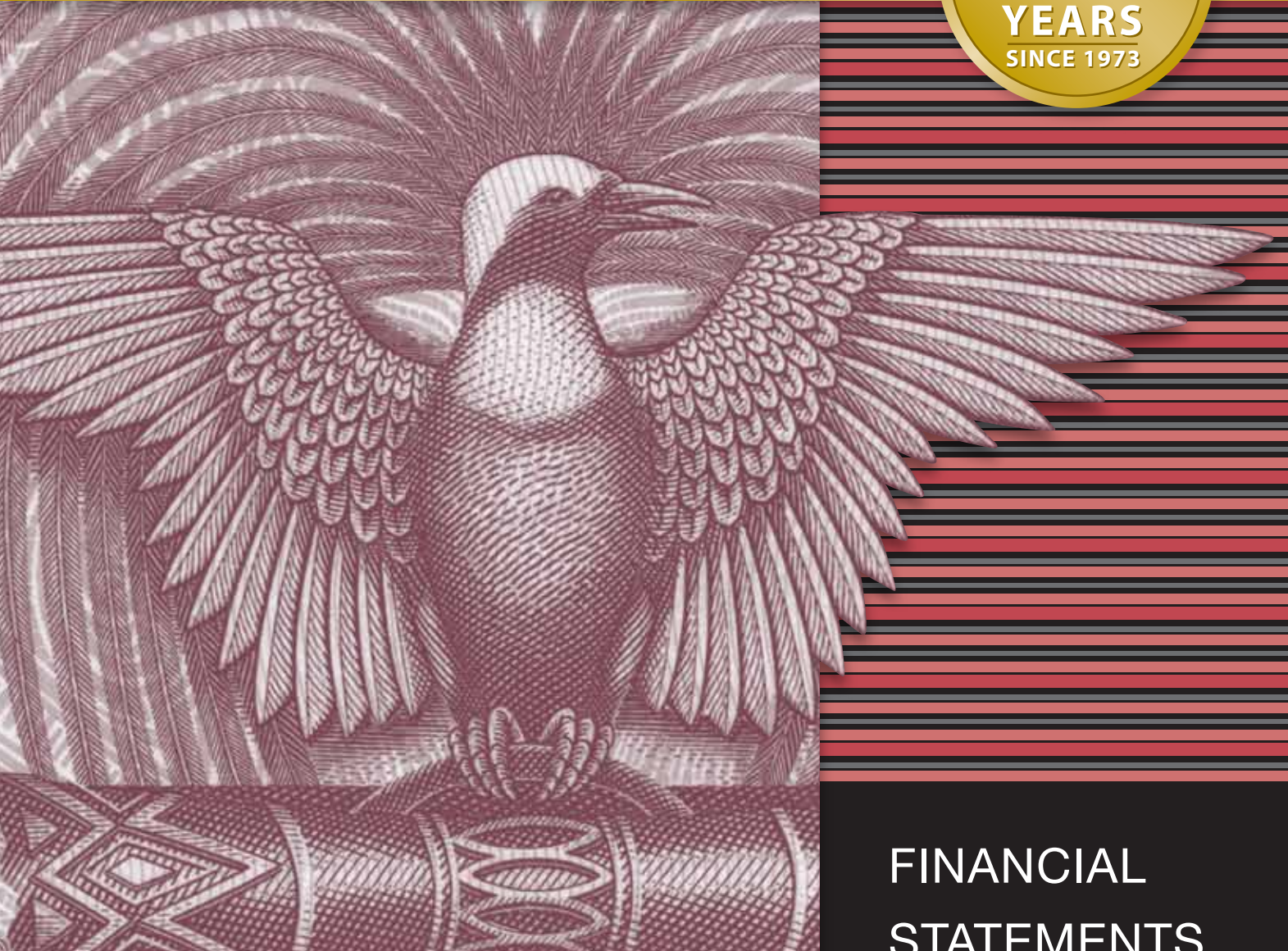




Bank of Papua New Guinea

40
YEARS
SINCE 1973



**FINANCIAL
STATEMENTS**

31 DECEMBER 2013



40 YEARS OF ACHIEVEMENT

In 2013 the Bank of Papua New Guinea celebrated its 40th anniversary.

From RBA Branch to PNG's Central Bank

The Bank of Papua New Guinea commenced operations as the country's central bank on 1 November 1973, established by the *Central Banking Act 1973*, which defined the Bank's functions and powers. Before that the Bank was a branch of the Reserve Bank of Australia.

The *Central Banking Act* was substantially amended in 2000 to allow the Bank more independence and freedom from political pressure.

As the cornerstone of the PNG financial system, the Bank also administers the *Banks and Financial Institutions Act* and the *Savings and Loans Societies Act*.

A currency of our own

The kina and toea were introduced as our national currency in April 1975.

Building a strong and proud presence

Construction of a purpose-built office block to house the Bank of Papua New Guinea started in 1988. Standing proudly in the Port Moresby central business district, "ToRobert Haus" was officially opened in 1991 by the then Prime Minister The Hon. Sir Rabbie Namaliu. The building is named in honour of the first Governor, Sir Henry ToRobert, who led the Bank for over 20 years.

A tradition of strong leadership

Since its establishment in 1973 seven Governors have led the Bank of Papua New Guinea

1973 to 1993	Sir Henry ToRobert
1993 to 1994	Sir Mekere Morauta
1994 to 1998	Mr Koiari Tarata
1998	Mr John Vulupindi
1998 to 1999	Mr Morea Vele
1999 to 2009	Sir L. Wilson Kamit
2009 to present	Mr Loi M. Bakani



Bank of Papua New Guinea

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2013

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

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Governor's Foreword



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

2013 has been another significant year for the Bank of Papua New Guinea with the Bank celebrating its 40th year of existence. We have remained committed to our price stability objective through our response and actions in a changing domestic and global economic environment.

At the same time, we have made further progress with the implementation of 2012 – 2015 Strategic Plan, notably the launch of the new payments system and the development of the financial inclusion strategy. I am pleased to present in this Annual Report a summary of our activities and achievements as the Central Bank and the prudential regulator in Papua New Guinea.

The Bank operated in a challenging domestic and global environment in 2013. The economy continued to grow for the 13th consecutive year and inflation remained below forecasts. However, this growth was moderate compared to previous years, as the PNG LNG Project construction phase approached completion and international prices of our key commodity exports declined. The flow-on effects from the LNG project have scaled down and Government's fiscal stimulus, of record proportions, provided much needed support to the economy.

On account of low international commodity prices and high demand for imported goods and services, the kina depreciated against major currencies, putting pressure on domestic prices. With low export and capital inflows, demand for foreign exchange outstripped supply, which resulted in the frequent intervention by the Bank to supply foreign currency in the foreign exchange market.

In October 2013 the Bank introduced new measures to restrict the financing of forward orders in the interbank market. The Bank's intervention to stabilise the kina resulted in a decline in the gross foreign reserves to US\$2.85 (K6.12) billion at the end of 2013, down from US\$4.0 (K8.3) billion at the end of 2012. These measures stabilised the mid-rate at 0.4130 USD/PGK.

The high level of liquidity in the banking system remained an important challenge. Although it has not been inflationary in recent years, the Bank is concerned that excess liquidity weakens the monetary policy transmission mechanism. As part of the strategy to absorb excess liquidity, the Bank increased the Cash Reserve Requirement "CRR" to 9.0 percent in October 2013.

During the year the Bank continued to make good progress towards implementing the Strategic Plan adopted in 2011. The first stage of the Kina Automated Transfer System (KATS) and the Banking Services System (BSS) successfully went live in October 2013, allowing commercial banks to achieve real time gross settlement of financial transactions at a bank-to-bank level. This brings the domestic payments system in line with international standards and on par with the rest of the world.

I am proud of the achievements reached on the financial inclusion agenda. Together with our partners, we launched the National Strategy for Financial Inclusion and Financial Literacy 2014 – 2015, a platform that will guide all initiatives in the country to achieve our financial inclusiveness targets. We have successfully started a nationwide Youth Savings Campaign, which aims to educate youngsters about the benefits of financial management and create a savings culture amongst them.

With increased responsibilities, the Bank has undertaken necessary changes to its governance and organisational structure. In 2013 we appointed the remaining Assistant Governor, responsible for Financial System Stability.

The Bank also expanded the former Financial Supervision Group to the Financial System & Stability Group. I am excited about this expansion because it demonstrates a growing recognition of the significant role that the financial system plays in the economy and in the lives of ordinary Papua New Guineans. It will ensure the Bank keeps pace with the challenges taking place in the financial sector at home and abroad.

I am also pleased to welcome three new members to the Bank Board who were appointed in 2013; Ms Betty Palaso, Commissioner General of the Internal Revenue Commission, Mr Bart Philemon, Former MP and Minister for Treasury and Mr Himson Waninara from the business sector.

“... in line with international standards and on par with the rest of the world.”

I acknowledge the good working relationship the Bank maintains with its international partners, including the IMF, the World Bank Group, the Asian Development Bank, the Reserve Bank of Australia, the Reserve Bank of New Zealand, SEACEN, SEANZA, the Australian Prudential Regulatory Authority (APRA), the Pacific Financial Technical Assistance Centre (PFTAC), the Alliance for Financial Inclusion and the Pacific Financial Inclusion Programme.

We will maintain focus on implementing our Strategic Plan and keeping to our mission, vision and core values. The Bank will continue to deliver on its core objectives in order to achieve its primary goal of maintaining price stability. This is not achievable without a dedicated and skilled staff. The Bank acknowledges the importance of continuous training and development for staff members to improve their skills and has provided such opportunities. During 2013 a substantial number of Bank staff attended industry-related courses, seminars, workshops and conferences while others undertook further studies, both in PNG and overseas.

Finally, I wish to thank my fellow Board members for their invaluable contribution and support during the year, our service providers and the staff for their continued support and commitment. As a Bank, we will continue to improve and maintain a high standard and quality of performance in order to meet our vision of being “a contemporary central bank and regulator excelling in performing its core functions and making a distinct and valuable contribution to the financial stability and economic prosperity of Papua New Guinea”.

Loi M. Bakani

Governor and Chairman of the Board

40th Anniversary

The Bank celebrated its 40th Anniversary on 1 November 2013 with a range of activities, including:

Commemorative banknotes

Marking this important milestone, the Bank released two commemorative banknotes, the K2 and K100, both bearing the overprint of the Bank's logo and 40th anniversary text.

Pictured: Governor Bakani unveils the commemorative banknotes to the Board and staff.





Celebration event

Celebrating the vital role employees have played in the history and development of the Bank of Papua New Guinea, the Bank hosted a special 40th Anniversary dinner attended by all staff members and former Governors as guests of honour.

*Pictured L to R:
Former Governors
Sir Henry ToRobert,
Sir L. Wilson Kamit and
Governor Loi Bakani*



*Governor Bakani presents
long service award
to Mrs Willing Maira
for 36 yrs of service
to the Bank*



New contemporary look

As part of marking its 40th anniversary, the Bank introduced smart new professional uniforms.

Anniversary events

Children of BPNG staff members enjoying the 40th Anniversary games.



KATS now goes live

In October 2013 the Kina Automated Transfer System (KATS) went live, a major achievement in the development of an effective national payment system for PNG. (see page 28)

National Financial Inclusion Strategy launched

PNG's National Financial Inclusion & Financial Literacy Strategy 2014-2015 was launched in 2013, coinciding with the Bank's hosting of the 2nd Financial Inclusion Expo, held in Port Moresby in December. Launching the Strategy, Minister for Treasury Hon. Don Polye said "it will pave the way for stakeholders including Government agencies, financial institutions and commercial banks to work with the grass roots people, including women, to provide ways for them to easily access financial services".

The Bank conducted several other key Financial Inclusion activities during the year, including:

- The launch by the Prime Minister of the Centre for Excellence for Financial Inclusion (CEFI);
- The National Youth Savings Campaign;
- Financial education training through the Microfinance Expansion Project (MEP);
- The Financial Diaries Project;
- The National Survey on Financial Capability (see page 32); and
- The Financial Inclusion Expo.

BPNG hosts South Pacific Central Bank Governors Meeting

The Bank hosted the 28th Annual South Pacific Central Bank Governors Meeting in Port Moresby in December. Attendees included Central Bank Governors from Tonga, Samoa, Fiji, Vanuatu and Solomon Islands and the Deputy Governors from the Reserve Banks of Australia and New Zealand. Development partners from the International Monetary Fund, International Finance Corporation, Pacific Financial Technical Assistance Centre, Pacific Financial Inclusion Programme and the Australian Prudential Regulatory Authority attended the meeting.

Meeting delegates discussed financial inclusion activities in the South Pacific and the roles and functions of central banks in adapting to the continually changing global economic conditions. The meeting also provided an opportunity for commercial banks operating in the Pacific (ANZ, BSP and Westpac) to provide an update of their activities.

SEACEN conference focus: Payment Settlement Systems

Representatives of 14 South East Asian Central Banks (SEACEN) attended the 9th annual conference and training activities hosted by BPNG in February. (see page 35)

Cross-border currency review

The Bank of Papua New Guinea and Bank Indonesia conducted a joint survey in the border region to review currency usage. (see page 28)

Coin survey

As part of Currency Day activities, the Bank conducted a survey to canvass public opinion on the current suite of coins. (see page 33)

BPNG wins significant HR award

During the year the PNG Human Resource Institute (PNGHRI) recognised the Bank of Papua New Guinea's commitment to best practice HR management and industrial relations with the prestigious Award for the Best Public Service Entity.

Mission Vision Values

Mission

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

Vision

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

Values

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

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

With **TRANSPARENCY** our decisions stand scrutiny.

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

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

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

Governance



Members of the Board of the Bank of Papua New Guinea
31 December 2013

*Back L-R Deputy Governor Mr Benny Popoitai MBE, Mr John Leahy, Mr Alex Tongayu, Mr Himson Waninara.
Front L-R Mr Denny Bray Guka, Mr Bart Philemon, Governor Loi M. Bakani, Dr Ken Ngangan. Insert: Ms Betty Palaso*

The Bank's governance practice starts with the Board and its responsibility to ensure the Bank's policies (other than monetary policy and financial system regulations, which are the exclusive responsibility of the Governor) are directed to the greatest advantage of the people of Papua New Guinea.

To this end, Board members are drawn from a range of interest groups within the PNG community – civil, church, regulatory, workers union and industry bodies. There were a number of changes to the composition of the Board during 2013.

THE BOARD

Governors

Governor and Chairman

Mr Loi M. Bakani

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

He is Chairman of PNG Institute of Banking and Business Management (IBBM), Chairman of the Centre for Excellence in Financial Inclusion (CEFI), the Alternate Governor to the IMF, Member of the Board of South East Asian Central Banks (SEACEN), Member of the PNG Institute of Directors (PNGID), and Deputy Chairman of the Advisory Board of Port Moresby Senior AFL Competition.

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

Deputy Governor

Mr Benny Popoitai MBE

Mr Popoitai was appointed Deputy Governor and Member of the Board in November 2000.

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

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

Members of the Board At 31 December 2013

Mr John Leahy

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

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

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

Admitted to practise law in both NSW and PNG, Mr Leahy is presently in private practice in PNG.

Dr Ken Ngangan

Dr Ngangan was appointed *ex officio* to the Board in April 2011 in his capacity as President of CPA PNG.

He is also Chairman of the Board of National Teachers Insurance Limited (NTIL) and Deputy Chairman of National Development Bank.

Dr Ngangan holds a Bachelor of Arts degree in Commerce with Honours from the University of Papua New Guinea, a Masters degree in Accounting from the University of Glasgow, Scotland, a Doctor of Philosophy from the University of Newcastle, Australia and a Post-Doctoral Fellowship from the University of Aberdeen, Scotland.

Fr Denny Bray Guka

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

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

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

Mr Alex Tongayu

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

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

Mr Bart Philemon

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

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

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

Ms Betty Palaso

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

She holds the position of Commissioner with the Internal Revenue Commission.

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

Mr Himson Waninara

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

He is a director of the NGIP Agmark group of companies and chairman of the Kimbe General Hospital Board. As a professional consultant and a legal practitioner, he advises leading PNG companies on tax and employment matters.

Mr Waninara holds a Bachelor of Law from the University of Papua New Guinea. He is admitted to practice by the National and Supreme Courts of Papua New Guinea.

Board Meetings

The Board meets at least once every three months.

The March 2013 meeting was held in Kavieng, New Ireland Province. Two meetings were held in Port Moresby (June and December) and the September meeting was held in Lae, Morobe Province.

Board Member	Meetings Eligible to Attend	Meetings Attended
Mr Loi M. Bakani	4	4
Mr Benny Popoitai MBE	4	4
Mr John Leahy	4	4
Dr Ken Ngangan	4	4
Fr Denny Bray Guka	4	4
Mr Alex Tongayu	4	3
Mr Bart Philemon	2	1
Ms Betty Palaso	2	2
Mr Himson Waninara	2	1

Commitment to Corporate Governance and Transparency

Within the Bank

Board Audit & Governance Committee

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

Dr Ken Ngangan chaired the Committee, which also comprised Messrs John Leahy, Alex Tongayu and Bart Philemon as members.

Internal committees

Several internal committees were established in previous years.

These included the Monetary Policy Committee, the Money Market Operations Committee, the Investment Committee, the Tender Committee and the Budget Committee. Each committee has specific roles and responsibilities designed to ensure the probity of the Bank's various activities.

Internal audit

A strong and independent internal audit function is a key part of the Bank's overall commitment to good governance. Over the course of 2013 the Bank's internal audit focus was on several significant reviews, including:

- a full review of the Bank's physical security facilities, including evaluation of surveillance effectiveness, security contractors and suppliers and controls over transport-related costs;
- an assessment of IT security associated with the LAN upgrade;
- review of the internal controls required for secured operations in money market, currency operations, foreign exchange management systems and banking activities.

Risk Management

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

During 2013 risk management activities included the comprehensive security review, building facilities audit, continued work on the Disaster Recovery Project and training workshops for Bank staff on the risk management system and how they relate to all work processes.

In line with the Bank's Strategic Plan 2012-2015, the Business Continuity Management project continued through 2013, advancing to the business plan development phase.

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 the following:

Annual financial statements audit

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

Employment conditions

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

Peer review

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

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

Co-operation with Government Agencies

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

Setting the right example

The Bank's Values Statement provides clear guidance to Bank employees that all staff members are required to conduct themselves with the highest standard of behaviour.



The Bank's Board took the opportunity to visit the Lae Port development site while in town for the September 2013 board meeting.

Financial Performance

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

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

Operating Income

Total operating income for the year ended 31 December 2013 was K280 million. The income was derived mainly from interest on overseas investments, fees and commissions on foreign exchange trading and interest on domestic government securities.

Operating Expenditure

Total operating expenditure comprising interest expense and general administration costs was K177 million, down by K78 million from 2012. The savings in expenditure was largely due to reduced issuance of Central Bank Bills for monetary policy operations.

Net Operating Profit

The Bank recorded a net operating profit of K102.9 million in 2013 year, compared to an operating profit of K24.3 million in 2012.

K million	2009	2010	2011	2012	2013
Total Comprehensive Income/(loss)	196.2	195.1	(1,737.1)	39.7	608.1
Unrealised profit/(loss)	(148.6)	(173.2)	(1,729.5)	15.4	505.2
DISTRIBUTABLE PROFIT/(LOSS)	47.6	21.9	(7.6)	24.3	102.9
Transferred to:					
Currency Movement Reserve	47.6	(47.7)	-	-	-
Property Revaluation Reserve	-	58.7	-	-	15.6
Unrealised Profits Reserve	-	63.6	(1,714.3)	8.2	517.6
Gold Reserve	31.8	(15.2)	7.2	(28.0)	
Retained Profit/(Loss)	-	66.8	(7.6)	24.3	102.9
Consolidated Revenue Fund (Government)	-	21.9	-	-	-

Unrealised Gain/(Loss)

The Bank recorded a net revaluation gain of K517.6 million for the year ended 2013, which was transferred to the Unrealised Profits/(Loss) Reserve. This was a direct result of the depreciation of the kina against most major currencies during the financial year. A valuation gain on bank properties of K15.6 million was transferred to the Property Revaluation Reserve.

Appropriation

In line with the provisions of the CBA, the Bank's Board is responsible for determining the distribution of the operating profits. These provisions require the Board to consult with the Minister for Treasury on the amount to be placed to the credit of the Bank's Retained Earnings, with the balance of net profits to be paid into the Consolidated Revenue Fund.

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

Financial Performance

2014 Budget Forecast

	Budget 2014 (K million)	Actual 2013 (K million)
Operating Income		
Interest received (overseas)	148.1	188.2
Interest received (domestic)	96.1	69.7
International trading/foreign exchange fees	15.1	9.0
Other income	12.9	13.0
TOTAL INCOME	272.2	279.9
Operating Payments		
Interest expenses – Domestic operations	73.1	88.2
Staff costs	49.3	38.5
Staff training and development	5.2	2.0
Premises and equipment	11.8	13.3
Depreciation of property, plant and equipment	6.8	5.8
Amortisation of notes and coins production	10.5	6.6
Currency distribution expenses	0.5	0.9
Audit fee	1.3	1.1
Travel	5.7	4.8
Legal and consultancy fees	6.9	5.3
Board and meeting expenses	1.5	0.9
Information & Communication Technology	6.5	2.9
Special Projects	7.4	2.0
Other expenses	13.7	4.7
TOTAL PAYMENTS	200.2	177.0
NET OPERATING PROFIT/(LOSS)	72.0	102.9

Projects

In 2013 the Bank of Papua New Guinea continued to implement a number of strategic projects as part of the Bank's Strategic Plan 2012-2015.

The Bank undertook further activities related to Financial Inclusion activities (reported in Economic Growth section, page 31) and Business Continuity Management project (reported in Risk Management page 14).

These included the Kina Automatic Transfer System (KATS) (see page 28).

Data Warehouse project

In the first half of 2013 the Data Warehouse project continued with achievements in the development and implementation of useful reports. These included:

- completion of the dashboard report function, enhancing the business intelligence value of the Bank's data collection; and
- the input of historical superannuation and life insurance data, enabling general industry trends to be analysed.

During 2013 the Bank's Local Area Network (LAN) underwent a major upgrade, which slowed anticipated progress. With the upgrade improving network connectivity, the Data Warehouse project resumed in October, working towards comprehensive testing of the reporting system.

Lae Currency Distribution Centre

During the year the Bank formed the technical team to progress the development of the Lae CDC, appointing Beacon Consulting Ltd as the project manager, Certis Cisco as security consultants and Pacific Architects Ltd as architect.

Core Functions

MONETARY POLICY

Formulation of Monetary Policy

The Bank formulates and implements monetary policy with the aim of achieving and maintaining price stability as stipulated under the *Central Banking Act 2000*.

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

On a monthly basis the Bank considers these influences in setting the policy signaling rate, the Kina Facility Rate (KFR). Assessment of the quarterly Consumer Price Index (CPI) released by the National Statistical Office and the monthly Retail Price Index (RPI) compiled by the Bank are key inputs into setting the KFR.

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

During 2013 the winding down of the construction phase of the PNG LNG project had a significant impact on the PNG economy. This resulted in reduced spin-off benefits to other business sectors, notably building and construction, transportation, manufacturing and services sectors. The reduced level of financial and economic activities was accordingly considered in the formulation of monetary policy.

Implementation of Monetary Policy

Open market activities

The Bank's open market operations, such as the auction of Central Bank Bills (CBBs), Treasury bills and Inscribed stock, are the main instruments of implementing monetary policy, after the release of the six-monthly Monetary Policy Statement and the monthly KFR. During the year the Bank released Monetary Policy Statements on 31 March and 30 September.

The Bank also uses its direct policy instrument, the Cash Reserve Requirement (CRR), for liquidity management.

Following low inflation throughout 2012 and an inflation outcome of 1.6 percent for December 2012, the Bank eased monetary policy in March 2013, reducing the KFR from 6.75 percent to 6.25 percent. While inflation increased from 2.8 percent in March 2013 to 4.7 percent in December 2013, it was still considered low. Consequently the Bank maintained the KFR at 6.25 percent for the rest of the year. Commercial banks however did not adjust their Indicator Lending Rates, maintaining them between 11.20 percent and 11.70 percent.

The easing of monetary policy was also intended to support lending to the private sector, thereby supporting economic activity to help offset the impact of reduced LNG project activity.

Liquidity levels remained high in 2013 and so the Bank increased the CRR to 9.0 percent in November 2013 from 8.0 percent, its former level since June 2012.

The Minimum Liquid Asset Ratio (MLAR) remained at zero throughout 2013.

Tap Facility

The Central Bank Bill Tap Facility continued to operate in 2013, following its reintroduction in 2012. The Tap Facility aims to encourage a savings culture by providing an alternative investment opportunity for small investors, in so doing increasing participation in Government securities.

In 2012 the Bank purchased K200m in 12 month Government Treasury bills, offset by the issuance of an equivalent amount in CBBs, which were offered under the Tap Facility to the general public, with a minimum investment amount of K10,000. The Bank chose to offer the CBBs under the Tap Facility in the 2 and 3 month terms, with a margin of 1.00 percent above the weighted average interest rate determined at the auctions to offer an attractive investment opportunity to small investors.

In 2013 the total amount sold under the CBB Tap Facility was K98.0 million, while K65.7 million CBBs matured, resulting in a net issuance of K32.3 million.

In October 2013 the Department of Treasury and the Bank of PNG agreed to roll over the Treasury bills for another year under the same terms.

Repurchase Agreement facility

The Repurchase Agreement (Repo) facility is a liquidity management tool for the conduct of monetary policy.

During the year the Bank undertook a review of the Repo facility. The review recommended using a collateralised rather than uncollateralised Repo arrangement, requiring the borrower to pledge a liquid asset, in this case Government securities, to repay the debt in the event of a default. The Bank also conducted a legal review of the agreement during the final quarter of 2013.

Registry Operations

The Bank of Papua New Guinea acts as an agent for the Government in the sale and registration of domestic debt instruments. As part of its liquidity management, the Bank underwrites issues and acts as a market maker in these instruments. The Bank's services include:

- issuing, transferring and registering securities
- maintaining ownership records
- reporting to investors and stakeholders on periodical payment of interest and redemption of securities at coupon and maturity date.

Government debt

At the end of 2013 total borrowing by the Government from the public amounted to K8,844.8 million, an increase of K2,726.8 million from the end of 2012. Total debt comprised of K4,644.1 million in Inscribed stock and K4,200.7 million in Treasury bills.

Inscribed stock

Issued in 2013	K1,416 million
Maturities in 2013	K138 million
Net Issuance	K1,278 million
Total holdings 31 December 2013	K4,644 million
Balance at 31 December 2012	K3,367 million
Increase in balance	K1,278 million

BPNG portfolio holdings Dec 2013	K674 million
BPNG portfolio holdings Dec 2012	K501 million
Increase in total holding	K173 million

Treasury bills

Outstanding at 31 Dec 2012	K2,752 million
Issued in 2013	K5,499 million
Maturities in 2013	K4,050 million
Outstanding at 31 Dec 2013	K4,201 million

The Bank held K200 million Treasury bills in its portfolio by the end of 2013 for monetary policy management (refer table on Tap Facility below).

Central Bank Bills

Balance as at 31 Dec 2012	K5,363 million
Issued in 2013	K20,683 million
Maturities in 2013	K22,872 million
Closing balance at 31 Dec 2013	K3,174 million

Central Bank Bill Tap Facility

Available for sale 2013	K200 million
Balance at 31 December 2012	K4 million
Issued in 2013	K98 million
Maturities in 2013	K66 million
Net issuance at 31 Dec 2013	K36 million

Foreign Reserves Operations

The *Central Banking Act 2000* provides the mandate for the Bank to manage gold, foreign exchange and other international reserves of Papua New Guinea. The management of foreign exchange reserves is crucial to achieving the Bank's price stability objective.

The Bank's main reasons for holding foreign exchange reserves are to:

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

Core Functions Monetary Policy

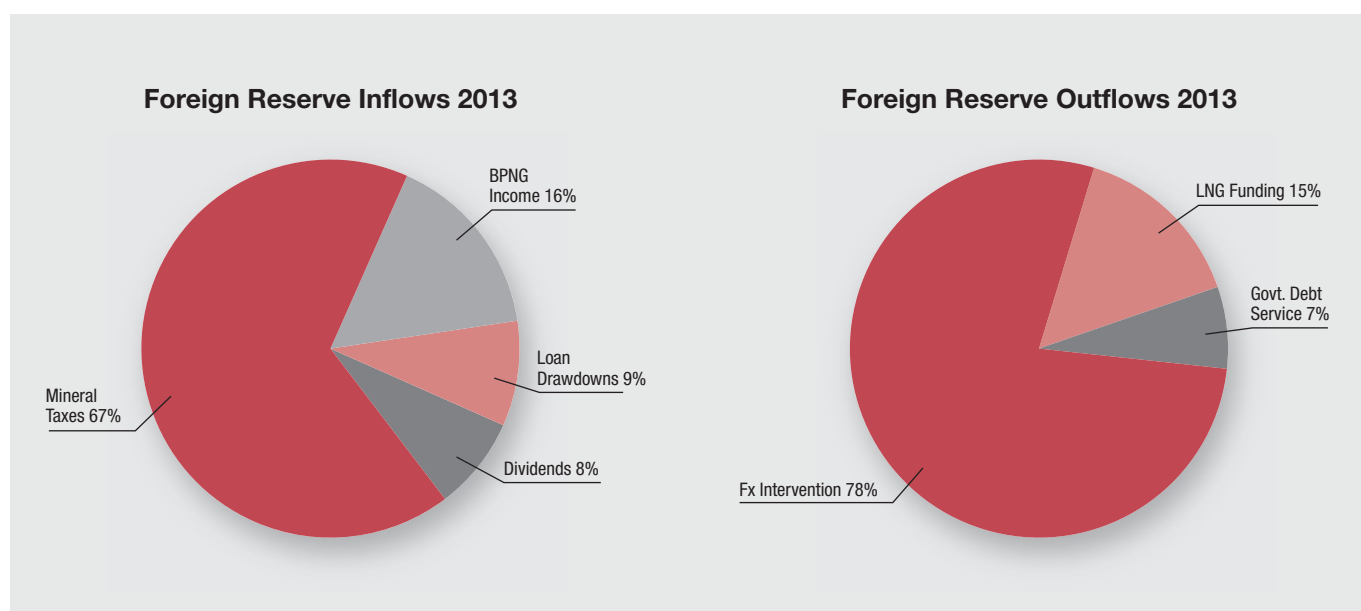
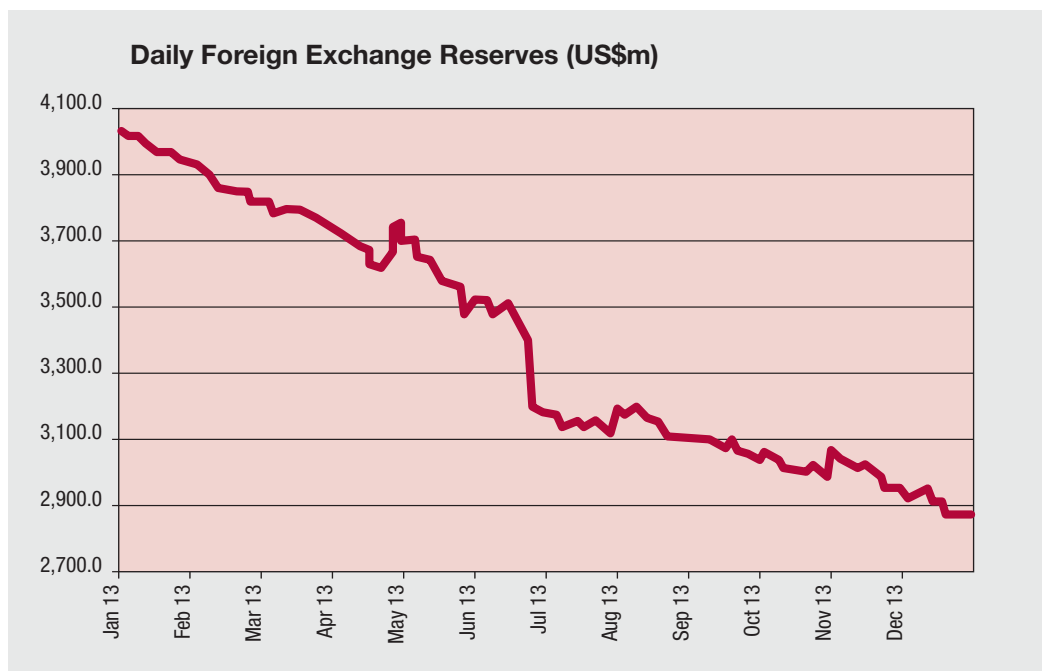
The Bank's investment of foreign reserves involves fulfilling these internal objectives as well as controlling the risks associated with their management. In this regard the Bank's primary objectives are to:

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

At the end of December 2013 the level of foreign reserves declined by US\$1.20 billion to US\$2.85 (K6.12) billion. This decline was mainly attributed to the sale of foreign exchange to support the exchange rate and to fund the remaining liabilities for the Government's share in the LNG project.

Foreign exchange inflows during 2013 totalled US\$432.7 million, compared to outflows of US\$1,397.4 million.

Inflows mainly comprised mineral taxes of US\$291.8 million and income from foreign investments totalling US\$68.6 million. Outflows mainly comprised of US\$1,084.6 million in foreign exchange intervention and government payment of US\$204 million for LNG equity stake.



Domestic Foreign Exchange Market

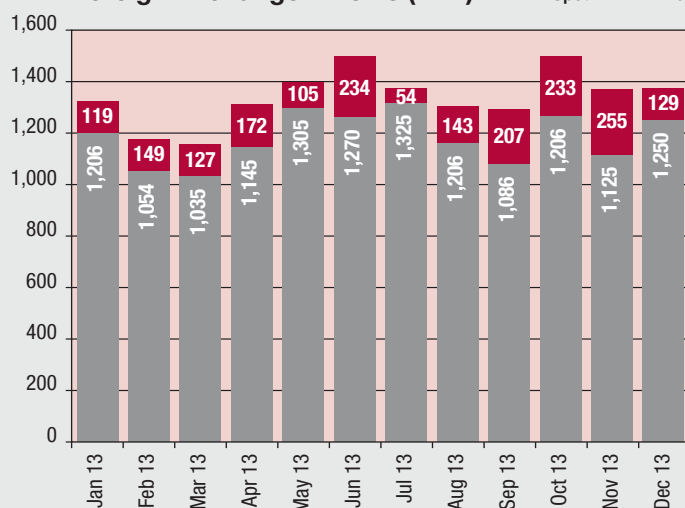
The kina came under significant pressure over the course of 2013 due to strong import demand, winding up of the construction phase of the LNG project and declining commodity prices. These developments contributed to the imbalance in the flow of foreign exchange into the domestic market.

The kina depreciated by 13 percent against the US dollar during the period January to December 2013. Over the same period, foreign currency inflows increased by 6 percent, which was more than offset by the 16 percent surge in outflows. The increase in outflows was attributed to demand for imported goods and services, including forward covers taken by importers.

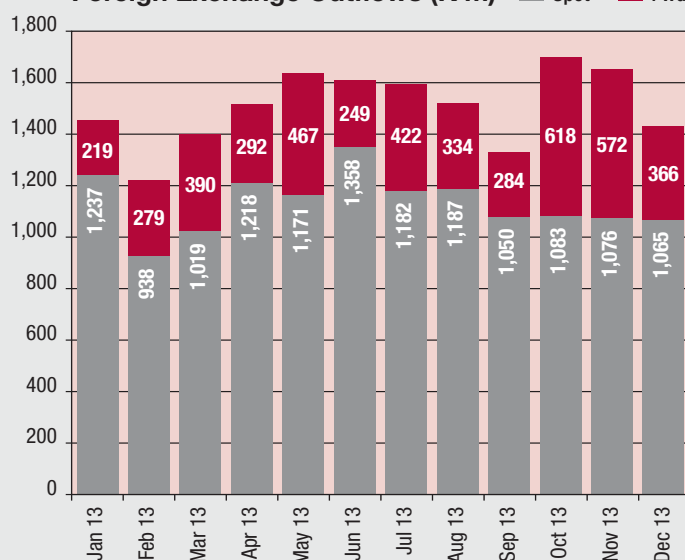
Major Sector Contributions to Foreign Exchange Flows (K'm)

	2012	2013	Change
Inflows			
Mining	4,695.0	4,623.6	-2%
Finance & Business	2,557.8	2,707.9	6%
Gas	2,143.1	2,341.9	9%
Agriculture	1,445.3	1,519.6	5%
Total Fx Inflows	15,239.0	16,161.3	6%
Outflows			
Finance & Business	3,005.9	3,546.6	16%
Retail	3,190.1	3,925.1	23%
Manufacturing	2,140.5	2,393.9	12%
Petroleum	2,173.0	2,440.8	12%
Total Fx Outflows	15,566.6	18,077.7	16%

Foreign Exchange Inflows (K'm) Spot Fwd



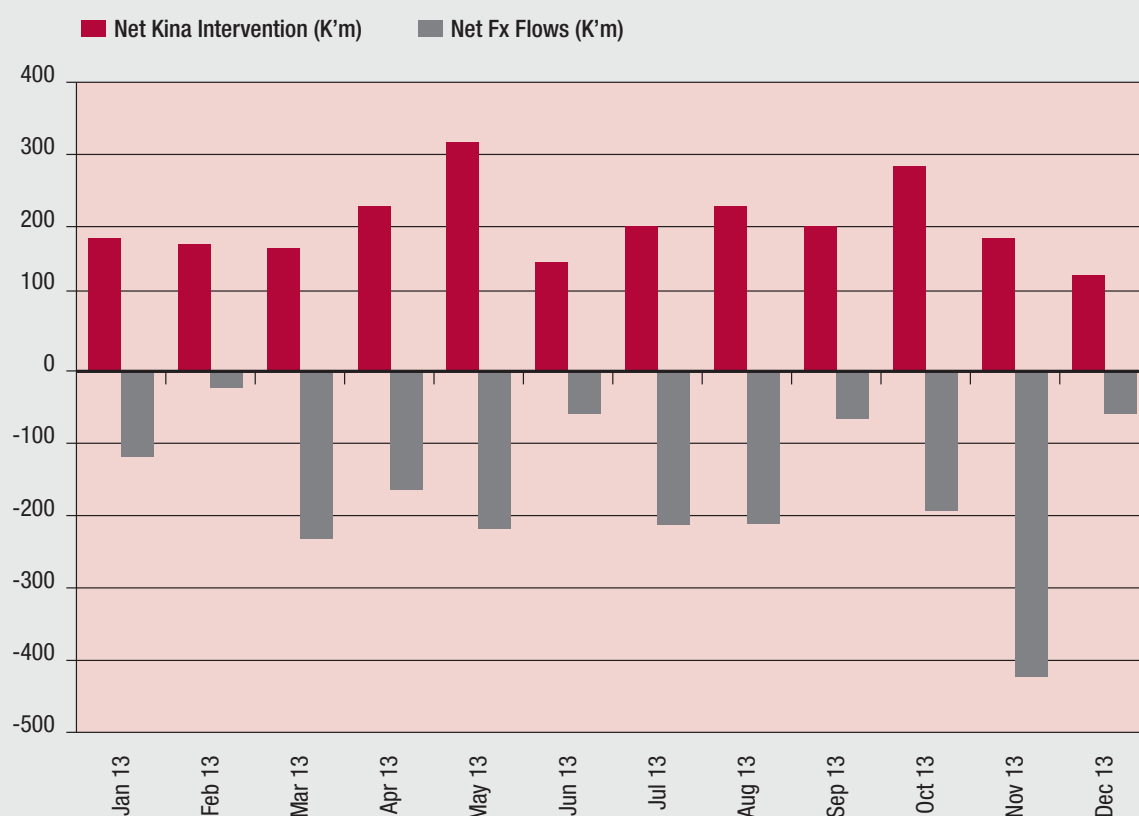
Foreign Exchange Outflows (K'm) Spot Fwd



The depreciation of the kina against the US dollar was more pronounced during the months of July through to October, depreciating by 10 percent, largely as a result of the dominance of import demand leading to increasing forward import cover.

In response to the sharp depreciation, the Bank introduced changes to the foreign exchange operational guidelines and also used "moral suasion" to stabilise the kina. The main policy change to the operational guidelines was the removal of forward transactions from the interbank market.

Under the new guidelines, participants were still permitted to underwrite forward covers but funded only through their internal books. The changes effectively restricted the participants from bringing in their forward orders to the interbank market.



In 2013 the Bank was a net seller of US\$1,116.3 million in the domestic foreign exchange market, equivalent to a net diffusion of K2.50 billion.

The total market turnover in 2013 increased to K37.7 billion, up from K36.6 billion in 2012.

The kina ended the year firmer against the Australian dollar (AUD) and the Japanese yen (JPY), while it depreciated against the Euro and the Great Britain pound (GBP).

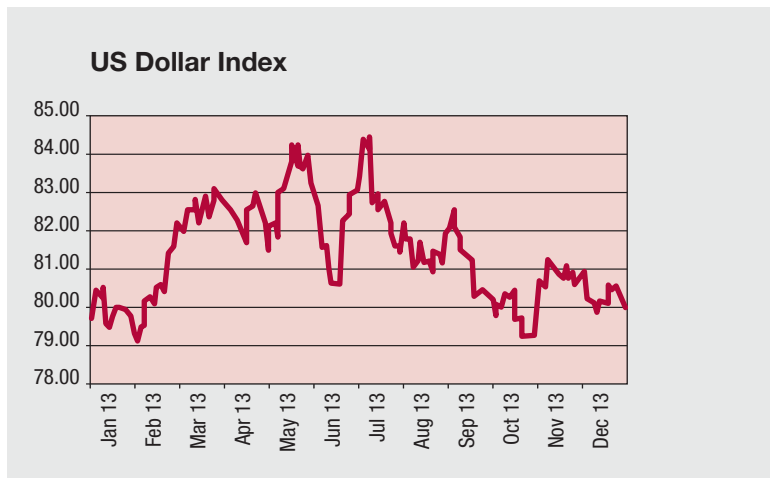
	End of Dec 2012	End of Dec 2013	YTD (%Change)
PGK/USD	0.4755	0.4130	-13.1
PGK/AUD	0.4580	0.4630	1.1
PGK/EUR	0.3602	0.3032	-15.8
PGK/GBP	0.2499	0.2519	-1.0
PGK/JPY	40.96	43.17	5.4
PGK TWI	37.61	35.89	-0.1

Foreign Currency and Interest Rates Risks

During 2013 the global financial market experienced a shift in growth momentum towards developed economies, buoyed by quantitative easing and “abonomics”¹. The recovery in developed economies was attributed to prolonged expansionary monetary policies. This led to improvements in the service and construction sectors over the course of the year, although activities in the manufacturing sector and global trade had not yet recovered. Major emerging economies weakened in 2013 mainly due to internal structural imbalances.

Central banks in developed countries maintained their key policy interest rates at very low levels and continued with quantitative easing policies. In contrast, the central banks of some emerging countries tightened monetary policy, responding to issues specific to their own economies. Some central banks tightened policy on the back of high inflation, while others increased key policy rates as a result of capital flight and depreciating exchange rates related to US tapering.

¹ “Abenomics” is a policy measure introduced by Japan’s Prime Minister Shinzo Abe aimed at reviving the sluggish Japanese economy with a massive fiscal stimulus, more aggressive monetary easing from the Bank of Japan, and structural reforms to boost Japan’s competitiveness.



Bond yields increased during the year on expectations that the US would commence tapering securities purchases in its open market operation. In the foreign exchange market the US dollar appreciated, especially against emerging market currencies.

In response to these market developments, the Bank of Papua New Guinea continued a cautious approach on its investments throughout the year, maintaining short durations in the portfolio and neutral currency exposure.

Fund Performance

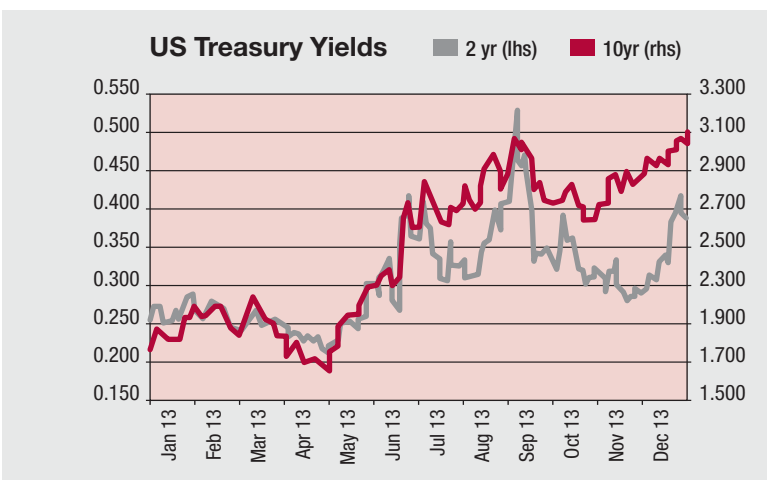
Increasing global bond yields affected returns for both the in-house and outsourced funds in 2013.

In-House Managed Funds

The in-house managed funds generated portfolio returns of 1.8 percent over the year to December 2013 compared with 2.9 percent in 2012. The decline reflects ongoing low global interest rates, the shift to short durations and maintenance of high liquidity position to fund the intervention in the foreign exchange market.

Outsourced Funds

Total value of the outsourced fund increased to US\$1,102.1 million over the year to December 2013 from US\$1,097.2 million in 2012, an increase of US\$4.9 million and equivalent to an annual return of 0.47 percent. This compares to the Citi Group 1-3 year fully hedged World Government Bond Benchmark return of 0.76 percent.



Core Functions Monetary Policy

International Transactions Monitoring

In October 2013 the Bank undertook a foreign exchange transactions audit with banks in Port Moresby on exports by the coffee, logs and marine/fisheries industries to identify discrepancies between shipment values reported by those industries and the export receipts received by banks.

Foreign Currency Accounts

The Bank received and reviewed four applications for opening of foreign currency accounts (FCAs) outside PNG during 2013. Of these, one was a new application and three were to replace existing FCAs. All were approved.

Gold Export Licences

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

Applications received in 2013	17
Applications approved and renewed	7
– Gold Exports Limited	
– Golden Valley Enterprises Limited	
– Issacc Lete Lumbu Gold Buyers Ltd	
– Itaipreziosi South Pacific Limited	
– Niugini AU Exports Ltd	
– Vertic Ltd	
– Wanaka Gold Limited	
New applications approved	
– Nanjang (PNG) Holding	1
Applications requiring more information	4
Application withdrawn	1
Application declined but resubmitted	1
Applications cancelled	3

Domestic Lending in Foreign Currency

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

Applications approved in 2013	4
Value of transactions	US\$88.399 (K211.885) million

Contingent Guarantees in Favour of Non-Residents

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

Applications received in 2013	5
Applications approved	3*
Value of transactions	K1,009.0 million**

*Approval was not required for two applications as the funds secured were used to fund projects in PNG.

** From approved transactions.

Cash Taken Abroad

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

Applications received and reviewed in 2013	43
Applications approved	43
Value of approved transactions	K2.601 million
Value of approved numismatic notes export	K1.208 million

PNG LNG Project Exemption

Companies engaged in transactions related to the PNG LNG Project sponsored by ExxonMobil and its partners are exempted from the operation of the Central Banking (Foreign Exchange and Gold) Regulation. To be entitled to this exemption, a company must demonstrate that its engagement or a transaction is primarily for the PNG LNG Project or Project Operations.

In 2013 there were no new exemptions issued, while exemptions granted to 14 sub-contractors expired on 31 December 2013.

Research Activities

The Bank undertakes a number of tasks necessary to aid policy analysis and decisions. In 2013 these included:

Surveys

Business Liaison Survey: The Bank surveys 412 companies in the private sector each year. Of these, 94 large companies are surveyed quarterly.

Employment Survey: All 412 companies are surveyed every quarter.

The analysis of the survey results is used to:

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

Expansion of Monetary and Financial Data Coverage

The International Monetary Fund (IMF) technical assistance mission in February 2013 for the Monetary and Financial Statistics project reported that improvements on data quality and coverage were required.

Following the visit, the Bank achieved full institutional coverage of the financial institutions, extending coverage to include General Insurance companies. In addition Bank staff assisted organisations to improve the data quality and timely submission of reports.

Balance of Payments System

The IMF also conducted a TA mission during May and June 2013 to review the BOP and International Investment Position compilation in the Bank. The mission provided recommendations to improve compilation and coverage, with the aim to enable the Bank to upgrade to the latest IMF BOP reporting standard, BMP 5.

The Bank implemented two recommendations from the review:

- exclusion of gold exports from merchandise exports and reclassification as monetary gold, and
- the collection of interest receipts and payments data from the Bank's Finance and Accounting department.

Research Papers

The Bank published 7 research papers in 2013 as part of its Research Working Paper series:

- Supply response of coffee in Papua New Guinea
- Supply response of cocoa in Papua New Guinea
- Supply response of palm oil in Papua New Guinea
- Determinants of real exchange rate in Papua New Guinea
- Constructing an Output Gap for Papua New Guinea
- Studies of the Economy of Papua New Guinea
- Estimating an Open-Economy Phillips Curve for Papua New Guinea

Core Functions

FINANCIAL SYSTEM STABILITY

The financial system included in this Report covers institutions authorised, regulated and supervised by the Bank of Papua New Guinea. In broader terms, the financial system includes financial institutions regulated by other authorities.

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

This is achieved through:

- setting strict licensing requirements

- promoting proper standards of conduct
- setting prudential guidelines for sound and prudent business practices for authorised institutions, and
- ensuring compliance consistent with the relevant legislation and prudential standards.

The financial system

Type of institution	31 Dec 2013	31 Dec 2012
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	11	10
Savings & loans societies (SLSs)	22	22
Authorised superannuation funds (ASFs)	4	4
Licensed investment managers (LIMs)	3	3
Licensed fund administrators (LFAs)	3	4
Life insurance companies (LICs)	5	5
Life insurance brokers (LIBs)	4	4
Authorised money changers	6	4
Money remitter	1	2
Foreign exchange dealers	2	2
Authorised mobile network operator	1	1
Total assets	K37.5 billion	K34.0 billion
Banking industry	77%	76.8%
ASFs	21.8%	21.9%
LICs	1.2%	1.3%
Total deposits	K21.9 billion	K20.3 billion
Commercial banks	93.8%	93.9%
LFIs	3.5%	4.1%
SLSs	2.0%	2.0%
Micro-banks	0.7%	-
Total loans outstanding	K11.3 billion	K10.0 billion

Licences and Approvals

In 2013 the Bank considered and made decisions on applications received regarding expansion, closure, relocation of operations and new licences.

During the year the Bank granted 4 new licences (micro-finance, money changers and investment manager), issued a 'no objection notice' allowing the extension of international money remittance services, assessed an additional 6 new and ongoing licence applications and rejected 2 applications (licensed financial institution and finance company sale).

Prudential Standards

Banking

The Bank's major review of prudential standards relating to the banking industry culminated in the development of new standards grouped into risk related areas - capital, credit, operational risk, corporate governance and market risk.

Corporate Governance prudential standards were released for consultation in November. Consultation is continuing with industry participants on the standards.

Superannuation

In July the Superannuation Prudential Standard on Investments was presented to industry participants including Licensed Trustees, Licensed Investment Managers and Licensed Fund Administrators of the ASFs to discuss the need for revision of the standard.

Issues discussed included:

- crediting rate policy
- investment proposals review procedure
- liquidity management
- clarity on existing requirements relating to investment objectives
- investment strategies
- offshore investments
- large exposures
- asset titles and
- regular review of funds' assets.

The first draft of the revised Investment Standard was circulated to the industry at the beginning of November.

At the same time the Bank also circulated a draft prudential standard on Risk Management to the industry for comments.

Legislative Developments

Savings & Loans Societies

Consultation on the final review of proposed changes to the *Savings & Loans Societies (Amended) Act 1995* was completed in October 2013. The Bank made a submission to the Minister of Treasury to refer the proposed amendment Bill to the National Executive Council for the necessary approval.

Superannuation

In July Parliament passed the Bill containing the proposed amendments to the *Superannuation (General Provisions) Act 2000*, as recommended in the June 2008 "Report of the BPNG/Treasury Working Group on the outstanding Superannuation Task Force Issues".

Review of the Life Policy Definition

The issue of the disputed life policy definition under the *Life Insurance Act 2000* continued from previous years, still without resolution reached with the Insurance Commissioner.

Supervisory Enforcement Actions

Reviews

As part of the Bank's supervisory role in strengthening the risk management systems and compliance capacities of the authorised institutions and licensed entities, 10 on-site prudential reviews or examinations were conducted in 2013. These included eight full scope reviews specifically targeting credit risks.

Reviews were conducted on 2 banks, 1 LFI, 5 S&LSs, 2 LIMs (one of which was visited twice), 1 LIC and 1 LFA. Five new applicants – 3 banking licences and 2 money changers – received a pre-licence visit.

The Bank also conducted prudential consultations with 2 banks, 3 licensed financial institutions, 7 savings and loans societies, 1 life insurance company and 2 life insurance brokers.

Comrade Trustee Services Limited (CTSL)

The prudential review of CTSL under the APRA Pacific Governance Programme was conducted in April. The review was a full scope review and covered all risk areas such as board, management, strategy, investment and other risks associated with CTSL's nature of business and the volume of transactions in its day-to-day business activities and operations.

On-site review program

The Bank conducted a full on-site prudential review of CTSL in April with assistance from APRA as part of its Pacific Governance Support Program.

Under this program the Bank also participated in the on-site review of ANZ (Fiji).

The Bank also conducted a full scope review on the Bank South Pacific (BSP) Group in Port Moresby in May. As part of this review the Bank conducted a prudential review of BSP Capital (BSPC) in May. The review of the licensed investment manager covered all risk areas such as board, management, strategy, investment and other risks associated with BSPC's nature of business and operations.

The review team conducted a targeted credit risk on-site review of the BSP Fiji branch in early July and operational risk on-site review of the Solomon Islands branch in late July. The review team involved participants from BPNG, the Reserve Bank of Fiji (RBF) and the Central Bank of Solomon Islands (CBSI).

Statutory Administration, Management and Liquidation Activities

The liquidation process continued through 2013 for Workers Mutual Insurance (PNG) Limited (WMI) and Eastern Highlands Savings & Loans Society Limited.

Key developments in 2013

Major payments system milestone achieved

The Bank achieved a major milestone with the rolling out of the Kina Automated Transfer System (KATS), effectively implementing electronic inter-bank funds transfer and Real Time Gross Settlement (RTGS).

KATS allows BPNG and all commercial banks to exchange funds electronically in real time during business days. The RTGS allows banks and their customers to settle payments immediately.

Cross-border currency review

During the year BPNG and Bank Indonesia conducted a joint survey in the Vanimo, Wutung, Skouw and Jayapura border areas to review currency usage in the northern land border between Papua New Guinea and Indonesia.

The review followed concerns raised by the public, financial institutions and border authorities on the shortage of currency, poor quality of currency, repatriation of kina and Rupiah and illegal transactions at the border areas.

The results were discussed at a meeting between representatives of the Bank of Papua New Guinea and Bank Indonesia in Port Moresby in November 2013 and a draft Memorandum of Understanding (MoU) on currency usage in the border areas was produced. The finalised MoU will be signed between both Central Banks in 2014.

National Payment System responsibilities

The Bank has statutory responsibilities for the national payment system, which is part of the core financial infrastructure that underpins the economy as a whole. In this context the Bank of Papua New Guinea provides:

- banking services to the National Government and statutory authorities;
- the National Government with the Temporary Advance Facility to cater for mismatches in cashflow;
- cheque matching and cheque clearance services; and
- issuing currency banknotes and coins.

Banking Services

The financial activities of the National Government are carried out by the Department of Finance through the Waigani Public Account, from which transfers of funds are initiated and executed to the various Government departmental drawing and trust accounts, provincial Government and statutory authority accounts. The revenue collections by Customs Department and Internal Revenue Commission are also deposited at the Bank of Papua New Guinea.

The National Government opened two new trust accounts during 2013, bringing to 78 the number of trust accounts held at BPNG. The balance held in trust accounts as at 31 December 2013 was K392.4 million, compared with K392.2 million at the end of 2012. During the year large transactions processed were for Tuition Fee Free Education and additional State equity financing in the PNG LNG Project.

During 2013 the Bank installed the Banking Services System (BSS) as part of the implementation of KATS. BSS was designed as the core retail banking system for managing the Bank's banking operations. Over the course of the year the Bank continued to work with key Government departments to prepare for the transition to BSS. When fully operational the BSS will enable Government departments to reduce reliance on using cheques by enabling direct electronic transfers and payments.

Telling Services

The Bank provides telling services to Government departments, and staff as well as limited services to the public and commercial banks.

Cash handled by tellers

2013	2012	2011
Inward receipts K110,743,567	Inward receipts K128,215,042	Inward receipts K99,398,730
Outward payments K108,485,483	Outward payments K126,509,734	Outward payments K98,175,120

Temporary Advance Facility

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

In 2013 the Government sought financing under the TAF, which the Bank approved on 7 January 2013. A total of K 51.7 million was drawn down and fully repaid on 14 January 2013. For the rest of 2013 the Government's cash position was in net credit and did not utilise the TAF.

Cheque Processing

As part of preparation for future enhanced facilities provided through KATS, security improvements for cheque forms were put in place in 2013.

During the year no major incidents of fraud in Government drawing accounts was reported, attributed to the Bank's effective Cheque Matching Process and the improvements made to the general cheque processing system.

Number of cheques and vouchers processed

2013	2012	2011
337,405	352,843	380,900

Number of presented cheques

Source	2013	2012
Government drawing accounts	186,223	210,502
Commercial bank cheques	109,628	100,702
Staff accounts	34,551	34,732
BPNG cheques	7,003	6,907

Total value of cheques processed

2013	K24,284,292,067
2012	K23,871,962,947

Core Functions Financial System Stability

Currency banknotes and coins

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

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

During 2013 the Clean Note Awareness program involved public presentations conducted by Bank staff and included sessions at the Garamut Show in Wewak, West New Britain Show, Morobe Agricultural Show and the Financial Inclusion Expo held in Port Moresby.

Notes and coins in circulation as at 31 December 2013

Notes Denomination	Value K'm 2013	Value K'm 2012	Value K'm 2011
K2	46.3	45.8	46.2
K5	45.6	44.4	44.4
K10	65.5	66.3	77.8
K20	209.8	213.9	213.9
K50	433.6	417.0	452.2
K100	877.1	822.7	635.4
Sub Total	1,677.9	1,610.1	1,469.9
Coins Denomination			
K2	0.2	0.3	0.3
K1	21.3	19.9	16.5
50 Toea	6.4	6.5	6.5
20 Toea	19.3	18.6	16.8
10 Toea	18.8	18.0	16.5
05 Toea	6.1	5.9	5.6
Sub Total	72.1	69.2	62.2
Total	1,750.0	1,679.3	1,532.1

New notes and coins issued in 2013

Notes Denomination	Value K'm 2013	Value K'm 2012	Value K'm 2011
K2	21.1	21.3	22.2
K5	22.8	19.8	21.8
K10	31.0	28.0	33.9
K20	106.0	86.6	118.8
K50	215.0	114.0	199.0
K100	250.0	280.0	291.0
Sub Total	645.8	549.7	686.7
Coins Denomination			
K2	0.00	0.00	0.00
K1	1.50	3.20	3.20
50 Toea	0.00	0.36	0.36
20 Toea	0.70	1.57	1.57
10 Toea	0.83	1.51	1.51
05 Toea	0.21	0.33	0.33
Sub Total	3.24	6.97	6.97
Total	649.04	556.67	693.67

Soiled notes destroyed

Note denomination	Value of soiled notes destroyed in 2013 (K'm)	Value of soiled notes destroyed in 2012 (K'm)	Value of soiled notes destroyed in 2011 (K'm)
K2	23.6	19.8	13.2
K5	18.3	22.4	16.4
K10	30.9	43.1	26.8
K20	120.4	101.1	62.2
K50	198.1	171.9	109.1
K100	189.1	134.5	136.3
Total	580.4	492.8	364.0

Demonetised K2 coins and paper banknotes

In 2013 the Bank demonetised the K2 coin and paper banknotes. The K2 coin and the old paper banknotes, both circulated and uncirculated, ceased to be legal tender from 30 June 2013.

Recycling polymer waste

The Bank supports a clean and green environment. As part of this policy, in 2013 BPNG secured a contract for a specialist recycling company to buy granulated polymer waste from destroyed polymer notes.

Purchase of banknote disintegration machine

In August the Bank purchased a new offline banknote disintegration and shredding machine, to replace the current machine donated by the Reserve Bank of New Zealand in 2002. The new machine will be commissioned in 2014.

Supporting Economic Growth

As well as its three core functions, the Bank of Papua New Guinea plays a vital role in supporting and contributing to the economic growth and development of the nation.

Financial Inclusion

The Bank believes strongly that improvement in financial inclusion and financial literacy can assist greatly in empowering PNG grass roots people to participate in economic activities.

To this end, financial inclusion forms a significant part of the Bank's Strategic Plan 2012-2015, further underlined by the Bank's membership of the Alliance for Financial Inclusion (AFI), the global network of financial policymakers from developing and emerging countries working together to increase access to appropriate financial services for the poor.

Maya Declaration commitment

The Bank signed the Maya Declaration presented at the AFI Global Policy Forum in September 2013 in Kuala Lumpur, Malaysia. As a signatory, the Bank formally committed to achieving certain targets for financial inclusiveness. These include:

- i. To reach 1 million more unbanked and under-served low-income people in Papua New Guinea, 50% of whom will be women;
- ii. To lead efforts to create a financially competent generation of Papua New Guineans through financial education and financial literacy;
- iii. To actively support innovative use of technology for scaling-up access to financial services and financial literacy;
- iv. To strengthen consumer protection by issuing prudential guidelines and creating a platform for various national regulators and industry networks to monitor consumer protection;

- v. To begin the process of integrating financial inclusion in local and national government, including getting the National Executive Council to endorse the National Financial Inclusion and Financial Literacy Strategy by quarter 4 of 2013;
- vi. To promote regular collection and use of financial access data to inform policy making and help identify key dimensions of financial inclusion in Papua New Guinea; and
- vii. To optimise these results through knowledge sharing and effective coordination of stakeholders, including development partners, by the newly established Centre of Excellence for Financial Inclusion (CEFI) chaired by the Bank of Papua New Guinea.

National Strategy

The National Strategy for Financial Inclusion and Financial Literacy 2014 – 2015 was launched in December 2013.

The National Strategy was designed to provide the platform from which all financial initiatives in PNG can be guided to achieve Maya Declaration commitments. In this context it is linked to the financial inclusion arm for the National Informal Economy Policy.



Minister for Treasury Mr Don Polye launched the National Strategy for Financial Inclusion and Financial Literacy 2014-2015 at the Financial Inclusion Expo in Port Moresby.

Supporting Economic Growth



L-R: Prime Minister the Hon. Peter O'Neill with Governor Loi M. Bakani launching the Centre of Excellence for Financial Inclusion.

Launch of the Centre of Excellence for Financial Inclusion

In December 2013 the Prime Minister the Hon. Peter O'Neill officially launched the Centre of Excellence for Financial Inclusion (CEFI) during the 2nd Financial Inclusion Expo.

Chaired by the Bank, CEFI's role is to monitor all financial inclusion activities in Papua New Guinea.

By the end of 2013 the CEFI website had been launched and consultative workshops held to familiarise industry representatives on the role and aims of CEFI.

2013 Financial Inclusion Expo

The Bank successfully hosted the Financial Inclusion Expo 2013 in Port Moresby in December 2013 with the theme "Financial Education – Way Forward for Financial Inclusion".

The Expo aimed to create awareness of new developments in the finance and banking sector, including innovative ways to deliver financial services, as well as focus on financial education.

Over 30 financial institutions participated in the two day Expo to showcase their products and services. More than 15,700 people visited the Expo.



National Youth Savings Campaign

Also launched at the 2013 Financial Inclusion Expo, the National Youth Savings Campaign was introduced to encourage children to adopt a savings culture by learning about money management, opening and operating bank accounts and saving money at an early age.

The Campaign is supported by commercial banks and other financial institutions across PNG.

Financial Diaries Project

Commenced in 2012, the Financial Diaries Project was completed during 2013 and the results presented in November to the project's sponsors BPNG, UNDP, AusAID and the Pacific Financial Inclusion Program.

The project was a longitudinal study of the financial behaviour of approximately 150 respondents from low income households in three locations – Port Moresby settlements, the Kimbe-Hoskins area of West New Britain and the Goroka area of Eastern Highlands province.

National Survey on Financial Capability

The Bank and the World Bank launched the National Survey on Financial Capability in November.

Funded by the Korean Government Trust Fund and BPNG, the Survey of Financial Competency aims to develop a national baseline to measure financial capability across income groups in PNG.

The results of the Survey are expected to provide a comprehensive understanding of financial behaviour of the PNG population, including money management decision making, financial planning habits and use of informal and formal financial services in PNG. It will also provide information to assist the Government to develop targeted financial inclusion, financial education and consumer protection programs.



Attendees at a financial education workshop held during the 2013 Financial Inclusion Expo

Microfinance Expansion Project (MEP)

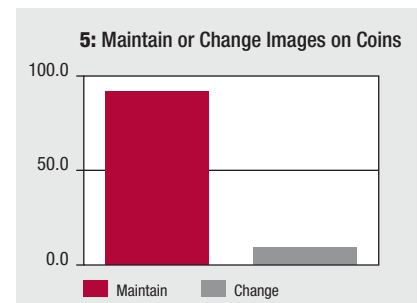
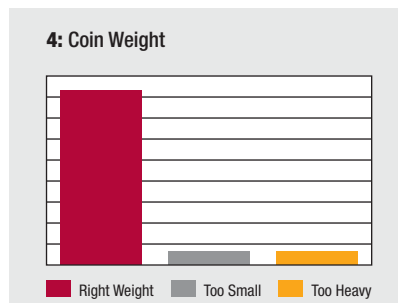
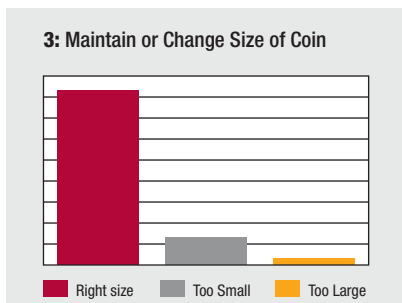
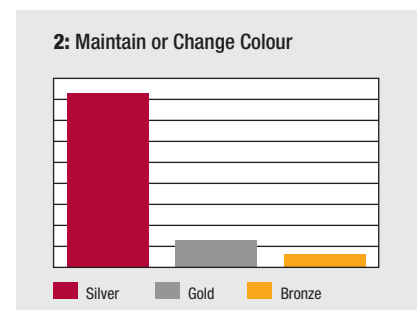
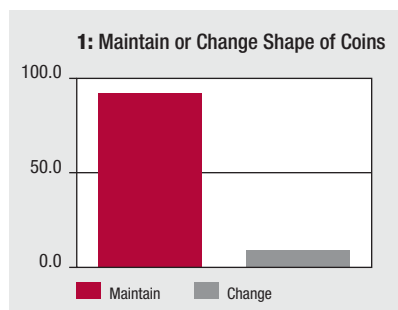
The Bank is the MEP's Executing Agency, with responsibility for providing support and oversight of the Project's implementation. Over the course of 2013 the Bank recorded a number of significant achievements, including:

- 9 financial institutions selected and MoUs signed as Partner Financial Institutions
- 26 savings and loans products developed
- "Savings for Young Minds" campaign prepared
- Contract signed with IBBM to deliver staff training over the next 3 years
- Procurement of Business Mentors initiated and progressing
- Rollout of trainer training and financial education in Madang and Simbu
- Financial education session attended by 89 participants in Boroko
- Financial education workshop held during Financial Inclusion Expo
- By the end of December over 2,100 people had attended financial education training.

Coin Survey

As part of the activities associated with Currency Day in April, Bank staff conducted a Coin Survey across three provinces to gauge public opinion.

The survey found that the people of Papua New Guinea were generally satisfied with the current coins, as shown in these charts.



Support Services and other Activities

Focus on capacity development

2013 was a year of bedding down the changes made during the organisational restructure undertaken in 2012 and improving the capability and capacity of the Bank's information technology function.

Information technology developments

A major achievement during the year was the successful delivery of the national payment system KATS, which went live in August 2013. Implementing KATS required additional IT resources, infrastructure and support systems. A number of the systems associated with the Bank's activities, such as domestic and international trading, were re-configured or re-engineered to allow for the necessary interface with KATS. In addition the Bank successfully commissioned 3 data networks to provide participants with access to the National Payment System – a primary fibre network, a backup wireless network and the SWIFT network.



Part of the Bank's primary data centre

Local area network updated with VoIP

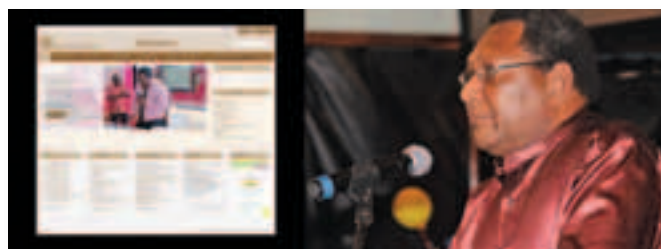
During the year the Bank rolled out a new system, merging the old dual LAN and Internet networks into one single VoIP based network, laying the foundation for IP based telephony system in the future.

IT governance and risk management improvements

A series of governance recommendations, developed with the assistance of an external audit group, were implemented progressively through 2013. The Bank also carried out a number of security improvements, including firewall capabilities, disaster recovery practices and website protection, as part of the Bank's LAN (network) upgrade.

Intranet site launched

Coinciding with the Bank's 40th anniversary celebrations, the Bank launched an intranet service in November. The site gives staff members access to corporate systems, information, business tools and resources to enhance communication and collaboration across the Bank.



Governor Loi M. Bakani launched the Bank's intranet in November 2013.

Numismatic activities

The Bank sells commemorative items to the public and currency collectors worldwide. Total sales for 2013 was K544,135, a significant increase over the K316,604 achieved in 2012. Demand for the commemorative notes was mainly for the K100, K50 and K20 polymer denominations.

Sales

2013	K544,134.96
2012	K316,603.92
2011	K307,846.28
2010	K154,366.01

Staff capacity building

In addition to ongoing formal and informal training activities, including workshops, seminars, conferences and study towards formal qualifications, both in PNG and overseas, the Bank also sponsors staff to attend a range of capacity and skills development activities.

During 2013 the Bank collaborated with a number of other institutions for provision of training for staff and management.

Research Collaboration and Training

The Bank collaborated with a number of institutions on research and modelling work. These included:

Pacific Financial and Technical Assistance Centre (PFTAC)

PFTAC conducted a workshop on financial programming and policies framework for participants from the Bank and Treasury Department. The training focussed on linkages of the various macroeconomic accounts, forecasting and running different simulations and correcting imbalances.

A further PFTAC technical assistance conducted during 2013 assisted Bank staff to improve the compilation of GDP estimates and forecasts.

South East Asia Central Bank (SEACEN) Training Centre

The Bank undertook 2 research projects in collaboration with the SEACEN Centre:

- Mortgage Finance and Consumer Credit: Implications on Financial Stability
- Analytical Framework in Assessing Systemic Financial Market Infrastructure

The first paper on mortgage and credit finance resulted in the development of models and indexes to be used by the Bank to conduct stress testing and to produce indicators to measure the stability of the financial system and enable the Bank to consider corrective measures.

SEACEN conference

Jointly hosted by the Bank of Japan, South East Asian Central Banks and Bank of PNG, the 9th annual SEACEN conference brought together representatives from SEACEN members Bank of Thailand, Autoriti Monetari Brunei Darussalam, National Bank of Cambodia, Reserve Bank of Fiji, Reserve Bank of India, the Bank of Korea, Nepal Rastra Bank, Central Bank Chinese Taipei, Bank of Japan, Hong Kong Monetary Authority, European Central Bank, Bank Indonesia, Bank Negara Malaysia, Banko Sentral ng Pilipinas and Bank of Papua New Guinea, held in Port Moresby.

The role and risk management of payment settlement systems was the key topic of the 2013 conference. In conjunction with the conference, participants attended a training program, which covered issues including the role of payment systems in financial stability and monetary policy, major risks in core payment and settlement systems and assessment of liquidity management options in Real Time Gross Settlement (RTGS) to enhance efficiency and risk management measures.

Other services

Cafeteria

During the year the Bank outsourced the operation of the staff cafeteria, in line with the Bank's policy of moving away from non-core activities.

Under the management of the new food service professionals, the cafeteria introduced healthier food choices, which also resulted in an increase in the number of staff patronising the facility.

BPNG in the Community

The Bank of Papua New Guinea supports a number of business, cultural, sporting and health-related activities, in line with its leadership position in the PNG business sector and broader community. During 2013 the Bank and its staff contributed to the activities of a range of business and community organisations.

As part of its ongoing commitment to foster best practice and build professional capacity, the Bank made significant contributions to Transparency International Walk Against Corruption, Institute of National Affairs, PNG universities and education facilities and the PNG Institute of Directors.



A large contingent of BPNG staff members participated in the Transparency International 2013 Walk Against Corruption.

Health, medical research and welfare charities and initiatives continued to receive support from the Bank during 2013, including Cancer Relief Society, Sir Buri Kidu Heart Foundation and City Mission. As well, to mark Papua New Guinea's 38th Independence anniversary, the Bank donated essential equipment, including generators and a blood storage fridge, to rural health services in Vanimo, West Sepik Province, Malalia Health Centre in West New Britain Province, Kudjip Nazarene Hospital in Jiwaka Province and Moreguina Health Centre in Central Province.

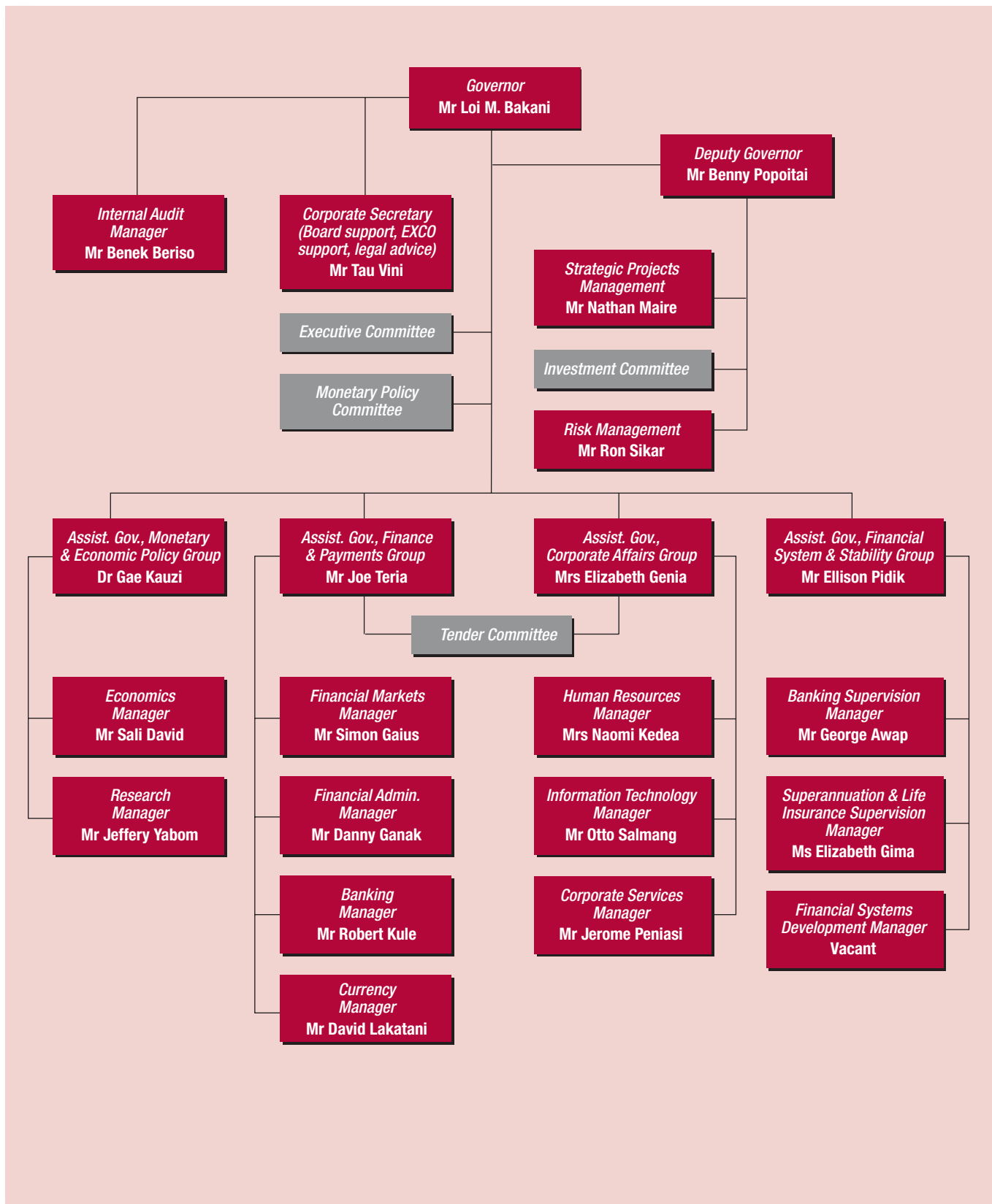


Representatives from BPNG presented a genset to Moreguina Health Centre, enabling the Centre to provide access to 24 hour service and proper storage of blood and medicines.

The Bank also contributed to and supported staff participation in corporate sporting challenges.

Organisational Chart

As at 31 December 2013



Staffing

Staff allocations

	31 Dec 2013
Governor	8
Deputy Governor	6
Assistant Governors	8
Secretariat	1
Audit	13
Economics	42
Research	11
Financial Markets	28
Banking Supervision	30
Superannuation & Life Insurance Supervision	20
Banking	33
Currency	25
Corporate Services	58
Information Technology	13
Human Resources	13
Finance & Accounting	38
TOTAL	347
Males	177
Females	170
Nationals	346
Non-nationals	1
	347

The Bank's staff enthusiastically embraced 40th Anniversary activities.



Senior officers	
Governor	Loi M. Bakani
Deputy Governor	Benny Popoitai MBE
Secretariat	
Corporate Secretary	Tau Vini
Internal Audit	
Manager	Benek Beriso
Monetary & Economic Policy Group	
Assistant Governor	Dr Gae Kauzi
Economics	
Department Manager	Sali David
Manager, Monetary Policy and Analysis Unit	Wilson Jonathan
Manager, Balance of Payments	Gaona Gwaibo
Manager, Public Information	Maryanne Kani
Manager, International Transactions Monitoring Unit	Elim Kiang
Research	
Acting Department Manager	Jeffrey Yabom
Manager, Economic Analysis Unit	Vacant
Manager, Projects Unit	Boniface Aipi
Finance & Payments Group	
Assistant Governor	Joe Teria
Financial Markets	
Department Manager	Simon Gaius
Manager, Foreign Reserves	Rowan Rupa
Acting Manager, Money Markets	Winnie Linken
Manager, Registry	Marie Martin
Financial Administration	
Department Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Oliver Kludapalo
Manager, Settlements	Soms Yankey

Senior officers (continued)	
Banking	
Department Manager	Robert Kule
Acting Manager, Customer Services	So'on Drewei
Manager, Clearing Accounts	Aiva Aku
Manager, Government Accounts	Jason Tirime
Currency	
Department Manager	David Lakatani
Manager, Control Unit	John Yenas
Manager, Processing Unit	Edward Kisakau
Corporate Affairs Group	
Assistant Governor	Elizabeth Genia
Manager, Human Resources	Naomi Kedeia
Manager, Information Technology	Otto Salmang
Manager, Corporate Services	Jerome Peniasi
Manager, Building & Property Management	Richard Angeli
Manager, Publication & Communication	Catherine Mackson
Manager, General Services	Eddie Levi
Manager, Security	Slim Rupusina
Financial System & Stability Group	
Assistant Governor	Ellison Pidik
Banking Supervision	
Department Manager	George Awap
Manager, Banks & Finance Companies Unit	Boas Irima
Manager, Savings & Loans Development Unit	William Saigir
Manager, Licensing & Policy Unit	Sabina Deklin
Manager, Micro-Finance Unit	Nickson Kunjil
Superannuation & Life Insurance Supervision	
Department Manager	Elizabeth Gima
Manager, Superannuation Unit	Tom Milamala
Manager, Policy and Licensing Unit	John Topal
Acting Manager, Life Insurance	Peter Samuel



Bank of Papua New Guinea

FINANCIAL STATEMENTS
FOR THE YEAR ENDING
31 DECEMBER 2013

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Statement of Comprehensive Income

For the year ended
31 December 2013

	Notes	2013 K'000	2012 K'000
Revenue from foreign currency investments			
Interest revenue	2	38,011	174,001
Realised gain/(loss) on financial assets		50,203	41,785
Foreign exchange gains and commissions		9,034	5,697
Total revenue from foreign currency investments		197,248	221,483
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(521)	(287)
Custodian and investment management fees		(3,878)	(3,545)
Total expenses from foreign currency investments		(4,399)	(3,832)
Net foreign currency income		192,849	217,651
Revenue from domestic investments			
Interest revenue	3	69,706	53,327
Other income	4	13,034	4,384
Total revenue from domestic investments		82,740	57,711
Expense on domestic liabilities			
Interest expense	5	(83,791)	(158,827)
Total expenses on domestic liabilities		(83,791)	(158,827)
Net domestic expense		(1,051)	(101,116)
Total net operating income		191,798	116,535
Operating expenses			
General and administration expenses	6	(88,890)	(92,263)
		102,908	24,272
Other unrealised income and (expense)			
Fair value and foreign exchange revaluation gain/(loss) on foreign currency investments		546,338	(68,328)
Fair value revaluation (loss)/gain on domestic investments		(28,743)	76,602
Profit for the year		620,503	32,546
Other comprehensive income			
Items that may be subsequently reclassified to profit and loss			
Gain / (loss) on gold asset revaluation		(27,963)	7,202
Items that will not be subsequently reclassified to profit and loss			
Gain on property revaluation		15,606	–
Other comprehensive income/(loss) for the year		(12,357)	7,202
Total comprehensive income/(loss) for the year		608,146	39,748

The above statement forms an integral part of these financial statements.

Statement of Financial Position

For the year ended
31 December 2013

	Notes	2013 K'000	2012 K'000
Assets			
Foreign currency financial assets			
Cash and cash equivalents	8	651,334	493,631
Gold		123,169	149,251
Financial assets at fair value	9	6,013,046	7,743,073
Assets held with IMF	7	34,791	30,643
Accrued interest		43,015	43,755
Total foreign currency financial assets		6,865,355	8,460,353
Local currency financial assets			
Government of Papua New Guinea securities	10	955,390	807,623
Loans and advances	11	11,520	9,935
Total local currency financial assets		966,910	817,558
Total financial assets		7,832,265	9,277,911
Non-financial assets			
Property, plant & equipment	13	150,837	131,926
Other non-financial assets	12	48,868	37,895
Total non-financial assets		199,705	169,821
Total assets		8,031,970	9,447,732
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF	7	469,056	406,813
Other financial liabilities	17	16,042	12,505
Total foreign currency financial liabilities		485,098	419,318
Local currency financial liabilities			
Deposits from banks and third parties	14	2,151,184	2,150,623
Deposits from Government and Government entities		980,172	985,402
Debt securities issued	15	3,198,986	5,345,946
Currency in circulation	16	1,749,226	1,679,329
Other financial liabilities	17	45,076	54,660
Total local currency financial liabilities		8,124,644	10,215,960
Total financial liabilities		8,609,742	10,635,278
Non-financial liabilities			
Provisions for employee entitlements	18	15,085	13,457
Total non-financial liabilities		15,085	13,457
Total liabilities		8,624,827	10,648,735

Statement of Financial Position

For the year ended
31 December 2013

	Notes	2013 K'000	2012 K'000
Equity			
Capital	19	145,540	145,540
Gold revaluation reserve		101,553	129,516
Property revaluation reserve		98,680	83,074
Unrealised loss reserve		(1,124,907)	(1,642,502)
Retained earnings		186,277	83,369
Total Equity		(592,857)	(1,201,003)
Total Liabilities and Equity		8,031,970	9,447,732

The above statement forms an integral part of these financial statements.

Statement of Distribution

For the year ended
31 December 2013

	Notes	2013 K'000	2012 K'000
Profit for the year		620,503	32,546
Transfer from unrealised loss reserve		(517,595)	(8,274)
Realised profit for the year		102,908	24,272

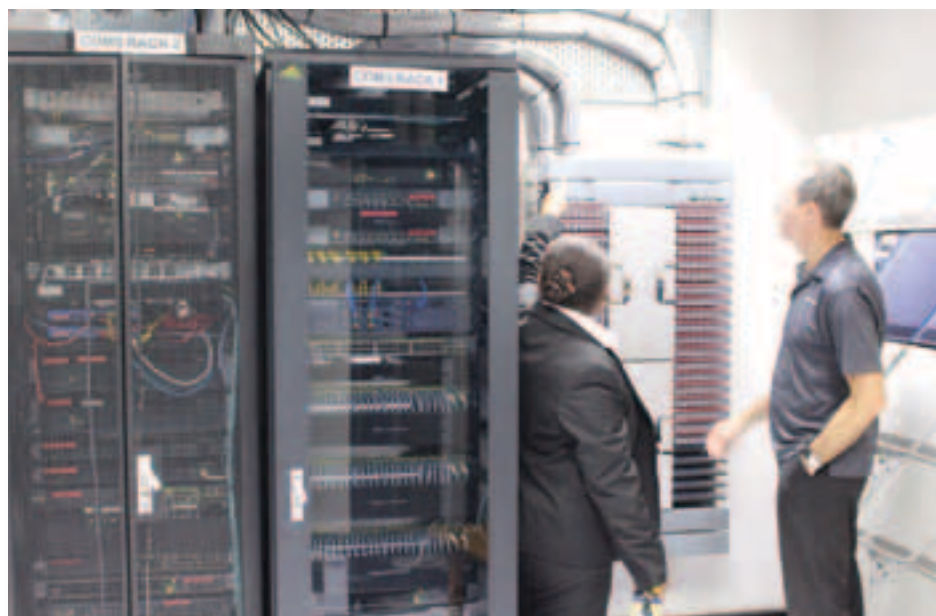
The realised profit for the year is K102.9 million. The unrealised loss reserve and net asset deficiency at 31 December 2013 were K1,124.9 million and K592.8 million respectively. In accordance with the *Central Banking Act 2000*, no distribution will be made where, in the opinion of the Central Bank, the assets of the Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital.

Statement of Changes in Equity

For the year ended
31 December 2013

In Kina (K'000)	Property Revaluation Reserve	Unrealised Profit/(loss) Reserve	Gold Reserve	Capital	Retained earnings	Total
Balance at 1 January 2012	3,074	(1,650,776)	122,314	145,540	59,097	(1,240,751)
Profit for the year	–	8,274	–	–	24,272	32,546
Other comprehensive income/(loss) for the year	–	–	7,202	–	–	7,202
Balance at 31 December 2012	83,074	(1,642,502)	129,516	145,540	83,369	(1,201,003)
Profit for the year	–	517,595	–	–	102,908	620,503
Other comprehensive income/(loss) for the year	15,606	–	(27,963)	–	–	(12,357)
Balance at 31 December 2013	98,680	(1,124,907)	101,553	145,540	186,277	(592,857)

The above statement forms an integral part of these financial statements.



Part of the Bank's primary data centre

Statement of Cash Flows

For the year ended
31 December 2013

	Notes	2013 K'000	2012 K'000
Cash Flows from Operating Activities			
Interest received – foreign currency		138,751	182,787
Interest received – local currency		65,384	49,758
Fees, commissions and other income received		48,185	51,866
Interest paid – foreign currency		(521)	(287)
Interest paid – local currency		(92,384)	(172,761)
Payments to employees		(41,742)	(32,321)
Payments to suppliers		(51,154)	(20,355)
Fees and commissions paid		(3,878)	(3,545)
Net proceeds from/(payments for) foreign investments		2,299,823	(17,883)
Net Cash Flow from Operating Activities	20	2,362,464	37,259
Cash Flows from Investing Activities			
Net increase/(decrease) in foreign deposits including IMF		64,527	(6,137)
Net increase/(decrease) in deposits from Banks		561	417,336
Net deposit from/(payment to) Government		(5,230)	(733,566)
Net increase/(decrease) in assets held with IMF		(4,148)	(3,556)
Net payment for/(proceeds from) investment in Government Securities		(172,188)	(282,772)
Purchase of property, plant and equipment		(9,091)	(13,920)
Proceeds from sale of institutional housing/motor vehicle		-	599
Net (decrease)/increase in other assets & liabilities		(10,722)	6,609
Net Cash Flow from Investing Activities		(136,291)	(615,407)
Cash Flows from Financing Activities			
Net issue of currency in circulation		69,897	146,883
Net (decrease)/increase in debt securities issued		(2,138,367)	(323,677)
Dividend paid to the Government		-	-
Net Cash Flow from Financing Activities		(2,068,470)	(179,794)
Net Increase/(Decrease) in Cash and Cash Equivalents			
Cash and cash equivalent at 1 January		493,631	1,251,573
Cash and Cash Equivalent at 31 December	8	651,334	493,631

The above statement forms an integral part of these financial statements.

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

(a) Basis of preparation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and in accordance with the CBA. In the event of any conflict between the requirements of the Act and the Accounting Standards, the Bank (BPNG) 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 BPNG major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for land and buildings. In all other cases, a historical cost basis of accounting is used. Revenues and expenses are brought to account on an accrual basis.

Going concern

The Bank was exposed to significant valuation losses in its foreign currency reserves as a result of the appreciation of the PNG kina against other major currencies in the previous years. A portion of these valuation losses reversed during the year due to the depreciation of the PNG Kina. The Bank recorded a total comprehensive profit of K608.1 million (2012: profit of K39.7 million) and experienced operating cash inflows of K2,362.5 million (2012: cash flow of K37.3 million) for the year. In addition, total liabilities of the Bank exceeded its total assets by K592.8 million (2012: K1,201 million). The Bank envisages this net deficiency position to improve as a result of ongoing depreciation of the PNG kina in the near future. Despite the improvement during the year, the continuing net assets deficiency condition resulted in material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern and therefore it may not be able to realise its assets and discharge its liabilities in the normal course of business.

Section 50(2) of the CBA 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. On this basis, the Governor, Deputy Governor and the Board of Directors of the Bank believe that the preparation of the financial statements of the Bank on a going concern basis is appropriate.

The Bank has brought this matter to the attention of the Minister and has submitted a letter dated 2 May 2014 to the Minister requesting a promissory note. However this promissory note has not been provided to the Bank at the current time.

(b) Revised standards, amendments to existing standards and interpretations adopted by the Bank

The following new standards and amendments were applicable for the first time during the accounting period beginning 1 January 2013:

- Amendment to IAS 1, 'Financial statement presentation' (effective 1 July 2012) regarding other comprehensive income requires entities to separate items presented in other comprehensive income into two groups, based on whether they may be recycled to profit or loss in the future. This will not affect the measurement of any items recognised in the balance sheet or profit and loss in the current period.

-
- Amendments to IAS 19, 'Employee benefits' (effective 1 January 2013) require the recognition of all re-measurements of defined benefit liabilities/assets immediately in other comprehensive income (removal of the so-called 'corridor' method) and the calculation of a net interest expense or income by applying the discount rate to the net defined benefit liability or asset. The Bank has defined benefit pension scheme. Given that only limited number of employees contribute to this defined benefit plan, the impact on the financial statements is considered immaterial.
 - IFRS 10, 'Consolidated Financial Statements' (effective 1 January 2013) replaces all of the guidance on control and consolidation in IFRS 27 *Consolidated and Separate Financial Statements*, and SIC 12 *Consolidation – Special Purpose Entities*. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation. However the standard introduces a single definition of control that applies to all entities. It focuses on the need to have both power and rights or exposure to variable returns before control is present. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both. There is also new guidance on participating and protective rights and on agent/principal relationships. Management does not expect the new standard to have any impact on the Bank.
 - IFRS 11, 'Joint arrangements' (effective 1 January 2013) introduces a principles based approach to accounting for joint arrangements. The focus is no longer on the legal structure of joint arrangements, but rather on how rights and obligations are shared by the parties to the joint arrangement. Based on the assessment of rights and obligations, a joint arrangement will be classified as either a joint operation or joint venture. Joint ventures are accounted for using the equity method, and the choice to proportionately consolidate will no longer be permitted. Parties to a joint operation will account their share of revenues, expenses, assets and liabilities in much the same way as under the previous standard. As the Bank is not a party to any joint arrangements, this standard will not have any impact on its financial statements.
 - IFRS 12, 'Disclosures of interests in other entities' (effective 1 January 2013) includes the disclosure requirements for all forms of interest in other entities, including joint arrangements, associates, special purpose vehicles and other off-balance sheet vehicles. Application of this standard will not impact the Bank as it does not have any interest in other entities.
 - IFRS 13, 'Fair value measurement' (effective 1 January 2013) aims to improve the consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards. The Bank uses fair value measurement extensively, however, the application of the new standard will only impact the type of information disclosed in the notes to the financial statements. Fair value information are presented in Note 22(v).
 - IAS 27 (revised 2011) 'Separate financial statements' (effective 1 January 2013) is now a standard dealing solely with separate financial statements. The revised standard is not relevant to the Bank.
 - IAS 28 (revised 2011), 'Associates and joint ventures' (effective 1 January 2013) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. The Bank is not a party to any joint ventures.
 - Amendment to IFRS 7, 'Financial instruments: Disclosures' on offsetting financial assets and financial liabilities (effective 1 January 2013) enhance current offsetting disclosures. They are unlikely to affect the accounting for any of the Bank's current offsetting arrangements, but will require a number of additional disclosures in relation to those arrangements.

- Amendment to IFRS 1, 'First time adoption', on government loans (effective 1 January 2013) is not relevant to the Bank.
- Annual improvements 2011 (effective 1 January 2013) include minor changes to IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34. The Bank does not expect that any adjustments will be necessary as of result of applying the revised rules.
- IFRIC 20, 'Stripping costs in the production phase of a surface mine' (effective 1 January 2013) sets out the accounting for overburden waste removal (stripping) costs in the production phase of a surface mine. The interpretation may require mining entities to write off existing striping assets to opening retained earnings if the assets cannot be attributed to an identifiable component of an ore body. This interpretation is not relevant to the Bank.

Standards, amendment and interpretations issued but not yet effective for the year ended 31 December 2013 or adopted early

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the entity's accounting periods beginning on or after 1 January 2014 or later periods, but the entity has not early adopted them:

- IFRS 9, 'Financial Instruments' (effective date is open) is the first phase of replacing IAS 39, 'Financial Instrument' with a standard that is less complex and principles based. The new standard addresses the classification, measurement and derecognition of financial assets and financial liabilities. The standard is not expected to change the Bank's existing accounting policy for its financial assets and liabilities. IASB has also amended IFRS 9 to allow entities to early adopt the requirement to recognise in OCI the changes in fair value attributable to changes in an entity's own credit risk (from financial liabilities that are designated under the fair value option). This can be applied without having to adopt the remainder of IFRS 9.
- Amendments to IFRS 10, 'Consolidated financial statements', IFRS 12 and IAS 27 for investment entities (effective 1 January 2014) provides an exemption to investment entities from consolidating controlled investees. The Bank is not an investment entity and will not therefore be affected by these amendments.
- Narrow scope amendments to IAS 36 "Impairment of assets" (effective 1 January 2014) address the disclosure of information about the recoverable amount impaired assets if that amount is based on fair value less costs of disposal. The Bank has no such impaired assets.
- Amendments to IAS 32, "Financial Instrument: Presentation" (effective 1 January 2014). These amendments are to the application guidance in IAS 32 and clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet.
- Amendment to IAS 39, Financial instruments: Recognition and measurement, amendment in relation to "novation of derivatives" (effective 1 January 2014). This amendment provides relief from discontinued hedge accounting when novation of a hedging instrument to a central counter party meets specified criteria.
- IFRIC 21 "Levies" . This is an interpretation to IAS 37, "provisions, contingent liabilities and contingent assets. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have present obligation as a result of past event (known as obligating event). The interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.
- IFRS 9 "Hedge Accounting" (no effective date – the standard is available for immediate application"). IFRS 9 relaxes the requirements for hedge effectiveness and, consequently to apply hedge accounting. IFRS 9 replaces the 80%-125% hedge effectiveness test with a requirement for an economic relationship between the hedged item and hedging instrument, and for the 'hedged ratio' to be the same as the one that the entity actually uses for risk

management purposes. Hedge ineffectiveness will continue to be reported in profit or loss (P&L). An entity is still required to prepare contemporaneous documentation; however, the information to be documented under IFRS 9 will differ. The new requirements change what qualifies as a hedged item, primarily removing restrictions that currently prevent some economically rational hedging strategies from qualifying for hedge accounting. The standard provides an accounting policy choice for an entity to continue to apply hedge accounting (and hedge accounting only) under IAS 39 instead of IFRS 9 until the IASB completes its separate macro hedging project.

The Bank has conducted investigations and does not consider that there are any measurement or recognition issues arising from the release of these new pronouncements that will have a significant impact on the reported financial position or financial performance of the Bank.

(c) Foreign currency

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

Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to kina at foreign exchange rates prevailing at the dates the values were determined.

(d) Financial assets and liabilities

Definition of financial instruments

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

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

(i) Domestic government securities

The Bank holds inscribed stocks and Treasury bills with fixed coupon rates issued by the Government. They are accounted for on a fair value basis with reference to prices determined using valuation models, with valuations occurring on a monthly basis with all changes in fair value taken to profit in accordance with IAS 39. Interest earned on the securities is accrued over the term of the security and included as revenue in the statement of comprehensive income. Interest is received biannually at the coupon rate and the principal is received at maturity.

(ii) Foreign exchange holdings

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

(iii) Foreign exchange translation

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

(iv) Foreign government securities

Foreign government securities comprise coupon and discount securities and rarely securities held under repurchase agreements. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal of these securities is received at maturity. Interest earned on discount securities is the difference between the actual purchase cost and the face value of the security; this is amortised over the term of the securities. The face value is received at maturity. Foreign securities, except those contracted for sale under repurchase agreements, are classified under IAS 39 as ‘at fair value through profit and loss, as they are held for trading. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains are available for distribution. Interest earned on securities is accrued over the term of the security as revenue in the profit & loss.

(v) Foreign deposits

The Bank invests part of its foreign currency reserves in deposits with highly-rated international banks; it also maintains working accounts in foreign currencies. Deposits are classified as ‘loans and receivables’ under IAS 39 and recorded at their face value, which is equivalent to their amortised cost using the effective interest method. Interest is accrued over the term of deposits and is received periodically or at maturity. Interest accrued but not received is included in interest receivable in the statement of financial position.

Foreign exchange holdings, foreign governments and private securities and foreign bank deposits are included in foreign investments in note 9 to the financial statements.

(vi) Foreign currency forward contracts

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

(vii) Repurchase agreements

(a) Buy repurchase agreements – In the course of its financial market operations, the Bank engages in repurchase agreements involving foreign and domestic marketable securities. Securities purchased and contracted for sale under buy repurchase agreements are classified under IAS39 as ‘loans and receivables’ and valued at amortised cost. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue.

(b) Sell repurchase agreements – Securities sold and contracted for purchase under sell repurchase agreements are classified under IAS 39 as ‘at fair value through profit and loss’, as they are held for trading, and reported on the Balance Sheet within the relevant investment portfolio. The counterpart obligation to repurchase the securities is reported in Other Liabilities at amortised cost; the difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense.

(viii) Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilities under IAS 39. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of the deposits and paid periodically or at maturity. Interest accrued but not yet paid and the deposit liabilities are included in Note 14.

(ix) Central Bank Bills on issue

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

(x) Gold

Gold holdings which are on loan to other institutions are valued at the kina equivalent of the prevailing exchange rate at balance date. Unrealised gains and losses on gold are recognised in the gold revaluation reserve until such time as they are realised whereby they are recognised in profit and loss from ordinary activities. The Bank lends gold to financial institutions participating in the gold market. Gold holdings are a financial instrument and the Bank accounts for these in accordance with IAS 39 and reports these loans under IFRS 7.

(xi) 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.

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

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

(xiii) 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.

(e) 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.

(f) Property, plant and equipment

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

The range of useful lives used for each class of assets is:

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

(g) De-recognition

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

(h) 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.

(i) Inventory – Notes & Coins

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

(j) 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.

(k) Other receivables

Other receivables are stated at amortised cost.

(l) Employee benefits

(i) Pension Fund

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

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

(ii) Provision for Leave Entitlement

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

(m) Other liabilities

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

(n) Reserves

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

(i) Bank of Papua New Guinea Reserve Fund

The Bank of Papua New Guinea Reserve Fund was created under the *Central Banking Act 2000* Section 42, and represents reserves set aside as determined to meet contingencies which arise in the course of the Central Bank's operations in carrying out its functions.

(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.

(o) 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.

(p) Accounting estimates

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

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

(q) Tax Exemption

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

(r) Comparatives

Comparative financial information have been rearranged to conform to current year presentation where necessary.

(s) Rounding

Financial information has been rounded to the nearest thousand kina.

	2013 K'000	2012 K'000
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Note 2: INTEREST REVENUE – FOREIGN CURRENCY OPERATIONS

Foreign securities and bank deposits	138,011	174,001
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Interest income on foreign securities and bank deposits includes income of K40.9 million (2012: K44.5 million) in relation to investments managed by external fund managers.

Note 3: INTEREST REVENUE – DOMESTIC OPERATIONS

Inscribed stock and other Government securities	69,706	53,327
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Note 4: OTHER INCOME – DOMESTIC OPERATIONS

Licensing and other fees	10,117	2,531
Numismatic currency	501	317
Property rent	2,416	1,536
	13,034	4,384

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

Central Bank Bills issued	82,370	157,289
Other deposits held	1,421	1,538
	83,791	158,827

Note 6: GENERAL AND ADMINISTRATION EXPENSES

Staff costs	38,529	34,697
Staff training and development	2,030	2,142
Premises and equipment	13,305	13,213
Depreciation of property, plant and equipment	5,786	6,164
Amortisation of notes and coins production expenses	6,579	15,551
Currency distribution expenses	929	2,759
Audit fee	1,063	1,400
Travel	4,833	4,827
Legal & consultancy fees	5,284	4,049
Board & meeting expenses	930	487
Other expenses	9,622	6,974
	88,890	92,263

Notes to the Financial Statements

	2013 K'000	2012 K'000
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Note 7: IMF RELATED ASSETS & LIABILITIES

Assets

SDR holding	34,791	30,643
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Liabilities

IMF number 1 and 2 loan accounts	1,557	1,557
SDR allocation	467,499	405,256
	469,056	406,813

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

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

Note 8: CASH & CASH EQUIVALENTS

Foreign currency holdings – Nostro accounts	651,334	493,631
	651,334	493,631

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

Note 9: FINANCIAL ASSETS AT FAIR VALUE

Foreign investments	5,998,148	7,723,001
Derivative assets	14,898	20,072
	6,013,046	7,743,073

Foreign investments include K2.63 billion (2012: K2.26 billion) of investments managed by the external fund managers. The remainder of K3.38 billion (2012: 5.46 billion) is managed directly by the Bank.

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

Inscribed stock	746,038	602,103
Treasury bills	193,946	194,436
Accrued interest receivable on domestic securities	15,406	11,084
	955,390	807,623

Note 11: LOANS AND ADVANCES

Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	10,134	8,549
	11,520	9,935

Note 12: OTHER NON FINANCIAL ASSETS

Inventory notes and coins	41,772	34,861
Commemorative notes & coins and other receivables	6,282	3,034
Other non-financial assets	814	–
	3,034	3,588

In Kina (K'000)	Land and Buildings	Equipment	Motor Vehicles	Computer Equipment	Computer Software	Total
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Note 13: PROPERTY PLANT & EQUIPMENT

At 31 December 2012						
Cost	117,815	4,834	1,642	5,983	16,923	147,197
Accumulated depreciation	(5,482)	(2,796)	(682)	(4,098)	(2,213)	(15,271)
Net Book Amount	112,333	2,038	960	1,885	14,710	131,926
Year end December 2013						
Opening net book amount	112,333	2,038	960	1,885	14,710	131,926
Additions	2,148	1,285	632	88	4,938	9,091
Depreciation charges	(3,739)	(316)	(336)	(614)	(781)	(5,786)
Revaluation gain	15,606	–	–	–	–	15,606
Closing Book Amount	126,348	3,007	1,256	1,359	18,867	150,837
At 31 December 2013						
Cost	126,348	6,119	2,274	6,071	21,861	162,673
Accumulated depreciation	–	(3,112)	(1,018)	(4,712)	(2,994)	(11,836)
Net Book Amount	126,348	3,007	1,256	1,359	18,867	150,837

In 2013 the Bank engaged the services of independent professional valuers for the valuation of its properties. The valuations were made on the basis of open market value. The revaluation surplus was credited to the Property Valuation Reserve in the equity section of the statement of financial position. As stated in note 1(f), the Bank's policy is to carry its land and buildings at their fair market values determined every three years by independent professional valuers.

The deferred cost on computer software is the net cost of the Opics system since going live upon completion in May 2010, plus accumulated cost of work-in-progress for payment and data warehouse systems. These costs will be amortised over a period of 13 years, which is in line with the life of the licence.

Additions to computer software during the year pertain primarily to capitalised cost incurred in relation to the Kina Automated Transfer System (KATS). In October 2013, the Bank successfully rolled-out the phase 1 implementation of KATS which allow commercial banks to process electronic payments/transfers against their exchange settlement accounts (ESA) in real time. KATS also allows the commercial banks to view their respective ESA and cash reserve requirement balances in real time to facilitate reconciliation.

	2013 K'000	2012 K'000
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Note 14: DEPOSITS FROM BANKS & THIRD PARTIES

Banks

Exchange settlement accounts	486,466	750,779
Cash reserve requirement	1,656,268	1,390,852
Other deposits	8,450	8,992
Total	2,151,184	2,150,623

Notes to the Financial Statements

	2013 K'000	2012 K'000
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Note 15: SECURITIES ISSUED

Central Bank Bills issued	3,190,336	5,328,704
Accrued interest payable on domestic securities	8,650	17,242
	3,198,986	5,345,946

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

Interest on securities issued varied between 1.84% and 3.17% during the year (2012: 1.90% and 3.50%).

Note 16: CURRENCY IN CIRCULATION – DOMESTIC LIABILITY

Currency in circulation	1,749,226	1,679,329
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Currency in circulation represents currency issued having a claim on the Bank of Papua New Guinea. The liability for currency in circulation is recorded at its fair value in the statement of financial position.

Note 17: OTHER FINANCIAL LIABILITIES

Foreign currency:

Derivative liabilities	12,463	10,179
Foreign currency deposits	3,579	2,326
	16,042	12,505

Local currency:

Expense creditors and cheques in the process of collection	40,772	46,161
Other liabilities	4,304	8,499
	45,076	54,660

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

Note 18: PROVISIONS FOR EMPLOYEE ENTITLEMENTS

Balance as at 1 January	13,457	11,082
Charged to Statement of Comprehensive Income	6,023	6,003
Utilised during the year	(4,395)	(3,628)
Balance as at 31 December	15,085	13,457

	2013 K'000	2012 K'000
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Note 19: SHARE CAPITAL AND OTHER RESERVES

At 31 December 2013 the authorised and subscribed capital of the Bank was K145.5 million (2012: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

At the beginning of the year	145,540	145,540
At the end of the year	145,540	145,540
Other Reserves:		
Property revaluation reserve	98,680	83,074
Unrealised profit/(loss) reserve	(1,124,907)	(1,642,502)
Gold revaluation reserve	101,553	129,516
Retained earnings	186,277	83,369
Total other reserves	(738,397)	(1,346,543)

Note 20: RECONCILIATION OF NET PROFIT TO OPERATING CASH FLOW

Total profit/(loss) for the year	608,146	39,748
Add /(Subtract) Non-Cash Items		
Depreciation	5,786	6,164
Provisions for staff entitlements	1,628	2,376
Net unrealised gain/(loss) on gold	27,963	(7,202)
Net unrealised market value changes	28,743	(76,602)
Add /(Subtract) Movements in Other Financial Assets		
Decrease/(increase) in interest receivable	(3,582)	5,217
(Decrease)/increase in interest payable	(8,593)	(13,935)
(Increase)/decrease in foreign investment including derivatives	1,742,384	50,446
(Increase)/decrease in other receivable	(12,558)	5,244
Increase/(decrease) in other payables	(27,453)	25,803
Net Cash Flow from Operating Activities	2,362,464	37,259

Note 21: 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 22: RISK MANAGEMENT

Note 22(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.

Notes to the Financial Statements

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

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

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

The Bank is subject to an annual audit by an external auditor. Auditing arrangements are overseen by an Audit 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 22(ii): Credit Risk

Credit risk is the risk of loss arising from a counterparty to a financial contract failing to discharge its obligations.

(a) Credit Risk Management

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:

	2013 K'000	2012 K'000
Papua New Guinea Government	955,390	807,623
Other Government Institutions	1,386	1,386
Foreign Governments, Banks and Financial Institutions	6,865,355	8,460,353
Other	10,134	8,549
Total financial assets	7,832,265	9,277,911

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the statement of financial position.

Credit exposures arising from securities under agreements to re-sell (reverse repurchase agreements) are classified according to the issuer of the credit exposure of the security for credit exposure concentration purposes.

24% (2012: 44%) of the total assets have a credit rating of A-1+ in short term investments and 50% (2012: 43%) of long term investments have a credit of AA or above.

(c) Credit Exposure by Credit Rating

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

Investment in Financial Assets	2013 K'000	% 2013 Financial Asset	2012 K'000	% 2012 Financial Asset
Short term:				
AAA	164,003	3	–	–
AA+	63,591	1	–	–
AA-	197,349	3	–	–
A	38,061	1	–	–
A-1+	992,144	17	3,436,052	44
A-1	299,539	5	197,225	3
A-2	418,872	7	15,468	0
A-3	197,954	3	–	–
B	23,390	–	–	–
NR	5,532	–	9,234	0
	2,400,435	40	3,657,979	47
Long term:				
AAA	1,530,481	26	1,995,505	26
AA+	251,147	4	339,839	4
AA	1,281,341	20	1,024,947	13
AA-	335,047	6	615,914	8
A+	18,364	–	48,497	1
A	15,429	–	5,158	0
A-1+	18,872	1	–	–
BBB	211,218	4	77,999	1
BB	–	–	20,990	0
NR	1,249	–	–	–
	3,600,148	60	4,128,849	53
Total Financial Assets	6,000,583	100	7,786,828	100

Notes to the Financial Statements

Note 22(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 of Papua New Guinea foreign exchange reserve management and investment functions are guided by an Investment Committee. The decision of the Investment Committee and dealing practices approved by the Investment Committee serve as operational guidelines for the Bank's reserve management and investments. The guidelines are directed towards managing different types of risks, while earning a reasonable return. There is an approved benchmark for investment in terms of currency composition, portfolio duration and proportion of different assets within a 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.

As at 31 December 2013 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

As at 31 December 2013	CURRENCY OF DENOMINATION								
	USD K'000	Gold 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 Financial Assets									
Foreign currency	170,838	–	165,336	82,845	145,602	86,046	–	667	651,334
Investments	1,658,678	–	1,732,698	1,623,882	292,801	558,793	–	131,296	5,998,148
Assets held with IMF	–	–	–	–	–	–	34,791	–	34,791
Derivative assets	14,898	–	–	–	–	–	–	–	14,898
Accrued interest	5,541	–	13,180	16,778	4,381	1,160	–	1,975	43,015
Other assets	–	123,169	–	–	–	–	–	–	123,169
	1,849,955	123,169	1,911,214	1,723,505	442,784	645,999	34,791	133,938	6,865,355
Foreign Currency Financial Liabilities									
Liabilities with IMF	–	–	–	–	–	–	469,056	–	469,056
Foreign currency liabilities	16,042	–	–	–	–	–	–	–	16,042
	16,042	–	–	–	–	–	469,056	–	485,098
Net Foreign Currency Exposure	1,833,913	123,169	1,911,214	1,723,505	442,784	645,999	434,265	133,938	6,380,257

As at 31 December 2012	CURRENCY OF DENOMINATION								
	USD K'000	Gold 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 Financial Assets									
Foreign currency	181,402	–	66,222	32,436	128,834	83,873	–	864	493,631
Investments	3,908,216	–	1,196,816	2,034,895	281,708	285,032	–	–	7,706,667
Assets held with IMF	–	–	–	–	–	–	30,643	–	30,643
Derivative assets	20,072	–	–	–	–	–	–	–	20,072
Accrued interest	10,329	–	10,216	8,069	748	14,393	–	–	43,755
Other assets	–	149,251	–	–	–	–	–	16,335	165,586
	4,120,019	149,251	1,273,254	2,075,400	411,290	383,298	30,643	17,199	8,460,354
Foreign Currency Financial Liabilities									
Liabilities with IMF	–	–	–	–	–	–	406,813	–	406,813
Foreign currency liabilities	12,371	–	–	–	–	–	–	134	12,505
	12,371	–	–	–	–	–	406,813	134	419,318
Net Foreign Currency Exposure	4,107,647	149,251	1,273,253	2,075,400	411,290	383,298	376,170	17,065	8,041,036

The functional currency of all operations is PNG 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 balance sheet date to the contractual maturity date.

Notes to the Financial Statements

	Balance Total K'000	MATURITY PERIOD				
		0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity
As at 31 December 2013						
Liabilities in 2013						
Foreign Currency Financial Liabilities						
Liabilities with IMF	469,056	–	–	–	–	469,056
Foreign currency liabilities	16,042	16,042	–	–	–	–
	485,098	16,042	–	–	–	469,056
Local Currency Financial Liabilities						
Deposits from banks and third parties	2,151,184	2,151,184	–	–	–	–
Deposits from Government	980,172	980,172	–	–	–	–
Securities issued	3,211,098	1,117,504	2,093,594	–	–	–
Currency in Circulation	1,749,226	–	–	–	–	1,749,226
Other financial liabilities	45,076	45,076	–	–	–	–
	8,136,756	4,293,936	2,093,594	–	–	1,749,226
Total Liabilities	8,621,854	4,309,978	2,093,594	–	–	2,218,282
As at 31 December 2012						
Liabilities in 2012						
Foreign Currency Financial Liabilities						
Liabilities with IMF	406,813	–	–	–	–	406,813
Foreign currency liabilities	12,505	12,505	–	–	–	–
	419,318	12,505	–	–	–	406,813
Local Currency Financial Liabilities						
Deposits from banks and third parties	2,150,623	2,150,623	–	–	–	–
Deposits from Government	985,402	985,402	–	–	–	–
Securities issued	5,366,932	3,504,332	1,862,600	–	–	–
Currency in circulation	1,679,329	–	–	–	–	1,679,329
Other financial liabilities	54,660	54,660	–	–	–	–
	10,236,946	6,695,017	1,862,600	–	–	1,679,329
Total Liabilities	10,656,264	6,720,980	1,862,600	–	–	2,086,142

Note 22(iv): Sensitivity Analysis

At 31 December 2013, if interest rates had been 10% lower with all other variables constant, profit for the year would have been K65.1 million higher and the net deficiency in equity at year end would have been K65.1 million lower (2012: K58.1 million). Conversely, if interest rates had been 10% higher with all other variables held constant, the profit for the year would have been K60.9 million lower and the net assets deficiency at year end would have been K60.9 million higher (2012: K55.2 million).

At 31 December 2013, if the kina had weakened by 10 per cent against the principal currencies in its foreign reserves portfolio with all other variables held constant, profit for the year would have been K625.7 million higher, (2012: K804.1 million). Conversely if the kina had strengthened 10 per cent against the same currencies with all other variables held constant the Bank would have experienced a decrease in the profit for the year of K625.7 million, (2011: K804.1 million).

Note 22(v): Fair Value

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

	2013 K'000	2012 K'000
Financial Assets		
At fair value through profit/(loss)	7,126,396	8,730,590
Loans and receivables	705,869	547,321
	7,832,265	9,277,911
Financial Liabilities		
At fair value through profit/(loss)	481,519	419,318
At amortised cost	8,568,245	10,229,417
	9,049,764	10,648,735

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

FAIR VALUE HIERARCHY

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

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

Notes to the Financial Statements

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. The table below shows the Bank's assets and liabilities in their applicable fair value level.

31 December 2013	Level 1 K'000	Level 2 K'000	Level 3 K'000	Total K'000
Financial assets held at fair value through profit and loss				
– Domestic Government securities (Inscribed Stock)	–	–	939,984	939,984
– Foreign Government and semi-Government bonds	2,052,910	–	–	2,052,910
– Money market instruments	–	1,327,449	–	1,327,449
– Derivatives managed by external fund managers	–	14,898	–	14,898
– Investments in bonds and other instruments managed by external fund managers	2,617,789	–	–	2,617,789
– Gold	123,169	–	–	123,169
– Assets held with IMF	34,791	–	–	34,791
Total assets	4,828,659	1,342,347	939,984	7,110,990
Financial liabilities held at fair value through profit and loss				
– Derivatives	–	12,463	–	12,463
– Liabilities with IMF	469,056	–	–	469,056
Total liabilities	469,056	12,463	–	481,519

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.



Installing the Bank's note shredding machine

31 December 2012	Level 1 K'000	Level 2 K'000	Level 3 K'000	Total K'000
Financial assets held at fair value through profit and loss				
– Domestic Government securities (Inscribed Stock)	–	–	796,539	796,539
– Foreign Government and semi-Government bonds	2,704,079	–	–	2,704,079
– Money market instruments	–	2,805,385	–	2,805,385
– Derivatives managed by external fund managers	–	20,072	–	20,072
– Investments in bonds and other instruments managed by external fund managers	2,257,293	–	–	2,257,293
– Gold	149,251	–	–	149,251
– Assets held with IMF	30,643	–	–	33,464
Total assets	5,141,266	2,825,457	796,539	8,763,262
Financial liabilities held at fair value through profit and loss				
– Derivatives	–	10,180	–	10,180
– Liabilities with IMF	406,813	–	–	406,813
Total liabilities	406,813	10,180	–	416,993

The following table presents the changes in Level 3 instruments (excluding the accrued interest) for year ended 31 December 2013:

	Level 3 K'000
Opening balance	796,539
Investments net of maturities	172,148
Fair value revaluation gains/(losses) on level instruments	(28,703)
Closing balance	939,984
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.	(28,703)

The following table presents the changes in Level 3 instruments for year ended 31 December 2012:

	Level 3 K'000
Opening balance	437,165
Investments net of maturities	282,772
Fair value revaluation gains/(losses) on level 3 instruments	76,602
Closing balance	796,539
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.	76,602

Note 23: EVENTS AFTER THE BALANCE DATE

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

Note 24: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2013 (2012 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 is 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 25: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

Note 26: 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 25 in total (2012: 21), including the Governor, Deputy Governor Regulation, 4 Assistant Governors, 7 non-executive Board members and 12 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 CBA. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

	2013 K'000	2012 K'000
Short term benefits	6,693	5,966
Post employment benefits	832	612
Other long term benefits	2,709	2,437
	10,234	9,015

Short term benefits include cash salary and in the case of staff, annual leave and motor vehicle and housing benefits.

Post employment benefits include superannuation benefit payments. Other long term benefits include long service leave.

The components of benefits are reported on an accruals basis.

As at 31 December 2013 the loans owed by the key management personnel to the Bank were K1,716,077 (2012: K1,688,387).

Note 27: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,063,500 (2012: K1,400,000). 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 28: 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 CBA in actively participating in Bank's decision and policy formulations. All related party transactions are carried out with reference to market rates. Transactions entered into include:

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

Declaration by Management

In our opinion the foregoing Statement of Financial Performance and Statement of Financial Position, 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 2013.

Going concern

The Bank recorded a total comprehensive profit of K608 million (2012: profit of K39.7 million) and experienced positive operating cash flows of K2,363 million (2012: positive cash flow of K37.3 million) for the year. In addition, total liabilities of the Bank exceeds its total assets by K593 million (2012 – net deficiency of K1,201 million). The net deficiency of the Bank reduced during the year as a result of the depreciation of PNG kina. The Bank envisages the net deficiency position to further improve as a result of the depreciation of PNG kina in the immediate future.

Safeguard available to the Bank

Section 50(2) of the *Central Banking Act 2000* (CBA) 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. This is a statutory obligation imposed on the Minister to ensure the viability of the Central Bank.

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).

The above provisions effectively require the Government to provide financial support to the Bank to the extent determined by the Bank's Board. Such financial assistance need not involve any cash flow.

Steps taken by the Bank and other mitigating factors

Building Capital and Reserves

In 1996, the Board of the Bank had approved the retention of part of the operating profits to build up capital and reserves for the Bank and continues to build its capital and reserves.

The Bank reported a distributable profit of K22 million for the year 2010. The Board recommended retaining that profit as part of the Bank's Capital and Reserves. Subsequent to the Board's endorsement, the Bank corresponded the same with the then Minister for Treasury, citing as well that the Government's 2011 budget had required no dividends from the Bank. However, the Bank was subsequently directed by a National Executive Council (NEC) Decision in September 2011 to pay the K22 million as dividends. The Bank intends to work with the Government in order to strengthen its capital and reserves.

Promissory Note

In the June 2011 meeting the Board of the Central Bank had determined that Section 50(2) of the CBA be invoked. There has since been continuous dialogue between the Bank, the Secretary for Treasury and the Minister requesting payment from Consolidated Revenue combined with the issue of a Promissory Note to the Bank.

The Bank has submitted a letter dated 2 May 2014 to the Minister following up on the Bank's request for a Promissory Note. A formal response has not been received for this request at the time of signing the financial statements.

Operation of TAP facility on behalf of the Government

In 2011 the Bank also initiated dialogue with the Treasury Department on the option of operating a TAP facility on behalf of the Government. This option was put forward as a means of reducing the Bank's major domestic liability of Central Bank Bills, by shifting some liquidity management burden to the Government, thereby easing pressure on the Bank's liquidity management operation, hence a healthier net position. The Treasury Department has subsequently issued a one-year Treasury Bill for face value of K200 million in August 2012. This Bill was rolled over in August 2013 for another 12 months to August 2014. The Bank has now been on-selling the K200 million Treasury Bill in smaller issues affordable to small-to-medium Investors through the TAP Facility.

Movement of Trust Accounts from Commercial Banks

Externally held trust funds continue to have an adverse impact on the liquidity management operations of the Bank. The Bank approached the Government to consider moving all trust accounts in commercial banks back to Bank of PNG resulting in the transfer of K200 million in 2012. Although there was no transfer of trust accounts to the Bank during 2013, the Bank continues to advise Government to do so going forward.

Resources Sector gains to be held as Reserves by the Bank

Discussions have been underway between the Bank and the Government on the possibility of the Government placing excess funds from the LNG operations and other mining and petroleum operations in the custody of the Bank to manage offshore in addition to the Bank's current in-house managed and externally managed foreign reserves. A final outcome of this dialogue is still pending. It is expected that the Bank may function as the secretariat for the operation and management of Government's Sovereign Wealth Fund.

The Bank will continue the dialogue with the appropriate Government authorities to ensure the Bank's net deficiency position and ensuing implications on going concern as well as stakeholder confidence are fully appreciated and addressed in a timely manner. On this basis, we believe that the preparation of the financial statements of the Bank on a going concern basis is appropriate.

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



Loi M Bakani
Governor

14 May 2014



Benny Popoitai MBE
Deputy Governor

Report of the Auditor-General



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Our Reference: 30-13-4

The Honourable Patrick Pruaitch, MP
Minister for Treasury
Office of the Minister
Vulupindi Haus - 4th Floor
PO Box 542
WAIGANI, NCD

INDEPENDENT AUDITOR'S REPORT ON THE *BANK OF PAPUA NEW GUINEA* FOR THE YEAR ENDED 31 DECEMBER 2013

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2013** as set out on pages **2 to 28** which comprise the statement of financial position as at 31 December, 2013, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Bank Board's Responsibility for the Financial Statements

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

Responsibility of the Auditor-General

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the *Audit Act, 1989 (as amended)* and *International Standards on Auditing*. These standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements as to whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements that give a true and fair view of the matters to which they relate to, 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

AUDIT OPINION

In my opinion:

- (a) the financial statements are based on proper accounts and records;
- (b) the financial statements are in agreement with those accounts and records and give a true and fair view of the financial position of the Bank as at 31 December, 2013 and its financial performance and cash flows for the year then ended; and
- (c) I have obtained all the information and explanation that were required.


PHILIP NAUGA
Auditor-General

30 May, 2014

Report of the Auditor-General



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Our Reference: 30-13-4

The Honourable Patrick Pruaitch, MP
Minister for Treasury
Office of the Minister
Vulupindi Haus - 4th Floor
PO Box 542
WAIGANI, NCD

BANK OF PAPUA NEW GUINEA

In accordance with the provisions of *Section 8(2) of the Audit Act, 1989 (as amended)*, I have inspected and audited the accounts and records of the financial transactions and records relating to the assets and liabilities and assets in the custody of the **Bank of Papua New Guinea** for the year ended **31 December, 2013**.

My report on the financial statements of the Bank together with a copy of the financial statements was forwarded to you on 27 May, 2014. The report did not contain any qualification.

OTHER MATTER

I wish to bring to your attention the following matter which, in my opinion, is important.

1. Net Asset Deficiency – Going Concern

The Bank has a net capital deficiency as at 31 December, 2013 where the Bank's total liabilities exceeded its total assets by K593 million. The capital deficiency along with other matters set forth in Note 1(a) indicated the existence of a material uncertainty that may cast doubt about the Bank's ability to continue as a going concern and therefore the Bank may be unable to realize its assets and discharge its liabilities in the normal course of business.

The Bank has brought this matter to the attention of the Minister for Treasury and has submitted a letter dated 2 May, 2014 to the Minister requesting a promissory note for the net asset deficiency. At the time of issuing this report the promissory note has not been provided to the Bank.



PHILIP NAUGA
Auditor-General

27 May, 2014

notes

