime fighting

In 2019 the Financial Analysis and Supervision Unit took part in specialised investigation training conducted by Interpol, targeting financial crime associated with forestry and land use.

Financial institutions sign up to REPS

The Retail Electronics Payments System (REPS) was launched in July. BSP, Kina Bank and NASFUND Contributors Savings and Loan Society (NCSL) signed up to REPS at the launch and Westpac, MiBank and People's Microbank joined in September.

Below L-R: Stephen Pouru (BPNG), Trudi Egi (Chief Operating Officer, Mibank), Anthony Dela Cruz (Chief Executive Officer, People's Micro Bank), Robin Fleming (Chief Executive Officer, BSP), Ellison Pidik (Assistant Governor, BPNG), Greg Pawson (Chief Executive Officer, Kina Bank), Elliot Griffin (Head of Corporate and Commercial Banking, Westpac), Theresa Lyon (BPNG) and Vari Lahui (General Manager, NCSL).

AML/CTF launches Strategic Plan

In partnership with the Department of Justice and Attorney General, FASU launched the National Anti-Money Laundering and Counter Terrorist Financing Strategic Plan and AML/CTF National Risk Assessment in 2019.

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, issue 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 and Chairman
Loi M. Bakani CMG

Deputy Governor Joe Teria

Mr John Leahy

Mr John Paska

Mr Richard Kuna

Bishop Denny Bray Guka

Mr Simon Tosali OBE

Mr David Toua

Members of the Board of the Bank of Papua New Guinea 31 December 2019

Late Dr Gae Kauzi

The Bank of Papua New Guinea has adopted best corporate governance principles, practices and standards. In line with the *Central Banking Act 2000* (CBA 2000), its strategic plans and code of conduct, the Bank's adherence to good corporate governance is reflected in its operations, processes, procedures and systems.

These practices are embedded in the role, structure and composition of the Board, including its committees, and in the Bank's organisational structure and management roles, 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, from a range of prominent institutions within the PNG community (civil, church, regulatory, workers' representation and industry bodies). The *non-ex officio* members are appointed by the Head of State acting on advice from the National Executive Council (NEC). All Board members are required to meet the key standards of good governance.

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

The Deputy Governor, appointed by the Governor in consultation with the Minister for Treasury for a term of up to 5 years, is a member of the Board and chairs the Board in the absence of the Governor. The Governor has the discretion to appoint either one or two Deputy Governors.

The other members of the Board include five *ex officio* members from a range of prominent institutions within the PNG community (church, regulatory, workers' representation and industry bodies). Up to three *non-ex officio* members are appointed by the Head of State acting on advice from NEC. All Board members are required by statute to meet the key standards of good governance.

The position of the Chairman of the Securities Commission was vacant in 2019.

Management Structure

The Bank has established a management structure with clear reporting lines, conforming with the principles of good governance. (see Organisation Chart page 41)

Each Assistant Governor is responsible for a functional group comprising related departments. A number of inter-departmental management committees are established to perform various functional and management responsibilities for and on behalf of the Governor.

In line with this structure, during 2019 the Deputy Governors, the Assistant Governors, the Internal Audit Department Manager, Director FASU and the Corporate Secretary reported directly to the Governor. Other Department Managers either reported to the Deputy Governors or to an Assistant 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

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 PNG on the IMF Board of Governors, Chairman of the Centre for Excellence in Financial Inclusion (CEFI), Director of the PNG Institute of Directors (PNGID), Director of the PNG Institute of Banking & Business Management and a Member of the Advisory Board of Port Moresby Senior AFL competition.

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

Deputy Governors

Late Dr Gae Kauzi

Late Dr Kauzi was appointed Deputy Governor and an *ex officio* member of the Board in July 2016. He served on the Board until his passing on 9 June 2019.

He was a career central banker, having joined the Bank of PNG 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 the Assistant Governor responsible for Monetary & Economic Policy Group prior to his appointment as Deputy Governor.

Late Dr Kauzi held a Bachelor's degree in Economics 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.

Mr Joe Teria

Mr Teria was appointed Deputy Governor and an *ex officio* member of the Board on 1 February 2019.

A career central banker of more than 40 years' experience, Mr Teria commenced employment with the Bank of Papua New Guinea in 1979. After holding a number of senior management positions in the Bank, in the areas of foreign reserves management, foreign exchange control and management, financial accounting and administration, Mr Teria was appointed the Assistant Governor responsible for Finance & Payments in October 2011.

He holds a Master's degree in Commerce from the University of Sydney, Australia.

Members of the Board

Mr John Leahy

Mr Leahy was appointed *ex officio* member of the Board in March 2008, in his capacity as President of the Papua New Guinea Chamber of Commerce and Industry.

Mr Leahy is in private practice as a lawyer in PNG. He is also a Director of a number of companies, including the BNG Trading Group Ltd and its 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.

Bishop Denny Bray Guka

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

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

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

Mr Richard Kuna

Mr Kuna was appointed *ex officio* member of the Board in November 2015 in his capacity as the President of Certified Practising Accountants PNG.

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

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

Governance

Mr Simon Tosali OBE

Mr Tosali was appointed a *non-ex officio* member of the Board in March 2016 for a three year term. He was reappointed for a further three years in March 2019.

Mr Tosali also sits on the Board of Mineral Resources Development Company Limited.

Mr Tosali 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 John Paska

Mr John Paska was appointed the President of the Papua New Guinea Trade Union Congress in 2018 and by virtue of that appointment is an *ex-officio* member of the Board. He is a labour advocate and a trade unionist.

Mr Paska is also a Member of the Boards of Security Industry Authority, National Tripartite Consultative Council and the National Training Council.

His education includes tertiary studies in law, labour economics and labour relations.

Mr David Toua

Mr Toua was appointed a *non-ex officio* member of the Board in February 2019 for a three year term.

As a very experienced business executive with comprehensive management and operational skills, he has served in various senior management executive positions in a range of organisations.

He is Chairman of the APEC Business Advisory Council and is a Board member of the Business Council of PNG, the Employers Federation of PNG, the Mineral Resources Authority and Post PNG Ltd and an Advisory Board Member of the Royal Port Moresby Golf Club.

Mr Toua holds a Bachelor of Arts in English Literature, Economics & Government from the University of Queensland, Australia.

Board Meetings

The Board meets at least once every three months. In 2019, the March Board meeting was held in Lae, Morobe Province. Meetings in June and December were held in Port Moresby. The September meeting was held in Madang.

Board Member	Meetings Eligible to Attend	Meetings Attended
Mr Loi M. Bakani CMG	4	3
Late Dr Gae Kauzi	1	1
Mr Joe Teria	4	4
Mr John Leahy	4	3
Bishop Denny Bray Guka	4	3
Mr Richard Kuna	4	4
Mr Simon Tosali OBE	4	4
Mr John Paska	4	3
Mr David Toua	4	2

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 by the charter of each individual Committee. The Committees generally comprise non-executive Board members.

Two Board Committees operated in 2019.

Board Audit & Governance Committee

The Board Audit & Governance Committee's role is to provide oversight of the Bank's operations and management, as well as assisting the Board to ensure that the Bank's performance in financial reporting, internal control, governance and risk management practices and processes meet the required standards and expectations.

During 2019 Mr Richard Kuna chaired the Committee, with Mr John Leahy, Mr John Paska and Mr David Toua as members.

Board Remuneration and 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 of the Governor.

During the year Mr John Leahy chaired the Committee, with Bishop Denny Guka, Mr Simon Tosali and Mr John Paska as members.

Other Governance Measures

Internal Management Committees

Several internal management committees also continued through 2019, each with specific roles and responsibilities to ensure probity of the Bank's activities. They included the Executive Committee, the Monetary Policy Committee, the Currency Committee, the Investment Committee, the Tender Committee and the Budget Committee.

Internal Audit

A strong, 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 2019 the focus of internal audit was on several significant reviews and investigations, along with an ongoing program of routine audits. The Department also contributed to the Bank's Strategic Project on the Corporate Governance Framework Review.

Risk Management

In 2019 the Bank concentrated on the operational risk management function. Risk management activities undertaken during the year included business impact analysis, review of the Bank's business continuity management system, risk awareness and risk profiling for the Lae Currency Processing Facility (CPF) operations and several onsite risk assessments.

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 help 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 the Values Statement, which provides clear guidance to Bank employees to conduct themselves with the highest standard of behaviour.

Financial Management

Operating Income

Total operating income for the year ended 31 December 2019 was K467.3 million, an increase of K61.7 million from K405.6 million in 2018. Revenue from foreign currency investments increased by K86.0 million over the previous year, as a result of increased interest income, foreign exchange gains and commissions. However, interest revenue from domestic investments and other income declined by K24.3 million, due to a reduced level of government securities.

Operating Expenditure

Total operating expenditure, comprising interest expenses and general administration costs, was K310.8 million, an increase of K92.4 million from 2018 operating expenses of K218.4 million. General and administration expenses increased by K70.6 million, while total investment expenses surged by K21.8 million. This increase was mainly due to increased interest expense on domestic liability.

Net Operating Profit

The Bank recorded a net operating profit of K156.5 million for the 2019 financial year, compared to K187.2 million in 2018.

Unrealised Gain/(Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K236.9 million for the year ended 31 December 2019, 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 K36.3 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 profit to be paid into the Government's Consolidated Revenue Fund (CRF).

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 rate movements shall not be made available for distribution as dividend to the Government or paid into the CRF.

Distribution of Profit

	2015 K'm	2016 K'm	2017 K'm	2018 K'm	2019 K'm
Total Comprehensive Income/(Loss)	680.7	441.2	390.0	372.3	441.5
Unrealised Profit/(Loss)	541.2	270.7	216.2	185.1	285.0
DISTRIBUTABLE PROFIT/(LOSS)	**139.5**	**170.5**	**173.8**	**187.2**	**156.5**
ALLOCATIONS MADE:					
Property Revaluation Reserve	-	0.2	-	24.8	11.8
Unrealised Profits Reserve	536.4	251.5	193.1	155.3	236.9
Gold Reserve	4.8	19.0	23.1	5.0	36.3
Building Reserve	-	-	-	73.8	-
Retained Profit/(Loss)	139.5	70.5	73.8	13.4	6.5
Consolidated Revenue Fund (Government)	-	100	100	100	150*

** The Bank paid a dividend of K150 million to the Government in 2020 out of the retained profits for the 2019 financial year.*

2019 Income and Expenses

	Actual 2019 K'm	Actual 2018 K'm
Operating Income		
Interest received – overseas	136.6	59.9
Interest received – domestic	275.7	308.4
International trading/foreign exchange fees	36.6	27.3
Other income	18.4	10.0
TOTAL INCOME	**467.3**	**405.6**
Operating Expense		
Interest expenses – domestic operations	67.2	48.2
Financial markets & external fund manager expenses	11.9	9.1
Staff costs	87.6	75.4
Staff training and development	6.5	6.1
Premises and equipment	56.6	49.4
Depreciation of property, plant and equipment	22.0	13.4
Amortisation of notes and coins production	15.2	16.3
Currency distribution expenses	1.9	1.2
Audit fee	1.9	1.4
Travel	13.2	11.6
Legal and consultancy fees	6.9	9.9
Board fees and meeting expenses	1.9	1.3
Information & communication technology	0.0	0.0
Special projects	0.0	0.0
Revaluation decrease from property valuation		-38.6
Other Expenses	18	13.7
TOTAL EXPENSES	**310.8**	**218.4**
NET OPERATING PROFIT/LOSS	**156.5**	**187.2**

Core Functions

MONETARY POLICY

MONETARY POLICY FORMULATION

The Bank released two monetary policy statements (MPS) as required by the Act, on 31 March and 30 September 2019. (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.

Each month the Bank considers development in the same variables in setting the policy signalling rate, the Kina Facility Rate (KFR). Assessment of the quarterly Consumer Price Index (CPI) produced 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 2019 the Bank's estimates and projections of gross domestic product (GDP), balance of payments and inflation were discussed with the Department of Treasury. These were used as inputs into designing fiscal policy, especially the National and Supplementary Budgets, as well as for discussions with the IMF for a Staff Monitored Program.

Inflation trended downwards in 2019, from 4.5 percent in March to 4.0 percent in June, 3.0 percent in September and 2.9 percent in December. The reduction reflected lower imported inflation, a slower pace of depreciation of the kina, cheaper sources of imports and lower prices of seasonal produce.

Taking into account the fall in inflation, the Bank eased its stance of monetary policy in the second half of 2019, reducing the KFR progressively from 6.25 percent in June to 5.00 percent by December. The easing stance was designed to stimulate economic activity, by supporting lending by the commercial banks to the private sector.

Improvement in Monetary Policy Framework

In its efforts to improve the transmission of monetary policy, the Bank refined its monetary policy operations in April 2019 by securitising borrowings under the Repurchase Agreement (Repo) Facility with government securities and Central Bank Bills, following the introduction of the Intra-Day Liquidity Facility.

Work on implementing the recommendations of the IMF Technical Mission to improve the transmission process continued through the year.

MONETARY POLICY IMPLEMENTATION

Outlined in the six-monthly MPS and the monthly KFR, during 2019 the Bank's main instruments of implementing monetary policy continued to be Open Market Operations (OMOs), involving the auction of Central Bank Bills (CBBs), Treasury bills and Treasury bonds (Inscribed stocks) and the Tap facility investments.

The Bank offers collateralised repurchase agreements (mainly for overnight term) to commercial banks who needed additional funds for settlement of transactions in their Exchange Settlement Accounts.

The Bank also uses its direct policy instrument, the Cash Reserve Requirement (CRR) for liquidity management.
The CRR was maintained at 10.0 percent throughout the year.

Minimum Liquid Asset Ratio (MLAR)

The MLAR remained at zero throughout 2019.

Late Dr Gae Kauzi, the Bank's Deputy Governor, presented a certificate to Nigel Ainui for participation in the PFTAC course held in April.

FOREIGN EXCHANGE

By 31 December 2019 the kina had depreciated by 1.18 percent, to close at US$0.2935. The depreciation was mainly attributed to higher demand for foreign currency. The market showed improved foreign exchange inflows in 2019, with the Mining sector recording the highest increase. Despite this improvement, net foreign exchange outflows in 2019 totalled K336 million, as import demand remained elevated all throughout the year. The net outflows were offset by the Bank's interventions in the foreign exchange market.

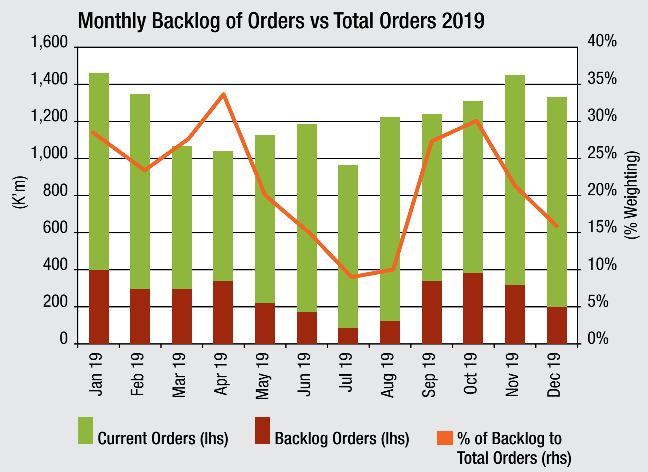
Over the reporting period, foreign currency inflows increased by 6.5 percent and outflows by 6.1 percent. The Mining, Finance & Business and Agriculture sectors were the main suppliers of foreign currency into the domestic market. The demand for foreign currency was dominated by the Finance & Business, Manufacturing and Retail sectors.

Major Sector Contributions to Foreign Exchange Flows

	2019 K'm	2018 K'm	Change
INFLOWS			
Top 5 Sectors			
Mining	5,863.7	4,637.1	26.45%
Finance & Business	2,201.8	2,128.4	3.45%
Agriculture	1,896.7	2,430.0	-21.95%
Petroleum	1,296.9	1,009.3	28.49%
Forestry	1,247.80	1,255.70	-0.63%
OUTFLOWS			
Top 5 Sectors			
Finance & Business	3,338.9	3,105.7	7.51%
Manufacturing	2,594.0	1,781.8	45.58%
Retail	2,993.2	2,203.0	35.87%
Petroleum	1,742.5	1,331.1	30.91%
Wholesale	1,021.3	919.5	11.1%

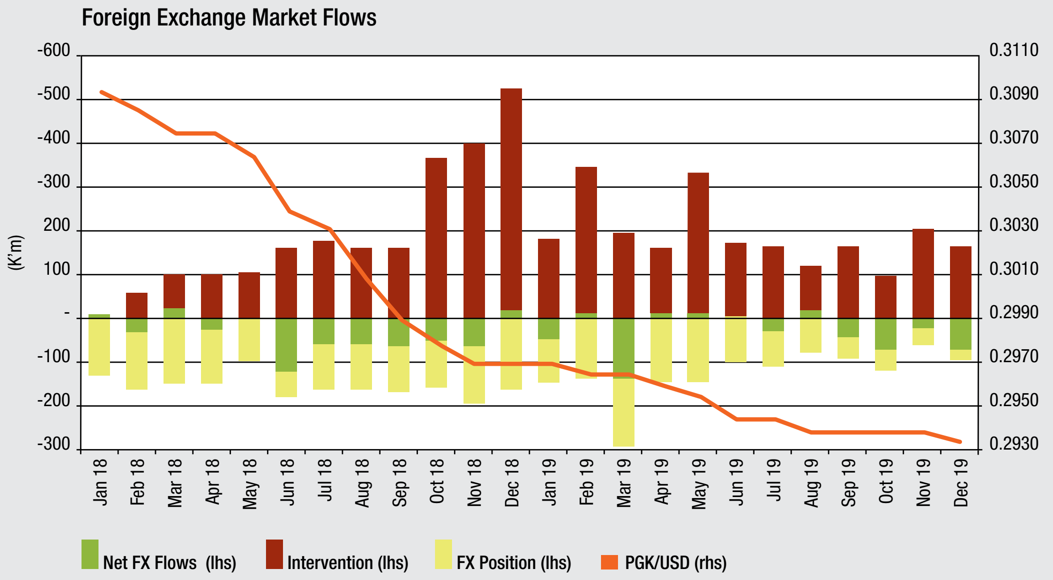
Kina trading

Total outstanding sell kina orders brought into the market by Authorised Foreign Exchange Dealers (AFEDs) stood at K1.3 billion at the end of 2019. Improved foreign exchange inflows and BPNG intervention helped support the market and maintained total orders below K1.5 billion. The time taken to clear orders improved, reduced to 2 months from an average of 3 months in 2018.



Intervention

In 2019 the Bank sold US$647.7 million (K2,193.0 million) in the foreign exchange market, primarily to reduce the backlog in outstanding orders (2018: US$695.0 million/K2,314.0 million).



Exchange Rates

	End of Dec 2019	End of Dec 2018	YTD (% Change)
PGK/USD	0.2935	0.2970	-1.18%
PGK/AUD	0.4188	0.4208	-0.48%
PGK/EUR	0.2619	0.2599	0.77%
PGK/GBP	0.2238	0.2341	-4.40%
PGK/JPY	31.90	32.78	-2.68%
PGK/TWI	29.27	29.60	-1.11%

During the year the Kina depreciated against the Australian Dollar (AUD), Great Britain Pound (GBP) and Japanese Yen (JPY), but was stronger against the Euro. The depreciation against AUD, GBP and JPY mainly reflected a weaker US dollar as a result of the US-China trade tensions and increasing geopolitical tensions. The Kina appreciated against the Euro as concerns around the exit of Great Britain (Brexit) from the European Union (EU) continued to weigh on the Euro.

Foreign currency and interest rates risks

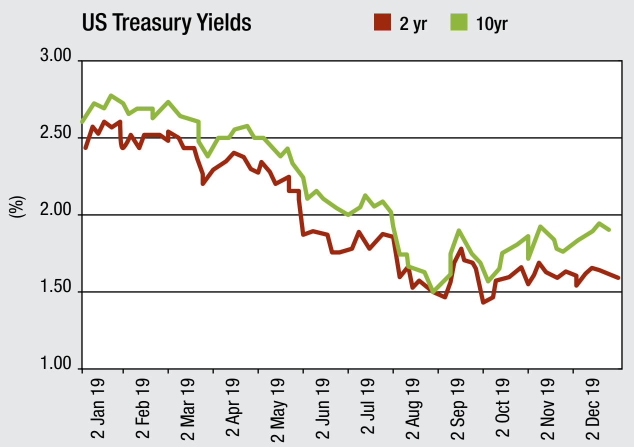
Global economic growth remained weak in 2019, as momentum weakened substantially to levels not seen since the global financial crisis, particularly in the manufacturing sector. Rising trade and geopolitical tensions increased uncertainty about the future of the global trading system and international cooperation, affecting business confidence, investment decisions, and global trade.

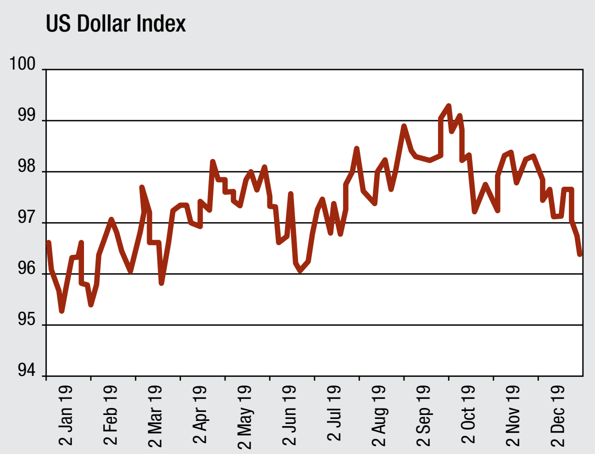
While financial market sentiment was undermined by these developments, a shift towards increased monetary policy accommodation in the United States and many other advanced and emerging market economies was a counterbalancing force. As a result financial conditions remained generally accommodative. A generally resilient service sector supported employment growth, however global inflation remained subdued.

Interest rates in the US continued to decline throughout 2019. The US Federal Open Market Committee (FOMC) reduced its federal funds rate on three occasions in 2019, to end the year at 1.75 percent. The Reserve Bank of Australia (RBA) also reduced its cash rate twice in 2019, ending the year at 0.75 percent. Other major central banks kept their interest rates unchanged and maintained their accommodative monetary policy stances. Given these circumstances, bond yields in the US declined throughout the year.

The US dollar remained firm against other major currencies in the first three quarters of 2019, but weakened in the final quarter due to continued trade tensions, uncertainty surrounding the US presidential impeachment and geo-political tensions.

In response to these market developments, the Bank maintained an accommodative portfolio duration and currency exposure strategy throughout 2019.





FOREIGN RESERVES MANAGEMENT

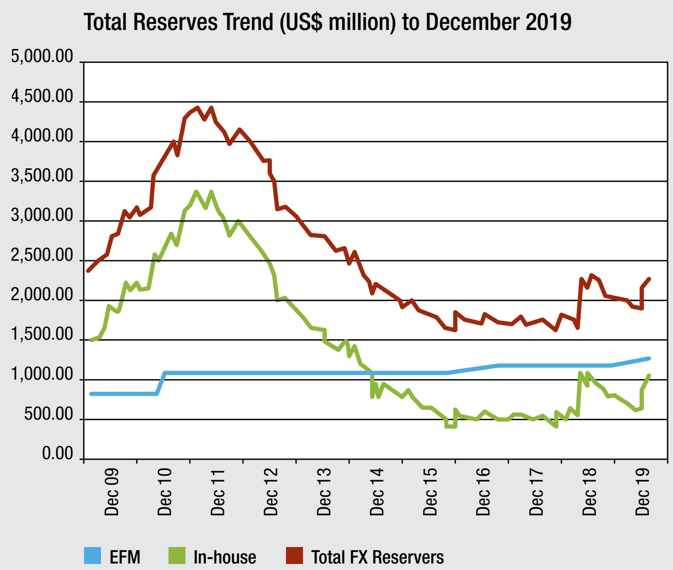
The Bank of Papua New Guinea is responsible for the management of PNG's international reserves, including foreign exchange and gold.

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:

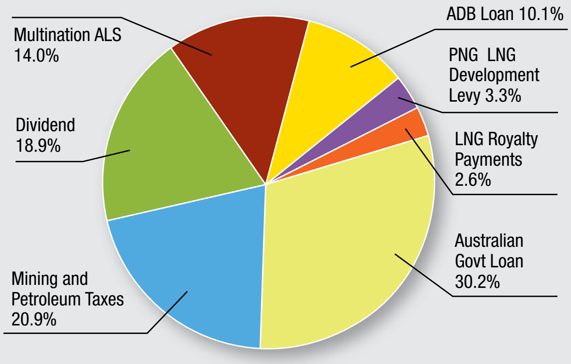
- preserve the capital value of the foreign exchange reserves
- maintain adequate foreign currency liquidity
- manage credit risk conservatively
- earn an acceptable rate of return on the investment of reserves
- accumulate savings for future generations.



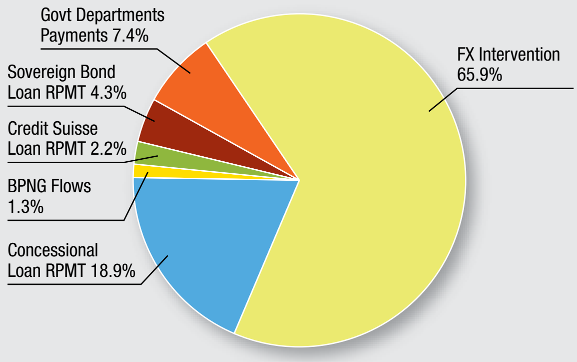
The Bank's foreign exchange reserves at end December 2019 was US$2,338.14 million (K7,832.97 million), a 1.85% increase from the December 2018 level.

The increase was largely the result of valuation gains of the outsourced funds.

Foreign Exchange Inflows 2019



Foreign Exchange Outflows 2019



Foreign reserve inflows for the year totalled US$993.65 million, compared to outflows of US$982.89 million, resulting in a net inflow of US$11 million.

Foreign exchange inflows mainly comprised:

- US$300 million bridging loan facility from the Government of Australia
- US$208 million in mining and petroleum tax (MPT) receipts
- US$188 million in dividends to the State
- US$139 million funding from PNG's multilateral partners
- US$100 million Asian Development Bank (ADB) loan
- US$33 million LNG development levy and US$26 million LNG royalties.

Outflows mainly comprised:

- US$648 million in domestic foreign exchange (FX) market intervention
- US$249 million loan repayments
  - US$186 million to multinationals
  - US$42 million for the Sovereign Bond
  - US$22 million for the Credit Suisse facility.
- US$73 million Government department payments.

Fund Performance

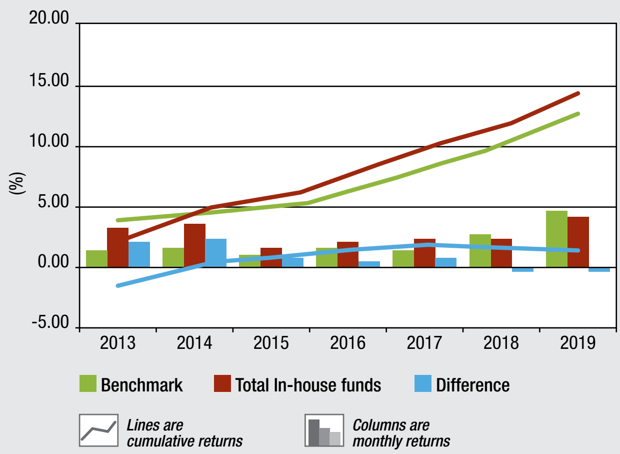
In-house Managed Funds

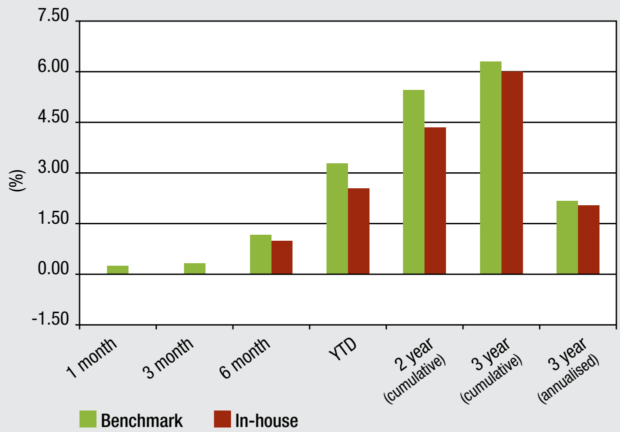
The Bank's in-house portfolio returned 3.02% for the 12 months to December 2019, underperforming the benchmark returns of 3.28%.

The strategy to invest in short term money markets yielded high returns for the portfolio. However, while the USD portfolio posted positive returns, the AUD portfolio recorded negative returns, attributed to negative valuations on the back of an increase in yield in December.

In-house Funds Performance

Performance for in-house reserves is calculated monthly and is measured against a benchmark (FTSE Russell Government Bond Index 1 – 3 years USD Hedged).





In-house Funds – Comparative Performance to Benchmark

	Return YTD	Benchmark YTD	YTD Difference
Dec 19	3. 04%	3. 28%	-0. 26%
Dec 18	2. 19%	2. 06%	0. 13%
Dec 17	1. 66%	0. 92%	0. 74%
Dec 16	1. 20%	1. 18%	0. 02%
Dec 15	0. 97%	0. 71%	0. 26%

Outsourced Funds

The outsourced funds generated a return of 3.76 percent, compared with 1.97 percent in 2018.

By December 2019 total outsourced funds had grown to US$1,218.66 million, an increase of 21.87 percent (US$218.66 million) since the inception of the outsourcing program in 2008.

Foreign Exchange Reserves Management – Annual Return (%)

Source	2019	2018	2017
In-house managed funds	3.04	2.19	1.66
Outsourced funds	3.76	1.97	1.18
Benchmark FTSE Russell Government Bond Index 1 – 3 years USD Hedged*	3.28	2.06	0.92

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

Composition of Foreign Exchange Reserves at December 2019

	In-house Managed Reserves	Outsourced Reserves	Gold	Total Invested Forex Reserves	IBRD	Total Foreign Exchange Reserves
Date	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)	USD ('m)
31 Dec 2019	1053.99	1218.66	65.25	2338.14	0.25	2338.14
31 Dec 2018	1066.10	1174.48	54.90	2295.43	0.25	2295.68
Change in USD	-12.07	44.18	10.35	42.46	0.00	42.46
Change in %	-1.13	3.79	18.85	1.85	0.00	1.85

International transactions monitoring

Foreign currency accounts

Opening and operating a domestic and offshore 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 conducted compliance checks to track monthly balances against the three months transaction forecast, to determine net credit or debit. The check reviewed 11 FCAs, resulting in amounts totalling USD11,631,486.09 and AUD1,437.80 converted to kina.

The Bank also monitored 13 FCAs for compliance with the monthly actual and forecast reporting requirements. The review resulted in the closure of 3 unauthorised FCAs.

Gold export licences

Residents and non-residents are allowed 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 2019	21
Licences approved	10
• Soi Gold Exports Ltd • BullionScope Limited • JIA Gold Holdings Ltd • Armstrong Precious Metals Ltd • Mi-Do Gold Buyers & Exporters Limited • Italpreziosi South Pacific Limited (ISPL) • Aviga Impex Limited • Golden Valley Enterprises Limited • Issac Lete Lumbu Gold Buyers Limited • Panners Gold Limited	
Applications declined	9
Applications cancelled	1
Applications requiring more information	1

Domestic lending in foreign currency

Lending by authorised dealers and other residents in any foreign currency to residents of PNG requires the prior approval of the Bank and their settlements must be in kina.

Applications approved and renewed in 2019	2
Value of transactions	K339.00 million US$99.50 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 2019	8
Applications approved	8

Removal of Physical Cash from PNG

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

Applications received and assessed in 2019	20
Applications approved	20
Value of approved transactions	K6,164,505.74
Value of physical cash	K3,319,505.74
Value of approved numismatic notes exported	K2,845,000.00

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 licencing 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.

The Financial System

Type of institution	31 Dec 2019	31 Dec 2018
Commercial banks	4	4
Licensed financial institutions including microbanks (LFIs)	14	13
Savings and loan societies (SLSs)	16	22
Authorised trustees (ASFs)	4	4
Licensed investment managers (LIMs)	5	5
Licensed fund administrators (LFAs)	3	3
Life insurance companies (LICs)	4	5
Life insurance brokers (LIBs)	6	5
Authorised money changers	9	9
Money remitters	2	2
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operators	1	1
TOTAL ASSETS (K billion)	**54.8**	**51.2**
Banking industry (%)	73.1	74.2
Authorised trustees (ASFs) (%)	26.4	25.4
LICs (%)	0.5	0.4
TOTAL DEPOSITS (K billion)	**29.3**	**27.7**
Commercial banks (%)	93.6	94.2
LFIs (%)	3.2	2.7
SLSs (%)	2.5	2.4
Microbanks (%)	0.7	0.7
TOTAL LOANS OUTSTANDING (K billion)	**20.7**	**19.9**

REGULATION AND SUPERVISION

Licences and approvals

In 2019 the Bank considered and made decisions on several applications regarding expansion, closure, relocation of operations and new licenses. During the year, the Bank:

- assessed 23 applications (granted 17 licences, refused 2 applications, 4 applications in progress)
- granted 1 approval (relocation of office).

February 2019

The Bank issued a no objection notice to BSP Finance Limited to enter the Laos asset finance and leasing market through a 50/50 joint venture partnership with an existing licensed leasing company in Laos, Davco Lao Leasing Company Limited.

Kwila Insurance surrendered its life insurance company licence.

June 2019

Kina Bank Limited (KBL) purchased a 15% share of Nationwide Micro Bank Limited (NMBL), with the aim of pursuing its financial literacy and financial inclusion programs to the unbanked population in Papua New Guinea.

September 2019

KBL successfully completed its acquisition of ANZ Bank PNG Limited's retail, SME and commercial businesses. The acquisition also included the transfer of 15 ANZ branches nationwide.

October 2019

Police Savings and Loan Society (POLSAV) and Teachers Savings and Loan Society (TISA) finalised their merger, completing the customer migration process and decommissioning the POLSAV computer system.

The Bank gave approval to the Bank of China to establish a representative office in PNG.

December 2019

The Bank granted approval in principle to Nationwide Micro Bank Limited to acquire PNG Microfinance Limited.

Supervisory enforcement actions

Reviews

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

During 2019 the Bank conducted 17 onsite prudential reviews or examinations on the 4 commercial banks (2 banks were visited twice), 3 licensed financial institutions, 2 savings and loan societies, 3 authorised superannuation funds, 1 investment manager and 2 life insurance companies.

The Bank also held 120 prudential consultations with 8 licensed financial institutions, 11 savings and loan societies and 1 life insurance broker.

Employee Superannuation Contribution Enforcement

During the year the Bank conducted onsite visits in the Autonomous Region of Bougainville, Milne Bay, Eastern Highlands, East Sepik, West Sepik, Western Highlands, Jiwaka provinces and the National Capital District.

In June 2019 the Bank took legal action against one of the non-complying companies, which resulted in the company appearing in court to face charges under the *Superannuation (General Provisions) Act 2000*. The Court adjourned the matter to 2020.

By November 2019 the Bank had received 85 complaints from employees against non-complying employers. The Bank referred 29 of these complaints to be addressed by the relevant Authorised Superannuation Funds.

Statutory administration, management and liquidation activities

In April 2019 Central Bank Officers Savings and Loan Society (CBOS&L) was removed from statutory management and an interim board was put in place to address the transitional requirements of the society under the *Savings and Loan Societies Act 2015*.

In July 2019 Comrade Trustee Services Limited (CTSL) was placed under Statutory Management.

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

Regulation and supervision development

Risk Based Supervisory Framework

The work on the enhancement of the risk-based supervision framework continued through 2019, with training focused on market and liquidity risk and offsite analysis. As part of the training, the Bank conducted an onsite review of BSP in which PFTAC provided technical expertise.

Financial Consumer Protection Framework

During the year the Bank conducted a series of stakeholder consultations in Kokopo, Lae, Madang and Mt Hagen, seeking comments on the draft Financial Consumer Protection Framework. In collaboration with the International Financial Corporation (IFC), the Bank completed the draft in 2019.

Financial services sector development

The Financial Sector Development Strategy was officially launched in January 2019. The responsibilities incorporated into the Strategy include:

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

PAYMENT SYSTEM

NATIONAL PAYMENT SYSTEM

The National Payment System (NPS) is part of the core financial infrastructure that supports the PNG economy. The Bank of Papua New Guinea holds responsibility for the NPS, in line with the *National Payment System Act 2013* (NPS Act 2013).

The Kina Automated Transfer System (KATS) was developed to implement the NPS, to meet the aim of delivering money from payer to payee, effectively and efficiently. The Bank's other NPS responsibilities include currency management and agency services.

NPS achievements during 2019 included:

- launching the National Switch
- establishing the National Payments Council
- improving the process of customs duties collection
- helping reduce the impact on commercial bank customers of a bank change.

National Switch enables start of Retail Electronic Payments System

The Retail Electronic Payments System (REPS) is designed to enable all providers, including mobile banking service providers, to exchange and use information across the NPS. The National Switch provides the shared infrastructure to enable providers to access REPS. It operates to process card payments 24 hours a day, 7 days a week, including public holidays.

During the first half of 2019 the Bank completed the commercial and regulatory framework for electronic retail payments, as well as the operational requirements and technical infrastructure required by the National Switch. These included new directives issued under the *NPS Act 2013* to enable a multi-lateral commercial arrangement to replace BPNG's bilateral arrangements with the commercial banks and for non-bank institutions to join REPS and connect to the National Switch.

The National Switch was launched in July 2019. BSP, Kina Bank and NASFUND Contributors Savings and Loan Society (NCSL) joined the system at the launch. Westpac, MiBank and People's Microbank Limited (PMBL) joined at the beginning of September. ANZ retail payments were routed through REPS on 23 September when their retail customers were transferred to Kina Bank.

By the end of the year REPS had achieved 4.3 million transactions, against a forecast of 1.05 million card payments. The decision by the commercial banks to route all payments to REPS, rather than retaining bilateral arrangements, contributed to the strong results.

REPS development

Planning for the next phase also commenced in 2019, with additional services being planned to extend to customers of non-bank financial institutions, such as Microbanks, Savings & Loan Societies and Mobile Network Operators, thereby increasing the capacity to drive financial inclusion.

National Payments Council

In 2019 the National Payments Council was established as a strategic forum and advisory body to the Bank, representing all major players in the market and relevant public bodies.

Kina Automated Transfer System (KATS)

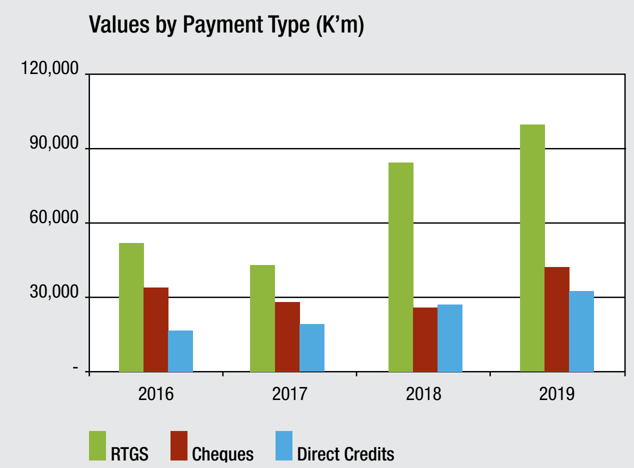
The reliability of KATS during 2019 continued to improve the efficiency and effectiveness of the NPS for participants and users, confirmed by favourable feedback from the commercial banks.

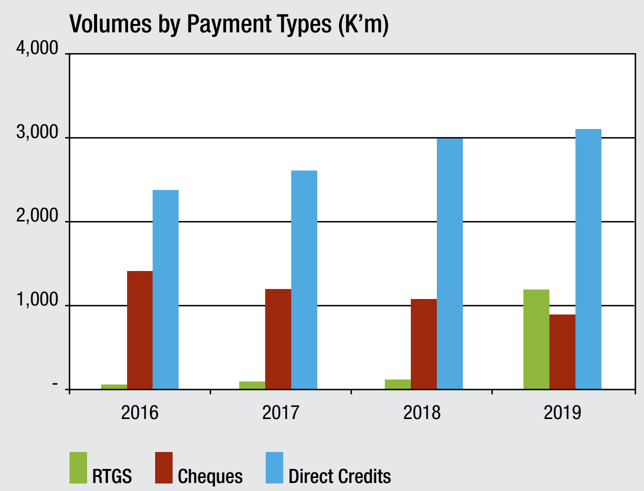
Integration with Government departments progressed well during the year. In particular the work with PNG Customs to automate the collection of customs duties received positive comment, with the link between the Bank and PNG Customs system enabling faster processing in allocating electronic payments cleared through KATS.

The Bank conducted a series of public information sessions around the country during 2019, to raise the awareness of the benefits of KATS. Topics included how KATS can help investors purchase securities safely outside the main centres and the use of digital payments in general.

Payment type trends

The use of real time payments and direct credits increased strongly during 2019, which also showed a strong decline in the use of cheques.





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 Centre in Kokopo, East New Britain province. During the year the Currency Processing Facility in Lae (CPF) commenced operation.

Currency in circulation

By the end of 2019 the value of currency banknotes in circulation had increased to K2,208.9 million (2018: K2,067.3 million) and the value of the coins in circulation had increased to K91.9 million (2018: K87.8 million).

Total currency in circulation by 31 December 2019 had increased to K2,300.8 million (2018: K2,155.1 million), in line with the trend of a constant gradual increase over the past several years. The K145.7 million increase was attributed to an increase in demand for K100, K50 and K20 denominations by the commercial banks and an increased demand for new notes arising from the establishment of CPF Lae.

Notes and Coins in Circulation

Notes Denomination	Value (K'm) 2019	Value (K'm) 2018
K2	62.1	58.2
K5	64.0	59.7
K10	87.5	86.8
K20	217.1	194.7
K50	559.9	518.1
K100	1,218.3	1,149.8
Sub Total	**2,208.9**	**2,067.3**
Coins Denomination		
K2	0.2	0.2
K1	30.3	28.4
50 Toea	8.1	7.7
20 Toea	22.9	22.1
10 Toea	23.3	22.5
5 Toea	7.1	6.9
Sub Total	**91.9**	**87.8**
Total	**2,300.8**	**2,155.1**

New notes and coins

The Bank issued new notes and coins in 2019 to the value of K909.86 million (2018: K519.25 million). The increase was mainly due to higher demand from the commercial banks for K100, K50 and K20 denominations.

New Notes and Coins issued in 2019

Notes Denomination	Value (K'm) 2019	Value (K'm) 2018
K2	25.9	21.7
K5	26.0	25.0
K10	37.5	27.0
K20	119.6	60.2
K50	272.5	168.0
K100	417.0	214.0
Sub Total	**898.5**	**515.9**
Coins Denomination		
K1	8.62	1.48
50 Toea	0.48	0.27
20 Toea	0.97	0.68
10 Toea	0.97	0.74
5 Toea	0.32	0.18
Sub Total	**11.36**	**3.35**
Total	**909.86**	**519.25**

Destruction of Soiled Notes

Notes Denomination	Value of Soiled Notes (K'm) 2019	Value (K'm) 2018
K2	30.1	11.7
K5	26.1	13.8
K10	38.3	13.0
K20	113.3	27.6
K50	248.9	100.4
K100	289.0	126.4
Total	**745.7**	**292.9**

Numismatic items

The Bank sells commemorative items to the public and currency collectors worldwide. In 2019 the total value of sales was K0.9 million (2018: K0.8 million) an increase due to the continuing popularity of the notes and coins released in 2018 to commemorate the APEC meetings.

Among the most popular items were the 2018 APEC K5 silver coin and K100 gold coin sets, the 2012 K5 uncirculated coin, the K2 note and coin pack and the 50 toea St Johns coin set.

GOVERNMENT BANKING AND AGENCY SERVICES

Government Banking

The Bank of Papua New Guinea provides banking services to the National Government and other authorities as part of its statutory function.

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 and provincial government and statutory authority accounts.

The Government maintained 42 drawing accounts for national departments and 96 trust accounts with the Bank during 2019. The balance of the trust accounts at 31 December 2019 was K519 million (2018: K732 million), with most of the funds held in the trust accounts for Tuition Fee Free Education (K110 million) and PNG LNG Royalties (K373 million).

As part of the National Government's Integrated Financial Management System (IFMS) for the provinces and districts, 104 drawing accounts were held at the Bank, comprised of 21 provincial treasury and 83 district treasury drawing accounts.

During the year large transactions processed included provincial and district services improvement projects, provincial and district grants, Tuition Fee Free Education, Autonomous Bougainville Government grants, medical supplies and infrastructure development projects co-ordinated by the Department of Works and Department of National Planning and Monitoring.

The streamlining of government banking continued during the year. During 2019 all organisations and businesses made their tax and customs payments through KATS to IRC and PNG Customs accounts maintained at the Bank. The KATS cheque truncation process and other improvements to cheque processing, such as standardising cheques, proved very effective and secure. No incidence of fraud in Government drawing accounts has been reported since the introduction of these measures during 2018.

Banking Services Development

The Bank held ongoing discussions with the Department of Finance during 2019 with a view to enabling all payments to service providers to be disbursed electronically through the Electronic File Transfer (EFT) function and thereby significantly reducing the need for cheques. At present this service is only available for Cash Fund Certificate (CFC) related payments, including provincial and district grants, development grants to the provinces, statutory bodies transfers and grants to hospitals.

The opening of the CPF in Lae during the year also enabled the Bank to provide limited general banking services to staff, with the aim of extending services to the general public in the future, such as encashment of travelling allowances, bail refunds, lodgement/exchange of soiled and mutilated bank notes and sale of numismatic items.

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 2019 the limit on TAF remained at K200 million. The Government used the facility frequently to meet temporary mismatches in its cashflow during the year.

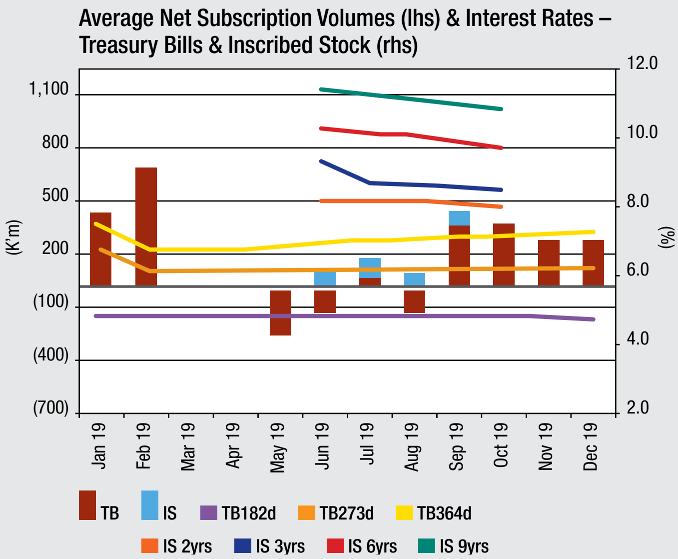
Government Agent Operations

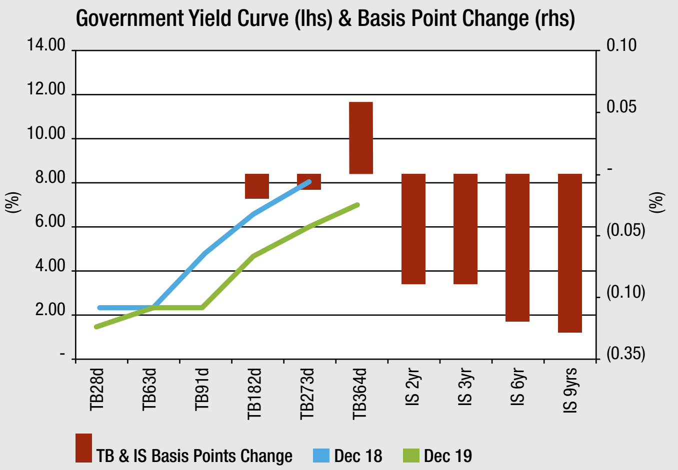
The Bank of Papua New Guinea is the Agent for the National Government as an authorised issuer, registrar and paying agent for Government securities.

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 2019 the Government issued its Treasury bills mainly in 182, 273 and 364 day terms. The Treasury Bonds were issued in 2, 3, 6 and 9 year terms. The Government's issuance strategy in 2019 was mainly rolling over of its Treasury bills, while the Treasury bond issuance strategy was as per the 2019 budget appropriation to issue new bonds of K560.7 million.

The interest rates for most Treasury bill and bond terms remained steady in 2019. The Treasury bills and bonds auctions in 2019 were mostly oversubscribed, reflecting a rise in demand throughout the year. In December demand picked up after the payment of the November 2019 coupon.

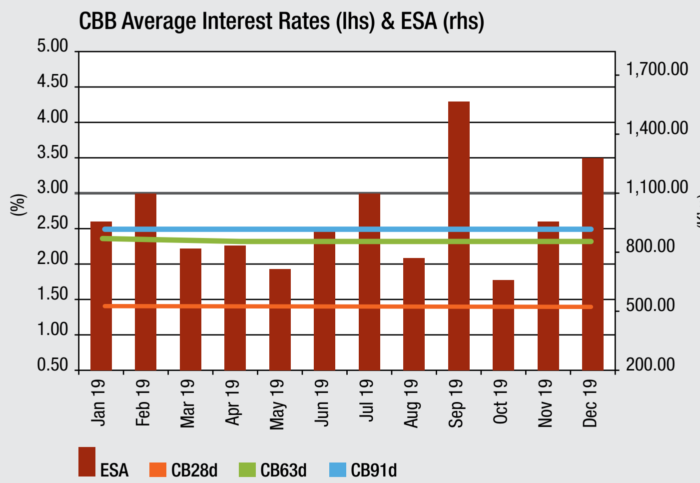


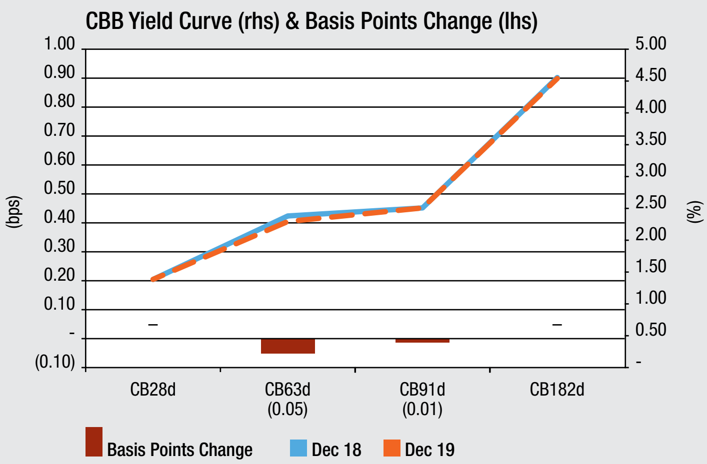


Central Bank Bills

The Bank issued its Central Bank Bills (CBB) mainly in the shorter-dated terms, 28 day, 63 day and 91 day. In 2019 CBB interest rates remained stable through the year. During the year CBBs were in moderate demand, with most auctions over-subscribed.

Banking system liquidity, as measured by the Exchange Settlement Account (ESA) Balances, averaged around K960.0 million, slightly above the 2018 level. The ESA level reflected liquidity injected through Government spending and retirement of investments in CBBs due to exposure limits and the maturing of Government Inscribed Stocks.





Tap facility

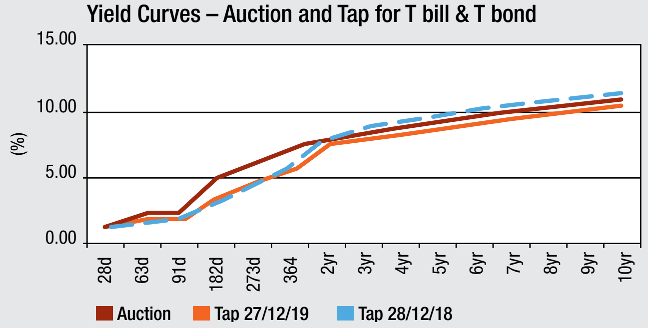
The CBB Tap facility aims to encourage investment by individuals, to help develop a savings culture within PNG. It provides an opportunity for individuals and small businesses, ineligible to participate at the primary auctions, to invest in government securities.

Under the facility, both Treasury bills (T bills) and Treasury bonds (T bonds) were offered with a minimum investment of K5,000.00. T bills were issued in shorter terms of 63, 91,182, 273 & 364 days. T bonds were offered in longer terms of 2,4,8 & 10 years, with the 10 year T bond the most popular investment in 2019.

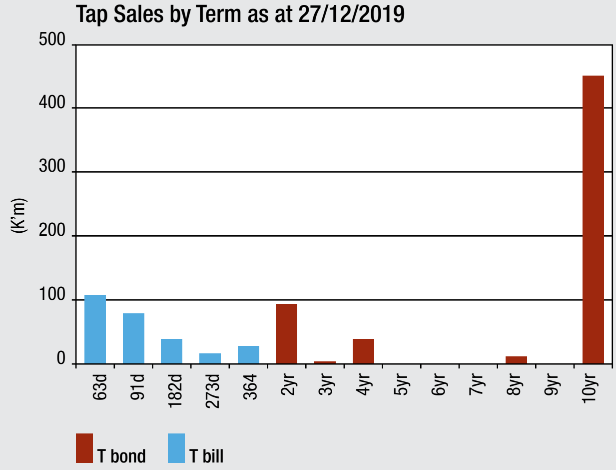
Contributing to strong sales during the year were favourable interest rates and an effective program by the Bank to raise awareness with potential investors, conducted in Lae, Maprik (Wewak), Jiwaka, Goroka, Walium (Madang), Mendi and Wabag.

By the end of 2019 the value of total cumulative sales was K797.3 million, a 123 percent increase over the previous year (2018: K357.3 million). The total outstanding amount at 31 December 2019 was K479.3 million, an increase of 209 percent over the previous year (2018: K242.2 million).

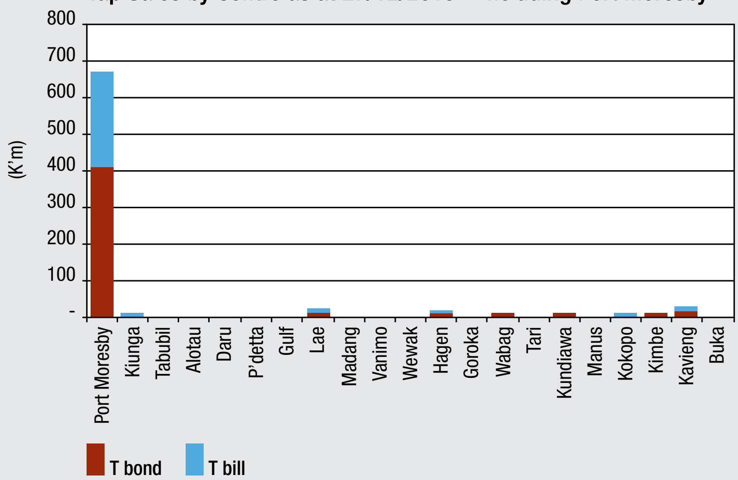
Yield Curves – Auction and Tap for T bill & T bond



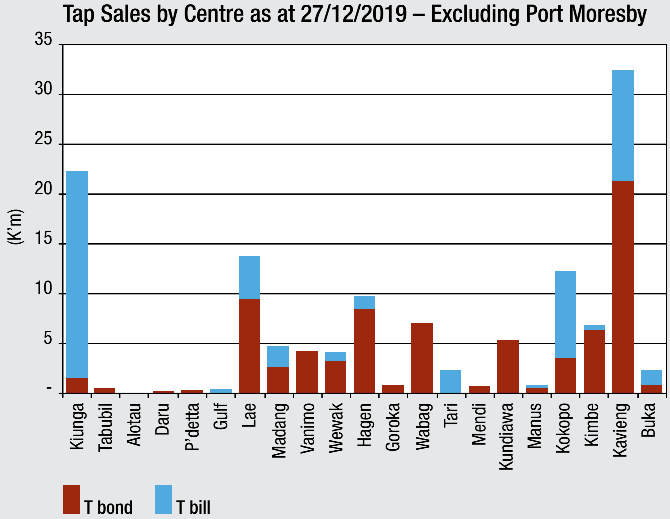
Tap Sales by Term as at 27/12/2019

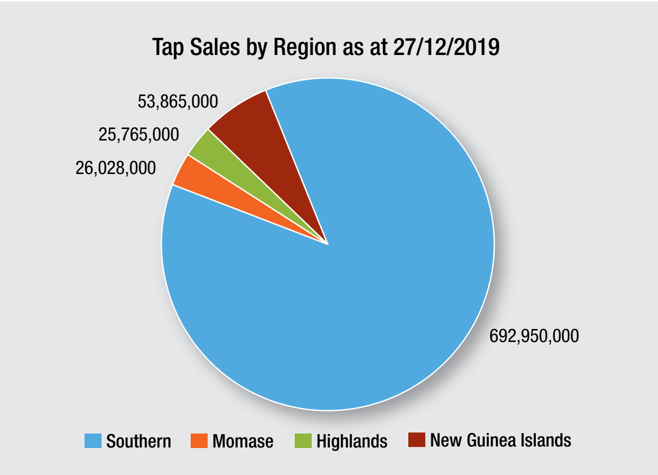


Tap Sales by Centre as at 27/12/2019 – Including Port Moresby



Tap Sales by Centre as at 27/12/2019 – Excluding Port Moresby





"Slack" arrangement

With the end of the agreement between the Bank and the Department of Treasury to take up the under-subscription of T bills ("slack") at weekly auctions at the end of 2018, no slack was taken up in 2019. By the end of the year the total holding of slacks had declined to K313.39 million (2018: K630.3 million).

Collateralised Repurchase Agreement facility

The Bank introduced the Collaterised Repurchase Agreement (CRA) facility during the year, replacing the unsecured Repurchase Agreement ("Repo").

The effect of the CRA is to secure lending to commercial banks by buying outright a nominated security asset (either T bill or T bond) and repurchasing at a predetermined maturity date. The ownership of the security transfers to the Bank of Papua New Guinea at the first stage and reverses at the second stage after successful repayment of the maturity by the commercial bank.

During the year 142 CRA repo transactions were completed, with a total value of K15,112.4 million. CRA transactions generated interest income for the Bank.

Government debt

By the end of 2019 total borrowing by the Government from the public amounted to K18.2 billion (2018: K17.0 billion). The borrowing comprised K8.0 billion Inscribed Stock (2018: K8.13 billion) and K10.2 billion in T bills (2018: K8.7 billion).

Treasury bonds (Inscribed stock)

	K'm
Issued in 2019	636
Maturities in 2019	991
Net issuance	355
Outstanding as at 31 Dec 2019	7,967
Outstanding as at 31 Dec 2018	8,322
Decrease in balance	355
BPNG holdings 31 Dec 2019	2,010
BPNG holdings 31 Dec 2018	2,063
Net maturity in BPNG holdings	0.53

Treasury bills

	K'm
Outstanding as at 31 Dec 2018	8,677
Issued in 2019	11,692
Slack outstanding in 2019	346.99
Maturities in 2019	10,178
Slack maturities in 2019	508
Net issuance	1,514
Outstanding as at 31 Dec 2019	10,191

Central Bank Bills

	K'm
Outstanding as at 31 Dec 2018	2,166
Issued in 2019	13,014
Slack issued in 2019	4,698
Maturities in 2019	14,010
Slack maturities in 2019	4,567
Net maturity	865
Outstanding as at 31 Dec 2019	1,301

BPNG Bill Tap facility

	K'm
Outstanding as at 31 Dec 2018	87
Issued in 2019	65
Maturities in 2019	117
Early Redemption	3
Net Maturity	55
Outstanding as at 31 Dec 2019	32

BPNG Bond Tap facility

	K'm
Outstanding as at 31 Dec 2018	155
Issued in 2019	375
Maturities in 2019	6
Early redemption	76
Net issuance	293
Outstanding as at 31 Dec 2019	448

Secondary Market Development

One of the Bank's strategic goals is to enable and promote an active domestic secondary market for Government securities.

Over the course of 2019 the Bank worked on the Central Securities Depository (CSD) project, which aims to introduce a secondary market platform. The CSD aims to encourage active trading of Government securities by providing the liquidity needed for investors to buy and sell securities quickly.

Secondary Functions

ECONOMIC ADVICE TO GOVERNMENT

The Bank of Papua New Guinea 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 Government policy may have on monetary policy.

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

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

INCREASING ECONOMIC KNOWLEDGE

Research activities are key to increasing economic knowledge. During 2019 the Bank continued to perform a range of research activities, including information gathering through PNG-wide industry surveys, collaboration on research papers with Griffith University, Australia and knowledge-sharing and capacity building through participation in international conferences, such as the South Pacific Central Banking Conference held in Vanuatu during the year.

These activities contributed to policy analysis, decisions and forecasts, which are essential in preparing the Bank's six-monthly Monetary Policy Statement.

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 with its close working relationship with the Centre of Excellence for Financial Inclusion (CEFI).

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

** With the development of the framework to provide financial consumer protection, the work of this group was concluded.*

2019 key financial inclusion results

	End 2019	End 2018
Total number of deposit accounts	3,259,843*	3,203,882
Access points	14,050	16,509
Branches	228	216
ATMs	471**	463
EFTPOS merchants	13,032**	15,379
Agents	327**	475
Mobile financial service accounts	739,115	600,881

** A substantial number of deposit accounts were closed as a result of Kina Bank's acquisition of ANZ Bank's retail business.*

*** During 2019 CEFI removed inactive savings and loan societies and inactive agents, also removing inactive EFTPOS machines and ATMs.*

One of the NFIS 2 objectives is to have 2 million additional accounts by the end of 2020, of which 50% are to be owned by women. By the end of 2019 the number of deposit accounts owned by women reached 995,315, which represented 30.53 percent of the total number of deposit accounts.

The launch was attended by leaders from government and the financial sector. Front L-R: Hon. Sasindran Muthuvel (Governor of West New Britain Province), Loi M. Bakani CMG (Governor, BPNG); Deputy Prime Minister Hon. Charles Abel MP, Hon. Soroi Eoe MP (Minister for Community Development, Youth and Religion), Anna Solomon (Secretary, Department of Community Development & Religion)

Back L-R: Koney Samuel (Secretary, Department of National Planning and Monitoring); Hon. Francis Maneke MP (Member for Talasea), Hon. Robert Agarobe, (Governor, Central Province), Dairi Vele (Secretary, Department of Treasury).

The launch of the Financial Sector Development Policy and the National Financial Inclusion Policy took place in January 2019 with a celebration in Port Moresby, which included a performance by the Huli Wigmen, shown here with Ms Marie-Rose Sau (Senior Secretary, Financial Systems Development Department – Financial System Stability Group).

Financial Inclusion Policy

During the year the National Financial Inclusion Policy was officially launched and acknowledged as a driver for PNG's future economic and social development.

The Policy provides a framework through which all government agencies support financial inclusion efforts.

Financial Inclusion Strategy

NFIS 2 provides the blueprint through which the Policy can be achieved.

Strategy rollout

With "usage" the focus of NFIS 2, the Strategy continued to concentrate on financial education and literacy and consumer awareness, towards the goal of driving usage. During 2019, in partnership with Department of Treasury, CEFI conducted the first of a series of workshops to raise public awareness about the Policy.

Information flow

Throughout 2019 CEFI continued to collect, verify and consolidate financial inclusion data on a quarterly basis from all the regulated financial institutions. The information was published on the Alliance for Financial Inclusion (AFI) and CEFI websites.

The CEFI newsletter was made available online during the year. Information is also available through www.thecefi.org, Facebook, Twitter and LinkedIn pages.

Strategic alliances

Market for Village Farmers

During the year CEFI and Market for Village Farmers Project entered into a partnership agreement to design new agriculture lending products as a financial inclusion project. The partnership aims to help villagers in Western Highlands, Jiwaka, Chimbu, Eastern Highlands, Morobe and East New Britain Provinces move from semi-subsistence agriculture to farming as a business involved in market-oriented production.

Financial Inclusion in provincial partnerships

CEFI signed agreements with West New Britain and Milne Bay provincial governments during 2019. These partnerships will promote the integration of financial inclusion in the planning and implementation processes of each provincial administration. It will also build the capacity of the administration staff to:

- expanding the banking and financial services network
- encourage residents to hold formal bank accounts
- facilitate financial literacy and business development training, and
- digitise provincial government payments.

Local project steering committees were appointed to direct these activities.

Partnership with MIX Market

CEFI's partnership with the international microfinance information exchange, MIX Market, operated during 2019.

Nine microfinance institutions provided data to MIX Market and reports were released and published on MIX Market and Consultative Group to Assist the Poor (CGAP) websites. The arrangement concluded at the end of the year when MIX Market changed its strategic direction. The PNG information previously available through MIX Market was transferred to the World Bank's data catalogue.

Projects

Data Mapping

The Financial Inclusion Mapping Tool went live in 2019 and was made available on the CEFI website. This interactive tool was designed for Government and development partners to see financial services access points in provinces and districts, enabling them to make informed decisions about improving access to financial products and services around the nation.

Simberi Mining area study

CEFI conducted a study on financial inclusion activities in the Simberi Mining area of New Ireland Province. The study aimed to assess the level and availability of banking services in the locality and to develop a work plan to establish viable banking services and build financial literacy. An initial financial literacy training session was conducted in June 2019.

Support for Productive Partnerships for Agriculture Projects (PPAP)

The World Bank funds PPAPs to build long term sustainability into the operations of smallholder cocoa and coffee producers. During 2019 CEFI contributed to the process through assisting the lead partners of the project by developing business plans suitable for funding applications, recommendations on business development and implementing financial inclusion activities to enable the project to move to the next phase.

Financial education and literacy

During the year CEFI laid the foundations for building a high standard of financial inclusion training, with the registration of 35 institutions as financial inclusion trainers using CEFI training modules and attending a CEFI training workshop.

Plans were also made in 2019 to improve the learning modules for Financial Literacy and Financial Education Training in partnership with the Department of Education and Department of Treasury.

In 2019 CEFI participated in Global Money Week, a worldwide annual financial awareness campaign organised by the OECD International Network on Financial Education. Designed to inspire children and young people to learn about money matters, livelihoods and entrepreneurship, Global Money Week activities in PNG included an art competition hosted by CEFI, with the theme LEARN EARN SAVE.

Microfinance Expansion Project

The overarching objective of the Microfinance Expansion Project (MEP) was to reduce poverty by providing financial services to the financially illiterate and to potential businesses.

MEP concluded on 30 June 2019. Its key activities, supporting the microfinance industry, promoting financial inclusion training and developing standards for the microfinance industry, were incorporated into CEFI.

FINANCIAL INTELLIGENCE MONITORING

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

AML/CTF activities conducted by FASU throughout 2019 included signing information-sharing agreements with 6 other international FIUs and 5 domestic agencies. By the end of 2019 FASU had agreements with 14 international FIUs and 12 domestic agencies.

FASU successfully met the final review requirements of membership of the Egmont Group, a global network of more than 170 FIUs. Papua New Guinea was granted admission as a member in July 2019, giving FASU access to the Group's communications and information exchange processes.

AML/CTF highlights in 2019 included:

- issuing AML/CTF compliance rules and guidelines to reporting entities
- participating in INTERPOL training
- conducting awareness and education forums on the roles and responsibilities of the FASU and the obligations of the reporting entities
- working on preparatory work for PNG's second Mutual Evaluation Review.

L-R: Benny Popoitai MBE, Director, FASU and Dr Eric Kwa, Secretary, Department of Justice and Attorney General announced the launch of the AML/CTF Strategic Plan and National Risk Assessment.

Institutional Support

STRATEGIC AND OPERATIONAL MANAGEMENT

Over the course of 2019 the Bank continued to monitor progress and achievements in line with the Strategic Plan 2016-2020 and commenced preliminary planning for the next Strategic Plan (2021 – 2025).

Key achievements in 2019 included:

- completion of Lae Currency Processing Facility and grand opening
- launch of the Regulatory Sandbox
- approval of the Financial Sector Development Strategy
- improvements to currency operations in Port Moresby facility
- launch of the Gender Equity and Social Inclusion Policy
- analysis of the Bank's governance framework and internal capability
- development of the Bank's transformational change framework
- completion of FASU structure, roles and responsibilities.

HUMAN RESOURCES MANAGEMENT

Staff Numbers

Staff Category	2019	2018	2017
Non-management level staff	462	417	388
Management	63	59	57
Executive	6	6	5
Total	531	482	450

Staffing

During 2019 the Bank undertook a number of key human resources projects, including establishing the staffing for operating 24/7 associated with the implementation of the Retail Electronic Payments System (REPS) and recruiting staff for the Lae CPF and other upcoming programs. The Bank's staff complement increased to 531 over the course of the year, mainly as a result of expanding functions and workloads.

Employee capacity development

The Bank continued its focus on employee capacity development during 2019. Over the course of the year, the Bank sponsored employees to attend local and offshore training programs related to their roles. These included workshops, conferences, short courses and longer-term formal studies. Twenty-nine staff members were engaged in studying various business and finance-related programs, from diploma level to post-graduate qualifications, in both local and overseas institutions. After successfully completing their programs of study, 4 employees resumed their duties with the Bank.

The Bank also recognises the benefit of affiliation with professional bodies to maintain its network and the professional standing of its employees and continues to encourage staff to hold memberships from relevant industry associations. In line with this, during 2019 in its capacity as a member of SEACEN, the Bank hosted a workshop on macro-economics, giving Bank staff the opportunity to network and share knowledge with staff from other central banks in the region. Similarly, teams from the Bank participated in regional research programs in conjunction with Griffith University, Australia, during the year.

The Bank also conducted structured capacity development programs for staff, including employee engagement workshops and opportunities to participate in activities to help build leadership and communications skills.

The Bank has encouraged staff to participate in healthy sporting activities for many years, recognising how team activities outside the office can translate into effective team building and positive staff morale in the workplace.

In 2019 the BPNG team won the grand final in the Corporate Netball competition. Team members included Ruth Jethro, Andiopa Sabadi, Lynne Raka, Priscilla Ipu, Anita Jonathan, Oraka Timothy, Agi Aruai and Marilyn Mailau.

Gender Equity and Social Inclusion (GESI)

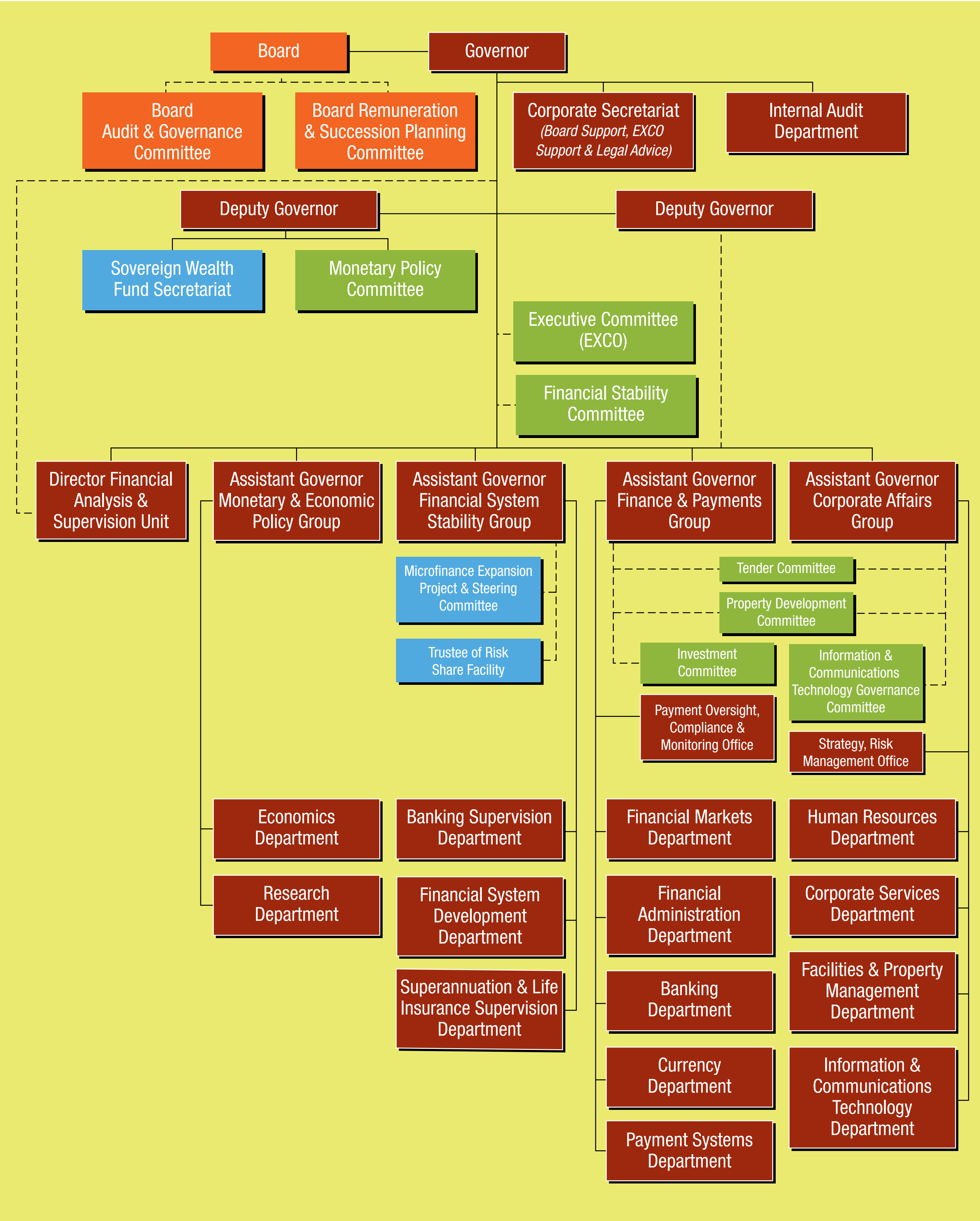
In 2019 the Bank started activities to introduce an effective Gender Equity and Social Inclusion (GESI) initiative, designed to align with the National Government's GESI Policy. By the end of the year the Bank had developed the GESI Policy using a consultative approach to identify policy objectives, goals and key concepts, established a group of GESI advocates within the Bank and launched the GESI Implementation Strategy 2020 - 2022.

The Bank initiated the development of a Gender Equity and Social Inclusion (GESI) policy during the year. "Focal Point Members", a group of staff selected as GESI representatives within the Bank, attended a workshop to establish the project.

Front L-R: Naomi Kedea, Beverley Mirou, Lilo Seni, Frieda Kamakom, Robyn Cornford, Maryanne Kani, Aiva Aku, Ruth Morere Wapunk, Brenda Koan.

Back L-R: Kerry Packau, John Nema, Meson Tumsok, Mark Steven, Alfred Napun, Jason Boude.

Organisation Chart (31 December 2019)



Institutional Support

Senior officers (31 December 2019)	
Governor	**Loi M. Bakani CMG**
Deputy Governor	Joseph Teria
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 Banik
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 (Acting)
Manager, Balance of Payments	Thomas Jiki
Manager, Library	Polycarp Reu
Manager, International Transactions Monitoring	Elim Kiang
Research	
Department Manager	Jeffrey Yabom (Acting)
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
Superannuation & Life Insurance Supervision	
Department Manager	Elizabeth Gima
Manager, Superannuation	Tom Milamala
Manager, Life Insurance	Joseph Nukints
Manager, Employer Contributions Enforcement	Nonza Makip

Senior officers (31 December 2019)	
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	Simon Gaius
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
Currency	
Department Manager	David Lakatani
Manager, Control	John Yenas
Manager, Processing	Edward Kisaku
Payment System	
Department Manager	Gaona Gwaibo
Manager, Switch Operations & Support	Stephen Pouru

Senior officers (31 December 2019)	
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
Information Communications & Technology	
Chief Information Officer	Naime Kilamanu
Manager, Corporate Systems	Elvis Haoda
Manager, Operations	Manea Joseph
Manager, Projects Management Office	Vacant
Corporate Services	
Department Manager	Jerome Peniasi
Manager, Media and E-Communications	Marie Kauna
Manager, General Services	Monica Toisenegila
Manager, Events, Marketing and Publications	Dennis Sapak
Facilities & Property Management	
Department Manager	Bruce Kitchen
Manager, Building	Gibson Param
Manager, Security	David Rutana
Currency Processing Facility – Lae	
Project Manager	Ron Sikar
Manager, Support Services Office	William Tiki
Manager, Cash Processing & Distribution	Frank Ababa
Manager, Cash Control & Distribution	Agnes Mark
Manager, Security	Bravo Vaieke (Acting)
Manager, Building	Israel Anduari

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 2019 the Bank completed or progressed several strategic projects across the activities of the Bank, including updating and upgrading key systems, overseeing and providing support for the Retail Electronic Payments System 24/7 operations and the opening of the Lae CPF.

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

Blockchain development

In partnership with the Asian Development Bank (ADB), Digizen and the Australian Government, the Bank developed the Digital Access Rights tool. The tool enables a digital identification system designed for localities with limited services, such as network connection, internet availability or electricity. The system provides a way to clearly identify individuals, which means financial transactions can be based on certainty about who the parties to the transaction are. During the year the Bank conducted a successful pilot test at Sogeri, Central Province.

Regulatory sandbox

At the end of 2019 the Bank established a "regulatory sandbox" as a measure to encourage innovations that may assist in the drive for financial inclusion. The regulatory sandbox provides a testing ground for innovation development, in which new technologies can be given a "trial run" without the added complications of restrictive regulations. It also allows the Bank to identify issues and potential pitfalls with the new technologies, as well as the opportunity to review and update existing regulation to ensure that it keeps pace with technology developments.

COMMUNICATIONS AND EVENTS COORDINATION

During 2019 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, including the official opening of the Lae CPF, launches of the Retail Electronic Payments System (REPS), the Gender Equity and Social Inclusion (GESI) Policy, the Regulatory Sandbox, organising the Bank's participation in formal announcements 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 several significant conferences and continued public information campaigns.

COMMUNITY SUPPORT

The Bank supports a number of professional, cultural, sporting and health related causes.

Donations to mark Anniversary *As part of the celebrations of the Bank's 46th Anniversary, the Bank made donations to Port Moresby General Hospital, the Rotary Club of Port Moresby, Cheshire Disability, Buk Bilong Pikinini and St Mary's Catholic Church in Lae.*

BPNG staff played a part in World Environment Day by collecting rubbish along Paga Ring Road and Ela Beach.

BANK OF PAPUA NEW GUINEA

FINANCIAL STATEMENTS
FOR THE YEAR ENDING
31 DECEMBER 2019

Table of contents

Statement of Profit or Loss and Other Comprehensive Income

For the year ended
31 December 2019

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

The financial statements are to be read in conjunction with the notes on pages 51 to 87.

Statement of Financial Position

For the year ended
31 December 2019

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

	Notes	2019 K'000	2018 K'000
Equity			
Capital	22	145,540	145,540
Gold revaluation reserve	22	197,412	161,108
Property revaluation reserve	22	95,028	83,234
Unrealised gain/(loss) reserve	22	299,888	63,030
Building reserve	22	73,800	73,800
General reserve	22	30,000	-
Retained earnings	22	418,662	412,152
Total Equity		**1,260,330**	**938,864**
Total Liabilities and Equity		**10,998,671**	**10,790,247**

The financial statements are to be read in conjunction with the notes on pages 51 to 87.

Statement of Changes in Equity

For the year ended 31 December 2019

	Capital K'000	Gold Revaluation Reserve K'000	Property Revaluation Reserve K'000	Unrealised gain/loss Reserve K'000	Building Reserve K'000	General Reserve K'000	Retained Earnings K'000	Total K'000
Balance at 1 January 2018	**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 retained 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**
Profit for the year	-	-	-	236,858	-	-	156,510	393,368
Net transfers from unrealised profit/(loss) reserve to retained earnings	-	-	-	-	-	-	-	-
Other comprehensive income	-	36,304	-	-	-	-	-	36,304
Net transfers from retained earnings to general reserve	-	-	-	-	-	30,000	(30,000)	-
Revaluation of PPE	-	-	11,794	-	-	-	-	11,794
Dividend declared and paid	-	-	-	-	-	-	(120,000)	(120,000)
Balance at 31 December 2019	**145,540**	**197,412**	**95,028**	**299,888**	**73,800**	**30,000**	**418,662**	**1,260,330**

The realised profit for the year is K156.5 million. The unrealised gain/(loss) reserve and net asset balance at 31 December 2019 are K299.8 million and K1.26 billion, respectively. The *Central Bank Act 2000* states that no distribution will be made where, in the opinion of the Central Bank, the assets of The Bank are, or after the payment, would be less than the sum of its liabilities and paid-up capital.

The financial statements are to be read in conjunction with the notes on pages 51 to 87.

Statement of Cash Flows

For the year ended 31 December 2019

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

The financial statements are to be read in conjunction with the notes on pages 51 to 87.

Notes to the Financial Statements

For the year ended
31 December 2019

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The principal accounting policies applied in the preparation of these financial statements are set out below. The application of these policies is consistent with the review and approval from the Bank's board as at 30 June 2020.

(a) Basis of preparation

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

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

Going concern

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

Section 50(2) of the Act provides that where the Bank incurs a loss due to a change in the value of assets or liabilities, the Minister shall cause to be paid to the Bank such amount out of the Consolidated Revenue Fund as is necessary to avoid the loss. Subsection 50(4) of that Act further provides that the Minister may create and issue to the Central Bank non-interest bearing non-negotiable notes for an amount not exceeding any payment made by the Minister to the Central Bank out of the Consolidated Revenue Fund in accordance with Subsections (1) and (2) of the Act. The above provisions of the Act effectively require the Government to provide financial support to the Bank.

(b) Functional and presentation currency

Transactions in foreign currency are translated to Kina being the functional and presentation currency of the Bank at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Kina at the foreign exchange rate prevailing at reporting date. Foreign exchange differences arising on translation are recognised in the Statement of Profit or Loss and Other Comprehensive Income.

(c) Use of judgements and estimates

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

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

(i) Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 December 2019 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

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

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

(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 makes assumptions that are mainly based on market conditions existing at the end of each reporting period. Derivative transactions are entered into on behalf of the Bank by the external fund managers and similar valuation techniques are used in valuing these derivatives.

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

(d) Standards issued but not yet adopted

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

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

(e) New standards implemented and adoption of IFRS 16 leases

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

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

IFRS 16 Leases

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

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

(i) The Bank as lessee

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

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

Lease payments included in the measurement of the lease liability comprise:

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

The lease liability is included under Other Financial Liabilities in the Statement of Financial Position.

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

The Bank remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

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

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

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

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

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

The right-of-use assets are included in the Property and Equipment line in the Statements of Financial Position.

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

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

(ii) Impact on transition

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

	1 January 2019
Right-of-use assets presented in Property and Equipment	K15,200,428
Lease liabilities	K15,200,428
Retained earnings	Nil

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

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

(iii) The Bank as lessor

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

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

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

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

(f) Financial instruments

Classification and measurement of financial instruments

Definition of financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The Bank's financial instruments are its domestic government securities, foreign government securities, Central Bank Bills issued, bank deposits, cash and cash equivalents, deposit liabilities and currency in circulation. The Bank accounts for its financial instruments in accordance with IFRS 9 and reports these instruments under IFRS 7 Financial Instruments: Disclosures and IFRS 13 Fair Value Measurement.

(i) Recognition and initial measurement

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

(ii) Classification and subsequent measurement of financial assets

The Bank classifies financial assets into one of the following measurement categories:

- Amortised cost;
- Fair value through other comprehensive income (FVTOCI); or
- Fair value through profit or loss (FVTPL).

The classification of debt instruments is determined based on:

a) the business model under which the asset is held; and

b) the contractual cash flow characteristics of the instrument.

Business model assessment

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

Solely payments of principal and interest (SPPI) criteria

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

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

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- Contingent events that would change the amount and timing of cash flows;
- Leverage features;
- Prepayment and extension terms;
- Terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- Features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

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

Financial assets measured at FVTPL – financial assets are measured at FVTPL if assets:

i) are held for trading purposes;

ii) are held as part of a portfolio managed on a fair value basis; or

iii) whose cash flows do not represent payments that are solely payments of principal and interest.

Financial assets measured at FVTOCI – financial assets are measured at FVTOCI if the financial assets are held within a business model that is achieved by both collecting contractual cash flows and selling, which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest. These comprise primarily marketable securities. They are recognised at the trade date when the Bank enters into contractual arrangements to purchase and are de-recognised when they are sold or redeemed. They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains or losses) are recognised in Other Comprehensive Income until the assets are sold. Upon disposal, the cumulative gains and losses in the Comprehensive Income are recognised in the income statement as Gains and Losses from Financial Instruments'. Financial assets measured at FVOCI are included in the impairment calculations and the impairment is recognised in Profit or Loss.

(iii) Classification of financial liabilities

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

(iv) Reclassifications of financial assets

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

(v) Impairment of financial assets carried at amortised cost

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

Expected credit loss impairment model

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

This impairment model measures credit loss allowances using a three-stage approach based on the extent of credit deterioration since origination:

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

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

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

Measurement of expected credit loss

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

- PD – The probability of default is an estimate of the likelihood of default over a given time horizon.

A default may only happen at a certain time over the remaining estimated life, if the facility has not been previously de-recognised and is still in the portfolio.

- EAD – The exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued interest from missed payments.

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

Forward-looking information

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

ECL calculation

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

(vi) De-recognition of financial instruments

De-recognition of financial assets

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

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

On de-recognition of a financial asset, the difference between the carrying amount and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in Other Comprehensive Income is recognised in the Profit or Loss.

De-recognition of financial liabilities

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

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

(vii) Modification of financial instruments

Modification of financial assets

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

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

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

Modification of financial liabilities

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

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

(viii) Domestic government securities

The Bank holds Inscribed stocks with fixed coupon rates issued by the Government. Interest is received biannually at the coupon rate and the principal is received at maturity. The Inscribed stock securities are managed by the Bank on a fair value basis, and are held to implement monetary policy and may be sold or lent, typically for short terms, under repurchase agreements, thus they are designated as FVTPL under IFRS 9. In accordance with this standard, the securities are accounted for on a fair value basis using the discounted present value model, with realised and unrealised gains and losses taken to profit. The Bank also holds Treasury bills purchased at a discount. The securities are held to collect contractual cash flows hence are measured at amortised cost.

Interest earned on the securities is accrued over the term of the security and included as revenue in the Statement of Profit or Loss and Other Comprehensive Income.

(ix) Foreign exchange holdings

Foreign exchange holdings are invested mainly in securities (issued by the Governments of Australia, the United Kingdom, United States of America, Germany, France and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). They are available to be traded in managing the portfolio of foreign exchange reserves. In accordance with IFRS 9, these assets are measured as "fair value through profit or loss". External fund managers engaged by the Bank also enter into forward exchange contracts to hedge the returns of portfolios under their management to the US Dollar. No PNG Kina forward contracts are entered into.

(x) Foreign exchange translation

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

(xi) Foreign government securities

Foreign government securities include coupon and discounted securities. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal is received at maturity. Interest earned on discount securities is the difference between the purchase cost and the face value of the security; this is accrued over the term the securities are held. They are available to be traded in managing the portfolio of foreign exchange reserves and are managed by the Bank on a fair value basis, thus they are measured as FVTPL under IFRS 9. In accordance with this standard, these securities are valued at market bid prices on balance date. Realised and unrealised gains or losses are taken to profit; only realised gains and losses are available for distribution in accordance with the *Central Banking Act 2000*. Interest earned on securities is accrued as revenue in the Statement of Profit or Loss and Other Comprehensive Income.

(xii) Foreign deposits

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

(xiii) Foreign currency forward contracts

External fund managers engaged to manage part of the Bank's investment portfolio enter into over-the-counter forward foreign exchange contracts to hedge the return of portfolios under their management to the US Dollar. Gains/(losses) on this portfolio are treated as unrealised by the Bank and recorded in a separate equity reserve as such gains and losses are not available for distribution. These forward contracts are accounted for on a fair value basis, with all changes in fair value being reflected in the Statement of Profit or Loss and Other Comprehensive Income in accordance with IFRS 9. The fair values are determined with reference to prevailing exchange rates at balance date.

(xiv) Repurchase agreements

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

(xv) Deposit liabilities

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

(xvi) Central Bank Bills on issue

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

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

(xvii) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable repayment terms that are not quoted in an active market. Loans are receivables and initially recognised at fair value, which is the cash consideration to originate or purchase the loan including any transaction costs and measured subsequently at amortised cost using the effective interest rate method under IFRS 9. Loans and advances owing from previous staff are treated as financial assets measured at amortised cost and will be assessed for impairment based on an expected credit loss model in accordance with IFRS 9; however, loans and advances to current staff represent a prepaid employee benefit (a non-financial asset).

(xviii) Assets and liabilities with the International Monetary Fund (IMF)

As Papua New Guinea is an IMF member nation, special drawing rights (SDR) are periodically allocated. The Bank recognises the allocation as an asset. The IMF assets and liabilities are denominated in SDR which are based on the weighted average of four main trading currencies. These are translated to PGK using the SDR market rate at balance date. Under voluntary arrangements with the IMF, the Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies. These assets and liabilities are managed by the Bank on a fair value basis and are measured as FVTPL in accordance with IFRS 9.

(xix) Currency in circulation

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

(xx) Revenue

Interest income

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

Foreign exchange gains and commissions

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

Realised gains/(loss) on financial assets

Gains and losses realised from the sale of foreign financial instruments are reflected in the Statement of Profit or Loss and Other Comprehensive Income at the time of transaction.

Other income

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

(g) Determination of fair value

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

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

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

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

(h) Property and equipment

Formal valuations of all the Bank's properties are conducted on a triennial basis. The properties are valued by local independent valuers. The most recent independent valuation of the properties was conducted during the year and the valuations reflected in the financial statements at 31 December 2019. In accordance with IAS 16 – Property and Equipment, properties are valued at fair value, which reflects observable prices and are based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Reflecting their specialised nature, the Bank's head office at ToRobert Haus and the Lae currency distribution facility are valued at depreciated replacement cost. Valuation gains and losses are transferred to the Property Revaluation Reserve. Management has assessed the fair value of all Property and Equipment as at year end and consider them to be appropriate. Property Revaluations are done and accounted for at the end of the year applying the elimination method to any accumulated depreciation.

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

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

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

(i) Computer software

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

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

(j) Gold

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

(k) Investment properties

Investment property is initially measured at cost and subsequently at fair value, with any change therein recognised in Profit or Loss within Other Unrealised Income: Fair value revaluation gain on domestic investment.

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

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

(l) Investment property rental income

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

(m) De-recognition

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

(n) Offsetting financial instruments

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

(o) Inventory – notes & coins

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

(p) Cash and cash equivalents

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

(q) Other receivables

Other receivables are stated at amortised cost.

(r) Employee benefits

(i) Pension fund

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

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

(ii) Provision for leave entitlement

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

(s) Other liabilities

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

(t) Reserves

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

(i) Bank of Papua New Guinea Reserve Fund

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

(ii) Property Revaluation Reserve

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

(iii) Unrealised Profits Reserve

Unrealised gains and losses on foreign exchange balances and domestic securities are recognised in the Unrealised Loss Reserve until such gains and losses are realised whereby they are recognised in Profit and Loss from ordinary activities. Such gains and losses are not available for distribution;

(iv) Distributable Profit Reserve

The distributable profit reserve reflects closing distributable profit which may be distributed to the Government of Papua New Guinea after ensuring that the current financial position of the Bank meets the requirements under the *Central Banking Act 2000* Section 49(3);

(v) Gold Revaluation Reserve

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

(u) Determination of distributable profit

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

(i) Section 50(1) states that net profit arising from revaluation and foreign currency movements shall not be available to be distributed to the Government or paid into the Consolidated Revenue Fund. Accordingly such unrealised profits are transferred to the Unrealised Profits Reserve;

(ii) The Board of the Bank is required to determine the net profit of the Bank and then consult with the Minister for Treasury to determine the amount of profit that is to be placed to the credit of the Bank's reserves;

(iii) The balance of net profit after any transfer in (a) and (b) in accordance with Sections 49(2)(a) and 50(1) of the Act is paid to the Consolidated Revenue Fund;

(iv) The amount shall not be paid into the Consolidated Revenue Fund under the above sections where, in the opinion of the Central Bank, the assets of the Central Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital;

(v) The unrealised profit reserve of the Bank represents gains or loss arising from the revaluation of gold, properties and other financial assets of the Bank. These gains and losses are separately classified under the respective reserves in the Statement of Changes in Equity.

(v) Tax exemption

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

(w) Comparatives

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

(x) Rounding

Financial information has been rounded to the nearest thousand Kina.

	2019 K'000	2018 K'000
Note 2: INTEREST REVENUE – FOREIGN CURRENCY INVESTMENTS		
Foreign securities and bank deposits	112,983	94,854
	112,983	**94,854**

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

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

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

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

	2019 K'000	2018 K'000
Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS		
Central Bank Bills issued	66,041	47,999
Other deposits held	291	246
Lease interest expense	882	-
	67,214	**48,245**

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

	2019 K'000	2018 K'000
Note 6: GENERAL AND ADMINISTRATION EXPENSES		
Staff costs	87,602	75,445
Premises and equipment	56,642	49,446
Property impairment/(Reversal of impairment)	-	(38,644)
Other Expenses	18,008	13,658
Depreciation of Property and Equipment	22,040	13,430
Travel	13,125	11,557
Amortisation of notes and coins production expenses	15,122	16,270
Legal & consultancy fees	6,873	9,933
Staff training and development	6,475	6,083
Board & meeting expenses	1,873	1,294
Currency distribution expenses	1,947	1,153
Audit fee	1,908	1,430
	231,615	**161,055**
Note 7: IMF AND OTHER FINANCIAL ORGANISATION RELATED ASSETS & LIABILITIES		
Assets – mandatorily measured at FVTPL		
IMF SDR holdings and deposits and other organisations	30,209	37,187
	30,209	**37,187**
Liabilities – designated as FVTPL		
IMF number 1 and 2 loan accounts	5,939	5,939
SDR allocation	591,396	587,796
	597,335	**593,735**

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

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

	2019 K'000	2018 K'000
Note 8: CASH & CASH EQUIVALENTS		
Foreign currency holdings - Nostro accounts	1,804,862	1,640,037
	1,804,862	**1,640,037**

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

	2019 K'000	2018 K'000
Note 9: FINANCIAL ASSETS AT FAIR VALUE		
Foreign investments – mandatorily measured at FVTPL	5,793,790	5,420,914
Derivative assets – mandatorily measured at FVTPL	(18,235)	143,535
	5,775,555	**5,564,449**

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

	2019 K'000	2018 K'000
Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES		
Inscribed stock – measured at FVTPL	2,113,222	2,067,450
Treasury bills – measured at Amortised Cost	295,748	593,518
	2,408,970	**2,660,968**

	2019 K'000	2018 K'000
Note 11: LOANS AND ADVANCES		
Loans to PNG commercial banks	-	25,000
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	3,940	3,328
Allowance for doubtful loans	(4,714)	(4,714)
Temporary Advances to PNG Government	125,481	124,025
	126,093	**149,025**

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

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

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

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

	2019 K'000	2018 K'000
Note 12: OTHER ASSETS		
Inventory notes and coins	27,354	38,118
Commemorative notes & coins and other receivables	(298)	(112)
Prepaid employee benefits	35,333	27,152
Other non-financial assets	6,318	5,520
	68,707	**70,678**

	Land and Buildings at Fair Value K'000	Equipment K'000	Motor Vehicles K'000	Computer Equipment K'000	Computer Software K'000	ROU Asset K'000	Capital Work-In-Progress K'000	Total K'000
Note 13: PROPERTY AND EQUIPMENT								
At 31 December 2018								
Cost or fair value	155,486	25,376	4,439	14,414	42,641	-	173,853	416,209
Accumulated depreciation	(24,739)	(7,950)	(1,668)	(7,893)	(12,128)	-	-	(54,378)
Net Book Amount	**130,747**	**17,426**	**2,771**	**6,521**	**30,513**	**-**	**173,853**	**361,831**
Year ended 31 December 2019								
Opening net book amount	130,747	17,426	2,771	6,521	30,513	15,200	173,853	377,031
Additions	18,168	13,022	1,362	2,311	117	1,655	45,047	81,682
Reclass/Transfers	136,195	-	-	-	-	-	(136,195)	-
Revaluation	11,794	-	-	-	-	-	-	11,794
Disposals	-	-	(44)	-	-	-	-	(44)
Depreciation charges	(8,529)	(1,417)	(993)	(2,681)	(4,051)	(4,368)	-	(22,039)
Closing Book Amount	**288,375**	**29,031**	**3,096**	**6,151**	**26,579**	**12,487**	**82,70**	**448,424**
At 31 December 2019								
Cost or fair value	288,375	38,397	5,801	16,725	42,758	16,855	82,705	491,616
Accumulated depreciation	-	(9,366)	(2,705)	(10,574)	(16,179)	(4,368)	-	(43,192)
Net Book Amount	**288,375**	**29,031**	**3,096**	**6,151**	**26,579**	**12,487**	**82,705**	**448,424**

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

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

Land and buildings carried at fair value

The fair values of land and building carried at fair value were determined by external, independent property valuers, having appropriate recognised professional qualifications and recent experience in location and category being valued. The independent valuers provide the fair value of the Bank's properties on a triennial basis. The most recent valuation was done in 2019.

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

	2019 K'000	2018 K'000
Note 14: INVESTMENT PROPERTIES		
Balance at 1 January	41,460	41,460
Acquisitions	-	-
Reclassification from Property and Equipment	-	-
Change in fair value	(2,290)	-
Balance at 31 December	**39,170**	**41,460**

Investment property comprises two commercial properties that are leased to third parties. The fair values of investment properties were determined by external, independent property valuers, having appropriate recognised professional qualifications and recent experience in location and the category being valued. The independent valuers provide the fair value of the Bank's investment property every 3 years. The most recent valuation was done in 2019. The fair value measurements for all of the investment properties have been categorised as level 3 fair value measurements. Rental income from investment properties is K4.7 million (2018: K4.3 million).

Note 15: DEPOSITS FROM BANKS & THIRD PARTIES

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

Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES

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

Note 17: SECURITIES ISSUED

	2019 K'000	2018 K'000
Central Bank Bills issued	1,775,731	2,402,654
	1,775,731	**2,402,654**

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

Note 18: CURRENCY IN CIRCULATION

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

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

	2019 K'000	2018 K'000
Note 19: OTHER FINANCIAL LIABILITIES		
Foreign Currency		
Foreign currency deposits	1,794	13,644
	1,794	**13,644**
Local Currency		
Expense creditors	38,871	37,487
Lease liability	12,860	-
	51,731	**37,487**

Expense creditors include cheques or warrant issued by the Bank but not yet presented for clearance and subsequent encashment by Government departments, investors and suppliers.

	2019 K'000	2018 K'000
Note 20: PROVISIONS FOR EMPLOYEE ENTITLEMENTS		
Provision for gratuity	4,497	3,407
Provision for long service leave	22,532	20,890
Provision for annual leave	6,769	3,664
	33,798	**27,961**
Reconciliation of leave provisions		
Balance at 1 January	27,961	23,943
Net charged to Statement of Profit or Loss	5,837	4,018
Balance at 31 December	**33,798**	**27,961**

Note 21: LEASES

A. Leases as lessee

Right-of-use assets

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

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

Lease liabilities

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

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

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

B. Leases as lessor

Operating lease

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

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

	2019 K'000
2019 – Operating leases under IFRS 16	
Less than one year	3,635
One to two years	386
Two to five years	32
More than five years	Nil
Total	**4,053**

Note 22: SHARE CAPITAL

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

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

Note 23: SEGMENT REPORTING

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

Note 24: RISK MANAGEMENT

Note 24(i): Financial risk management

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

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

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

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

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

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

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

Note 24(ii): Credit risk

(a) Credit risk management

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

The Bank manages credit risk by employing the following strategies:

- Selection of a counterparty is made based on their respective credit rating. Investment decisions are based on the credit rating of the particular issuer, the issue size, country limits and counterparty limits in place to control exposures;
- Foreign currency placements are made in approved currencies with Government, Government guaranteed or other approved counterparties. Geographical exposures are controlled by country limits. Limits are updated periodically where necessary based on the latest market information. Credit risk in the Bank's portfolio is monitored, reviewed and analysed regularly.

(b) Concentration of credit exposure

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

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

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

(c) Credit exposure by credit rating

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

Investment in Financial Assets	2019 K'000	% of 2019 Financial Assets	2018 K'000	% of 2018 Financial Assets
Short term foreign investments				
A-1+	1,783,152	22	1,328,791	16
A-1	147,583	1	521,558	7
A-2	69,244	1	93,720	1
A-3	-	-	-	-
NR	148,056	2	158,513	2
	2,148,035	**26**	**2,102,582**	**26**
Long term foreign investments				
AAA	2,157,719	26	1,793,893	22
AA+	-	-	157,848	2
AA	631,787	8	527,593	7
AA-	-	-	23,839	-
A+	-	-	24,060	-
A	426,528	5	492,083	6
A-	-	-	-	-
BBB+	-	-	-	-
BBB	411,486	5	442,551	5
BBB-	-	-	-	-
	3,627,520	**44**	**3,461,867**	**42**
Total foreign investments	**5,775,555**	**70**	**5,564,449**	**68**
Short term domestic investments				
B	295,748	4	593,518	7
	295,748	**4**	**593,518**	**7**
Long term domestic investments				
B	2,113,222	26	2,067,450	25
	2,113,222	**26**	**2,067,450**	**25**
Total domestic investments	**2,408,970**	**30**	**2,660,968**	**32**
Total investments	**8,184,525**	**100**	**8,225,417**	**100**

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

Note 24(iii): Market risk

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

(a) Foreign exchange risk

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

As at 31 December 2019 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows;

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

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

The functional currency of all operations is Kina.

(b) Interest rate risk

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

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

(c) Liquidity risk

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

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

The table below 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 2019	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
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	1,804,862	915,250	889,612	-	-	-	-
Financial assets at fair value	5,775,555	-	1,461,471	671,788	3,264,278	378,018	-
Assets held with IMF	30,209	-	-	-	-	-	30,209
Accrued interest	19,714	-	16,451	724	2,539	-	-
	7,630,340	**915,250**	**2,367,534**	**672,512**	**3,266,817**	**378,018**	**30,209**
Local Currency Financial Assets:							
Government of Papua New Guinea securities	2,408,970	-	-	295,747	375,800	1,737,423	-
Loans and advances	126,093	-	126,093	-	-	-	-
Accrued interest and receivables	58,947	-	517	10,493	10,441	37,496	-
	2,594,010	**-**	**126,610**	**306,240**	**386,241**	**1,774,919**	**-**
Non-financial assets:							
Gold	218,020	-	-	-	-	-	218,020
Property and Equipment	448,424	-	-	-	-	-	448,424
Investment properties	39,170	-	-	-	-	-	39,170
Other financial assets	68,707	-	-	-	-	-	68,707
	774,321	**-**	**-**	**-**	**-**	**-**	**774,321**
Total Assets	**10,998,671**	**915,250**	**2,494,144**	**978,752**	**3,653,058**	**2,152,937**	**804,530**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	597,335	-	-	-	-	-	597,335
Other financial liabilities	1,794	-	1,794	-	-	-	-
	599,129	**-**	**1,794**	**-**	**-**	**-**	**597,335**
Local Currency Financial Liabilities:							
Deposits from banks and third parties	3,625,837	3,625,837	-	-	-	-	-
Deposits from Government	1,351,160	1,351,160	-	-	-	-	-
Securities issued	1,775,731	-	1,297,426	31,001	67,270	380,034	-
Accrued interest payable	2,381	-	2,381	-	-	-	-
Currency in circulation	2,298,574	2,298,574	-	-	-	-	-
Lease Liability	12,860	-	1,074	2,756	9,030	-	-
Other financial liabilities	38,871	-	27,242	-	-	11,629	-
	9,105,414	**7,275,571**	**1,328,123**	**33,757**	**76,300**	**391,663**	**-**
Non-Financial Liabilities:							
Employee provision	**33,798**	**-**	**33,798**	**-**	**-**	**-**	**-**
Total Liabilities	**9,738,341**	**7,275,571**	**1,363,715**	**33,757**	**76,300**	**391,663**	**597,335**

As at 31 December 2018	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
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	1,640,037	1,056,844	583,193	-	-	-	-
Financial assets at fair value	5,564,449	-	1,194,186	800,283	3,211,393	358,587	-
Assets held with IMF	37,187	-	-	-	-	-	37,187
Accrued interest	19,462	-	15,627	3,835	-	-	-
	7,261,135	**1,056,844**	**1,793,006**	**804,118**	**3,211,393**	**358,587**	**37,187**
Local Currency Financial Assets:							
Government of Papua New Guinea securities	2,660,968	-	232,362	598,774	946,574	883,258	-
Loans and advances	149,025	-	149,025	-	-	-	-
Accrued interest and receivables	63,434	-	7,967	13,979	25,615	15,873	-
	2,873,427	**-**	**389,354**	**612,753**	**972,189**	**899,131**	**-**
Non-financial assets:							
Gold	181,716	-	-	-	-	-	181,716
Property and Equipment	361,831	-	-	-	-	-	361,831
Investment properties	41,460	-	-	-	-	-	41,460
Other financial assets	70,678	-	-	-	-	-	70,678
	655,685	**-**	**-**	**-**	**-**	**-**	**655,685**
Total Assets	**10,790,247**	**1,056,844**	**2,182,360**	**1,416,871**	**4,183,582**	**1,257,718**	**692,872**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	593,735	-	-	-	-	-	593,735
Other financial liabilities	13,644	-	13,644	-	-	-	-
	607,379	**-**	**13,644**	**-**	**-**	**-**	**593,735**
Local Currency Financial Liabilities:							
Deposits from banks and third parties	3,116,735	3,116,735	-	-	-	-	-
Deposits from Government	1,505,423	1,505,423	-	-	-	-	-
Securities issued	2,402,654	-	2,161,297	108,845	4,899	127,613	-
Accrued interest payable	1,751	-	1,751	-	-	-	-
Currency in circulation	2,151,993	2,151,993	-	-	-	-	-
Other financial liabilities	37,487	-	37,487	-	-	-	-
	9,216,043	**6,774,151**	**2,200,535**	**108,845**	**4,899**	**127,613**	**-**
Non-Financial Liabilities:							
Employee provision	**27,961**	**-**	**27,961**	**-**	**-**	**-**	**-**
Total Liabilities	**9,851,383**	**6,774,151**	**2,242,140**	**108,845**	**4,899**	**127,613**	**593,735**

Note 24(iv): Fair value

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

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

Fair values are estimated to be the same as their carrying values in the Statement of Financial Position.

Fair value hierarchy

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

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes over-the-counter derivative contracts. The sources of input parameters are Bloomberg or Reuters;
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

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 2019				
Financial assets held at fair value through profit or loss				
Domestic government securities – Inscribed stock	-	-	2,113,223	2,113,223
Foreign government and semi-Government bonds	1,709,398	-	-	1,709,398
Derivatives managed by external fund managers	-	(18,235)	-	(18,235)
Investments in bonds and other instruments managed by external fund managers	4,084,392	-	-	4,084,392
Assets held with IMF	-	30,209	-	30,209
Total assets at fair value through profit or loss	**5,793,790**	**11,974**	**2,113,223**	**7,918,987**
Non-financial assets at fair value				
Gold	218,020	-	-	218,020
Property and Equipment	-	-	448,424	448,424
Investment property	-	-	39,170	39,170
Total assets at fair value	**218,020**	**-**	**487,594**	**705,614**
Financial liabilities held at fair value through profit & loss				
Derivatives	-	1,794	-	1,794
Liabilities with IMF	-	597,335	-	597,335
Total liabilities at fair value through profit or loss	**-**	**599,129**	**-**	**599,129**
31 December 2018				
Financial assets held at fair value through profit or loss				
Domestic government securities – Inscribed stock	-	-	2,067,450	2,067,450
Foreign government and semi-Government bonds	-	1,691,076	-	1,691,076
Derivatives managed by external fund managers	-	143,535	-	143,535
Investments in bonds and other instruments managed by external fund managers	3,729,838	-	-	3,729,838
Assets held with IMF	-	37,187	-	37,187
Total assets at fair value through profit or loss	**3,729,838**	**1,871,798**	**2,067,450**	**7,669,086**
Non financial assets at fair value				
Gold	181,716	-	-	181,716
Property and Equipment	-	-	361,831	361,831
Investment property	-	-	41,460	41,460
Total assets at fair value	**181,716**	**-**	**403,291**	**585,007**
Financial liabilities held at fair value through profit & loss				
Derivatives	-	13,644	-	13,644
Liabilities with IMF	-	593,735	-	593,735
Total liabilities at fair value through profit or loss	**-**	**607,379**	**-**	**607,379**

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

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

	Level 3 K'000
Opening balance	2,067,450
Maturities, net of additional investment	(39,298)
Fair value revaluation gains/(losses) on Level 3 instruments	85,070
Closing balance	**2,113,222**
Total gains and losses for the period included in the Profit or Loss for Level 3 assets held at the end of the reporting period.	**85,070**

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

	Level 3 K'000
Opening balance	3,264,954
Additional investment, net of maturities	(1,202,777)
Fair value revaluation gains/(losses) on Level 3 instruments	5,273
Closing balance	**2,067,450**
Total gains and losses for the period included in the Profit or Loss for Level 3 assets held at the end of the reporting period.	**5,273**

	Valuation Technique	Unobservable Input	Range of Inputs		Fair value movement due to change in unobservable Input	
			2019	2018	Increase	Decrease
Domestic Government securities – Inscribed stock and Treasury bills	Discounted cash flows present value method	Current market yield	8% to 14%	9% to 12.6%	Decrease	Increase
Investment property	Income capitalisation	Capitalisation rate	10% to 14%	10% to 14%	Decrease	Increase

Note 24(v): Sensitivity analysis

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

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

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

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

Note 25: EVENTS AFTER THE BALANCE DATE

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

On March 11, 2020 the World Health Organisation declared the Coronavirus COVID-19 outbreak to be a pandemic. Many governments are taking increasingly stringent steps to help contain the spread of the virus, including: requiring self-isolation/quarantine by those potentially affected, implementing social distancing measures, and controlling or closing borders and "locking-down" cities/regions or even entire countries. The pandemic is an unprecedented challenge for humanity and for the economy globally, and at the date of finalisation of the financial statements its effects are subject to significant levels of uncertainty. There is potentially adverse effect on the foreign exchange reserves as the global equity markets experience negative shocks and volatility. The Bank continues to monitor the markets to be proactive in maintaining as far as possible the safety of the foreign exchange reserves portfolio. There is, however, a high chance that this continued pressure on global markets, as a result of the COVID-19 pandemic, would lead to significant unrealised market losses and/or withdrawals by Government to fund emergency operations. On the other hand, there could be delays to execution of Government and associated spending due to supply disruptions in the short-term and measures to contain the disease, thus off-setting the impact of any withdrawals.

In light of the above, management has re-assessed the appropriateness of the use of the going concern assumption in the preparation of these financial statements. Based on the assessment performed, management is of the view that the significant doubt associated with the current uncertainties related to the COVID-19 virus currently does not result in a material uncertainty related to such events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern.

Note 26: CONTINGENT LIABILITIES

The Bank had no contingent liabilities at 31 December 2019 (2018: nil) and there are no transactions or events that will have material impact on the financial report during the preparation of this report.

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

Note 27: CAPITAL COMMITMENTS

The Bank has no capital commitments.

Note 28: REMUNERATION OF MEMBERS OF THE BOARD AND KEY MANAGEMENT PERSONNEL

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank: this group comprises 32 in total (2018: 28), including the Governor, 1 Deputy Governor, 3 Assistant Governors, 6 non-executive Board members and 21 senior staff. The Salaries and Remuneration Committee (SRC) and Salaries, Conditions & Monitoring Committee (SCMC) determine the terms and conditions on which the Governor and Deputy Governor hold office in accordance with the *Central Banking Act 2000*. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

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

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

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

Note 29: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,340,625 (2018: K1,430,162). This represents the total statutory audit fee paid to the Auditor General's Office and other auditors in relation to external fund manager operations. These transactions are performed at arm's length.

Note 30: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

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

(a) Acting as the fiscal agent, banker and financial advisor to the Government; the Bank is the depository of the Government and or its agents or institutions providing banking services to Government and Government departments and corporations;

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

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

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

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

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 2019.

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

Loi Martin Bakani CMG
Governor

Joseph Michael Teria
Deputy Governor

30 June 2020

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

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Our Reference: 30-13-4

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

OPINION

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

In my opinion:

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

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

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

(b) proper accounting records have been kept by the Bank as far as it appears from my examination of those records; and

(c) I have obtained all the information and explanation that were required.

BASIS FOR OPINION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GORDON KEGA MBA, CPA
Acting Auditor-General

30 June 2020

Notes


BANK OF PAPUA NEW GUINEA