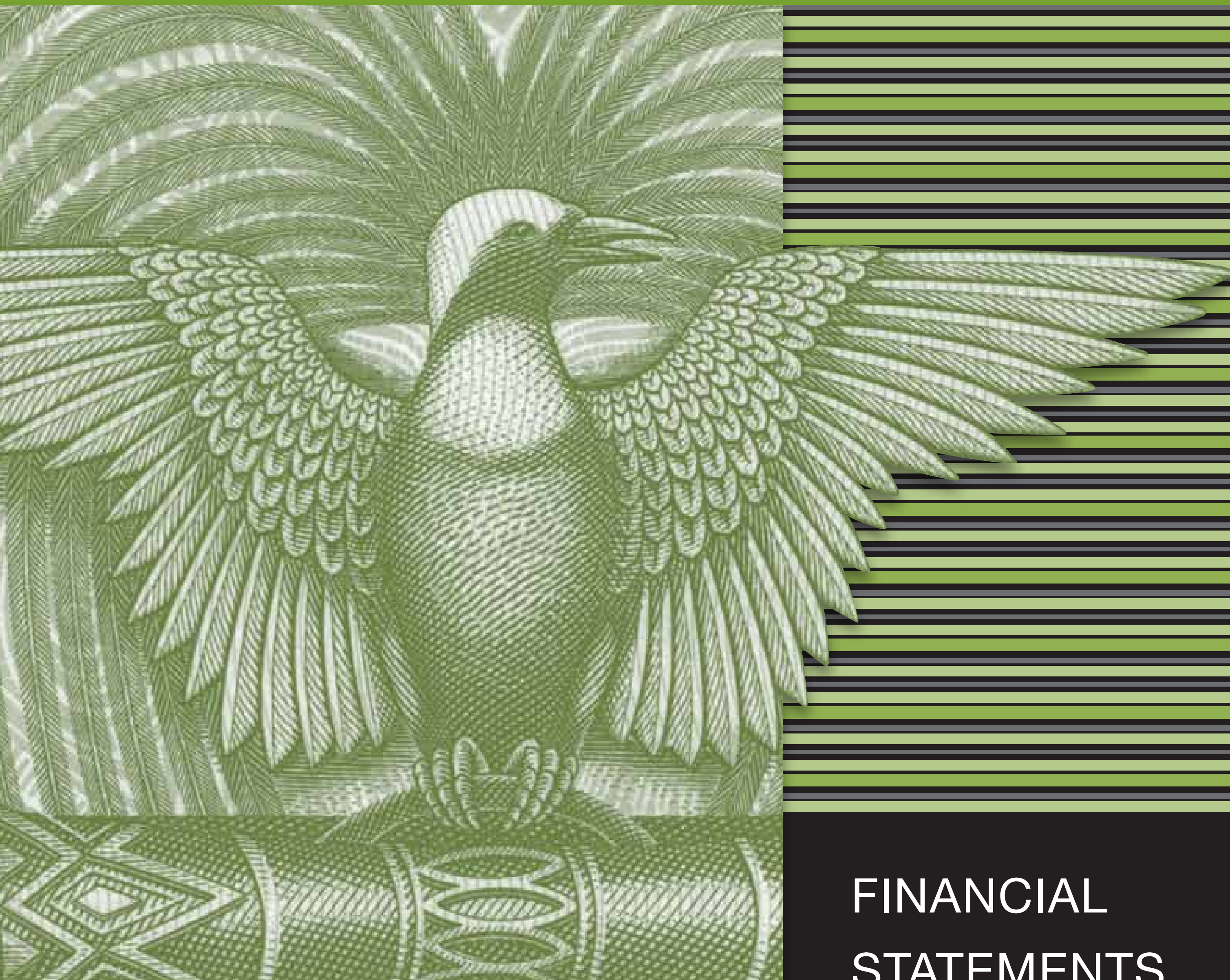
Bank of Papua New Guinea



FINANCIAL STATEMENTS

31 DECEMBER 2014

Bank of Papua New Guinea

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2014

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

2014 was a milestone year for Papua New Guinea with the production and export from the country's first Liquefied Natural Gas (LNG) project. It was also the second year of a large National budget to support economic activity in the light of the winding down of the construction phase of the LNG project, which drove activity over the past five years.

These developments posed challenges and opportunities for the Bank of Papua New Guinea during the year. Nonetheless, we continued to perform well on our objectives of price stability, supervision of the financial system and improving the national payments system. At the same time, we have made further progress with the implementation of our 2012 – 2015 Strategic Plan.

I am pleased to present in this Annual Report a summary of our activities and achievements towards our mandated objectives stated in the *Central Banking Act 2000*. Consistent with the theme of the 2014 Annual Report of "moving forward with inclusive financial services" and the fourth objective of the Bank in supporting economic growth, the Report also outlines our efforts and achievements in driving financial inclusion activities during the year.

The challenges we faced in the domestic environment in 2014 were compounded by developments abroad. The PNG economy continued to grow for the 13th consecutive year and inflation remained below forecasts. The growth mainly reflected the start of LNG production and export, the full production of nickel and cobalt as well as increased activity in the non-mineral sector. The Government's fiscal stimulus also supported economic activity following the end of the construction phase of the LNG project.

Low international commodity prices and high demand for imported goods and services contributed to a depreciation of the kina against the major currencies, especially the US dollar. The kina continued to depreciate sharply despite the Bank's frequent intervention to supply foreign currency. Following the restriction of placing Forward Orders in the interbank market in October and December 2013, the interbank exchange rate was stabilised at 0.4130 USD/PGK, while banks traded away at much wider margins with their customers.

Accordingly, in June 2014 the Bank introduced an exchange rate trading band, setting the buy and sell margins at 75 basis points on either side of the interbank mid-rate. The floating exchange rate régime was maintained, whilst the trading band was designed to instil order in the price setting mechanism in the foreign exchange market. Between the introduction of the band and the end of December 2014, the interbank rate depreciated by 14.0 percent.

The high level of liquidity in the banking system continued to be an issue. Although this has not had any inflationary impact, the excess liquidity has weakened the monetary policy transmission mechanism. To help absorb some of the excess liquidity the Bank increased the Cash Reserve Requirement (CRR) to 10.0 percent in September 2014.

During the year the Bank continued to make good progress towards implementing the strategic plan adopted in 2011. The second phase of the National Payments System project, automating the cheque clearing process ('cheque truncation') was launched. Together with the real time gross settlement of financial transactions at the bank-to-bank level in the first phase, our domestic payments system is now in line with international standards, and on par with the rest of the world.

I am proud of our on-going achievements on the financial inclusion agenda, through the implementation of the *National Strategy for Financial Inclusion and Financial Literacy 2014 – 2015*. The Strategy aims to have 1 million accounts opened over the two years, with 50 percent by women. During the year we continued to extend financial literacy programs and expanded access to financial services to support economic growth, with ongoing participation by financial service providers and other key stakeholders. We also continued to drive *Youth Savings Campaign*, to educate our youngsters on financial management and create a savings culture for the next generation. Together with the advancement of our National Payments System, these activities are important in enhancing inclusive financial services for the unbanked population.

In November 2014 the Bank hosted a very successful SEACEN Board of Governors meeting and conference.

Our Board and the various Board sub-committees continued to perform well in meeting their charters. During the year, we had two board meetings outside Port Moresby, one in Madang and the other in Kokopo. These meetings provide opportunities for the Board and senior management members to have first-hand experiences of activities outside Port Moresby, and to interact with citizens and business houses on national and central bank matters.

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

> "...we will continue to improve and maintain a high standard and quality of performance."

I would like to encourage management and staff of the Bank to remain focused on and committed to implementing our strategic plan and keeping 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 cannot be achieved without a dedicated and skilled workforce. The Bank acknowledges the importance of our human resource development and provides continuous training and development to improve their skills and knowledge. During 2014 a good number of Bank staff attended industry-related courses, seminars, workshops and conferences while others undertook post graduate studies, both in PNG and overseas.

Finally, I wish to thank my fellow Board members for their invaluable contribution and support during the year 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 and
Registrar of Savings and Loan Societies

Highlights

KATS Phase 2 Launched

The second phase of the kina Automated Transfer System (KATS), which involved cheque truncation (see page 27) and enhancement of the Bank's internal payments and accounting processes (see page 27) through the Bank Services System (BSS), was launched during 2014.

The implementation of these KATS milestones was a significant move towards achieving an effective national payment system for Papua New Guinea.

SEACEN Activities

South East Asian Central Banks (SEACEN) is the peak body for central banks in the Asia-Pacific region. It delivers learning programs, fosters research work and provides networking and collaboration opportunities to promote and share central banking knowledge. During 2014 the Bank of Papua New Guinea actively participated in SEACEN conferences, learning programs and research work.

Conferences

The Bank played a key role in SEACEN activities in 2014. This included hosting the 9th SEACEN-CeMCoA/BOJ training course on payment and settlement systems in February that coincided with the 50th SEACEN Conference and High-Level Seminar themed "Regional Initiatives in the Midst of Vulnerabilities" and the 34th Meeting of the SEACEN Board of Governors in November 2014.

Participants in the Conference were Autoriti Monetari Brunei Darussalam, National Bank of Cambodia, People's Bank of China, Reserve Bank of Fiji, Hong Kong Monetary Authority, Reserve Bank of India, Bank Indonesia, The Bank of Korea, Bank of the Lao PDR, Bank Negara Malaysia, The Bank of Mongolia, Central Bank of Myanmar, Nepal Rastra Bank, Bank of Papua New Guinea, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore, Central Bank of Sri Lanka, Central Bank of Chinese Taipei, Bank of Thailand and State Bank of Vietnam.

SEACEN training and development

Bank staff members attended the 35th SEACEN Directors of Research Training Conference in Bali and SEACEN Intermediate Leadership Training in Brunei.

SEACEN Training Centre activities

During 2014 the Bank participated in two research projects in collaboration with the SEACEN Training Centre. These were:

– Building on the counter-cyclical capital buffer consensus: an empirical test, and

– Advancing inclusive financial system in the next decade: the case of mobile banking in Papua New Guinea.

The Bank of PNG has made significant advances towards achieving a paperless office. During 2014 tablet computers replaced paper-based information for Board and Executive Committee meetings, SEACEN conferences, workshops and seminars.

Commemorative Stamp Issue

Marking 40 years of the Bank's operation, a commemorative stamp issue, featuring past and present Governors of the Bank was released during the year. (See page 34)

Kina Trading Band Introduced

The Bank introduced the exchange rate trading band in June 2014 to instil discipline in exchange rate setting and trading by authorised foreign exchange dealers. (See page 20)

Financial Expos and Financial Awareness

The Bank hosted Financial Expos and conducted numerous financial awareness campaigns during the year. Over 42,000 visitors attended Financial Expos during 2014. (See page 33)

Brainstorming for 2016-2019 Strategic Plan

The Bank conducted inhouse meetings with staff and the Board members to brainstorm the new Strategic Plan for 2016-2019.

Mission Vision Values

Mission

The Bank of Papua New Guinea's MISSION is to serve the people of Papua New Guinea by conducting effective monetary policy and maintaining a sound financial system. We will act at all times to promote macro-economic stability, provide a first class payments system 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 2014

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

The Bank of Papua New Guinea has an essential role in ensuring the integrity of the PNG financial system. The Bank's governance structure and practice is key to this role.

Development and implementation of monetary policy, financial system regulations and national payment system are the exclusive responsibility of the Governor. The Bank's Board is responsible for the Bank's operational policies.

Board members are drawn from a range of interest groups within the PNG community – civil, church, regulatory, workers union and industry bodies.

The Board

Governors

Governor and Chairman

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 Loans 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, Chairman of the Board of Governors of South East Asian Central Banks (SEACEN) in 2014/15, the Co-chair of the National Coordinating Committee for AML-CTF and Deputy Chairman of the Secretaries Committee on Sovereign Wealth Fund. He is also a Member of the PNG Institute of Directors (PNGID) and Deputy Chairman of the Advisory Board of Port Moresby Senior AFL Competition.

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

Deputy Governor

Benny Popoitai MBE

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

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

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

Members of the Board

Mr John Leahy

Mr Leahy was appointed *ex officio* to the Board in March 2008, in his capacity of 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.

He has been admitted to practise law in both NSW and PNG. Mr Leahy is presently in private practice as a lawyer 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. His term as Board Member concluded in November 2014, at which time Mr Daniel Biti was appointed President of CPA PNG.

Dr Ngangan is also Chairman of the Board of National Teachers Insurance Limited (NTIL), Chairman of Motor Vehicles Insurance Limited (MNIL) and Deputy Chairman of National Development Bank.

He 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 Laws degree 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 degree 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 as a legal practitioner, he advises leading PNG companies on tax and employment matters.

Mr Waninara holds a Bachelor of Laws degree 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 2014 meeting was held in Madang, Madang Province. The June and December meetings were held in Port Moresby, National Capital District. The September meeting was held in Kokopo, East New Britain 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	3
Dr Ken Ngangan	3	3
Fr Denny Bray Guka	4	4
Mr Alex Tongayu	4	4
Mr Bart Philemon	4	2
Ms Betty Palaso	4	2
Mr Himson Waninara	4	4

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.

In line with best practice, the Committee comprised four non-executive directors. Dr Ken Ngangan chaired the Committee until November 2014. The members of the Committee were Mr John Leahy, Mr Alex Tongayu and Mr Bart Philemon.

Internal Committees

Several internal committees continued through 2014, each with specific roles and responsibilities to ensure probity of the Bank's various activities. They included the Monetary Policy Committee, the Money Market Operations Committee, the Investment Committee, the Tender Committee and the Budget Committee.

During 2014 the Bank established a new committee comprised of the four Assistant Governors to oversee tender and procurement processes. As part of achieving the objective of improving efficiency and accountability in purchasing goods and services, the Bank also introduced an online procurement system during the year.

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 2014 the Bank's internal audit focus was on several significant reviews, including:

- post-implementation review of the upgrade to the Bank's Local Area Network
- procurement, expenditure and tendering processes
- corporate governance and risk management
- KATS
- management reporting associated with miscellaneous payments.

Risk Management

The Bank has been operating 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 its core functions – monetary policy, financial stability and payment system – and has relevant policies and an effective framework to mitigate these risks.

During 2014 risk management activities included:

- Transition of the Bank's Business Continuity Management response from a strategic project to implementation as an ongoing functional responsibility. With fully documented Business Continuity and Disaster Recovery Plans in place, BPNG achieved compliance with Basel II requirements.
- Identification and assessment of risks and formulation of comprehensive risk profiles for the functional units within the Bank's support services, including corporate affairs, information technology, human resources and building and facilities functions.

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.

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 threats to the financial and payments systems.

Setting the Right Example

The Bank's Values Statement provides clear guidance to Bank employees to conduct themselves with the highest standard of behaviour.

Financial Performance

Under the terms of the *Central Banking Act 2000* (CBA), the Board in consultation with the Minister determines the distribution of the Bank's operating profit.

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

Operating Income

Total operating income for the year ended 31 December 2014 was K270 million, compared with K280 million in 2013. The income was derived mainly from interest on overseas investments, fees and commissions on foreign exchange trading and interest on domestic investments in government securities.

Operating Expenditure

Total operating expenditure, comprising interest expense and general administration costs, was K181 million, up K4 million from 2013. The increase in expenditure was largely due to higher general administration costs, consisting of staff costs, Bank premises and equipment costs, as well as production and circulation of currency notes and coins.

Net Operating Profit

The Bank recorded a net operating profit of K89.7 million for the 2014 year, compared to an operating profit of K102.9 million in 2013.

Unrealised Gain/ (Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K42.2 million for the year ended 31 December 2014, which was transferred to the Unrealised Profits/(Loss) Reserve. This was a direct result of the depreciation of the kina against most major currencies during the financial year. Gold valuation gain of K7.6 million was transferred to the Gold Reserve.

Appropriation

In line with the provisions of the CBA, the Bank's Board is responsible for determining the amount distributable as dividend to the Government from the Bank's realised profits. These provisions require the Board to consult with the Minister on the amount to be placed to the credit of the Bank's Retained Earnings, with any balance of net profits to be paid into the Government's 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 the 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 shall not be available as a dividend to the Government or paid into Consolidated Revenue.

K million	2010	2011	2012	2013	2014
Total Comprehensive Income/ (loss)	195.1	(1,737.1)	39.7	608.1	139.5
Unrealised profit/(loss)	(173.2)	(1,729.5)	15.4	505.2	49.8
DISTRIBUTABLE PROFIT/(LOSS)	**21.9**	**(7.6)**	**24.3**	**102.9**	**89.7**
Transferred to:					
Currency Movement Reserve	(47.7)	-	-	-	-
Property Revaluation Reserve	58.7	-	-	15.6	-
Unrealised Profits Reserve	63.6	(1,714.3)	8.2	517.6	42.2
Gold Reserve	31.8	(15.2)	7.2	(28.0)	7.6
Retained Profit/(Loss)	66.8	(7.6)	24.3	102.9*	89.7
Consolidated Revenue Fund (Government)	21.9	-	-	-	-

** In consultation with the Minister, the Bank paid a dividend of K102 million to the Government in December 2014 out of the retained profits from the 2013 financial year, in exchange for a promissory note issued pursuant to section 50 of the CBA.*

2014 Budget Forecast

	Budget 2015 (K million)	Actual 2014 (K million)
Operating Income		
Interest received – overseas	177.1	129.5
Interest received – domestic	229.3	114.1
International trading/foreign exchange fees	6.1	12.4
Other income	12.9	14.8
TOTAL INCOME	**425.4**	**270.8**
Operating Payments		
Interest expenses – domestic operations	111.6	62.5
Financial markets & EFM expenses	8.6	6.5
Staff costs	55.8	48.6
Staff training and development	5.6	3.2
Premises and equipment	19.8	14.5
Depreciation of property, plant and equipment	7.3	6.0
Amortisation of notes and coins production	12.0	11.0
Currency distribution expenses	3.9	0.7
Audit fee	1.4	1.2
Travel	8.1	6.2
Legal and consultancy fees	7.6	5.9
Board and meeting expenses	1.5	1.0
Information & communication technology	8.6	3.6
Special projects	7.0	4.0
Other expenses	7.1	6.2
TOTAL PAYMENTS	**265.9**	**181.1**
NET OPERATING PROFIT/(LOSS)	**159.5**	**89.7**

Projects

In 2014 the Bank of Papua New Guinea continued to implement a number of strategic projects as part of the Bank's Strategic Plan 2012-2015.

Kina Automated Transfer System

The second phase of the Kina Automated Transfer System (KATS), including enhancement of the Banking Services System (BSS) and improved cheque clearing processes (cheque truncation), was launched in September 2014.

The BSS project is designed to improve the Bank's provision of banking services to the National Government and other statutory authorities, by enhancing the Bank's internal payment and accounting processes.

The cheque truncation project is expected to result in quicker cheque clearing. (See page 27)

Re-alignment of Bank's Accounts

In September the Bank commenced a project to review and re-align the Bank's chart of accounts to ensure it reflects the operations accurately and complies with international financial reporting standards.

Data Warehouse Project

The Data Warehouse project continued through 2014, progressing the implementation of superannuation and life insurance reporting and data management processes. The project also commenced implementation of the banking and financial services processes.

Lae Currency Distribution Facility

The Bank approved the concept design of the Lae Cash Distribution Facility and progressed to the schematic design phase.

Core Functions

MONETARY POLICY

Formulation of Monetary Policy

The Bank formulates and implements monetary policy with a view to achieving and maintaining price stability as stipulated under the *Central Banking Act 2000*. During the year, the Bank released two Monetary Policy Statements (MPS) as required by the Act, on 31 March and 30 September.

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

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

The Bank's estimates and projections of gross domestic product (GDP), balance of payments and inflation were discussed in consultative meetings with the Department of Treasury. The Department then used the information as inputs into formulating fiscal policy, specifically the 2015 national budget.

After five years of construction, the PNG LNG project commenced production much earlier than expected, with first exports in May 2014. The economy entered a period of significant growth, underpinned by an expansionary fiscal policy. While inflation was on an upward trend in 2014, increasing from 3.7 percent in March 2014 to 5.3 percent in September 2014, the increase was within forecast.

Implementation of Monetary Policy

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

With inflation remaining within the Bank's forecast, BPNG maintained a neutral stance of monetary policy, keeping the KFR at 6.25 percent throughout the year. This position was also intended to support lending to the private sector and foster economic activity. Commercial banks maintained their Indicator Lending Rates (ILRs) between 11.20 percent and 11.70 percent.

High levels of liquidity persisted in 2014, as a result of the Government's expansionary fiscal policy, prompting the Bank to increase the CRR in September 2014 to 10.0 percent, up from 9.0 percent.

The Minimum Liquid Asset Ratio (MLAR) remained at zero throughout 2014.

Government Agent Operations

The Bank of Papua New Guinea is the agent for the Government as an authorised issuer, registrar and paying agent for Government securities. As part of its liquidity management activities the Bank underwrites issues and is a market maker in these securities.

During the year the Bank assisted the Department of Treasury with a review of Treasury bills Agency Agreement and Inscribed stock terms and conditions.

Treasury Bills and Inscribed Stock

Interest rates on Government securities increased sharply in the first half of 2014. The increase was mainly driven by under-subscription at the auctions, reflecting the preference of market participants for shorter dated CBBs, which were issued in 1-3 month terms, as opposed to the Treasury bills issued in 6-12 month terms.

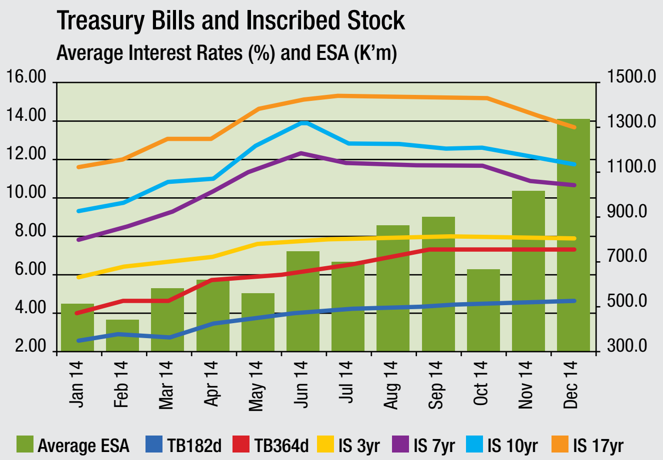
The largest increase in interest rates was seen in the 364 day Treasury bills, which increased by approximately 370 basis points over the year. Large increases in yields were also experienced in the government bond market for Inscribed stock, with the 3 years and 17 years issues increasing by more than 300 basis points in 2014.

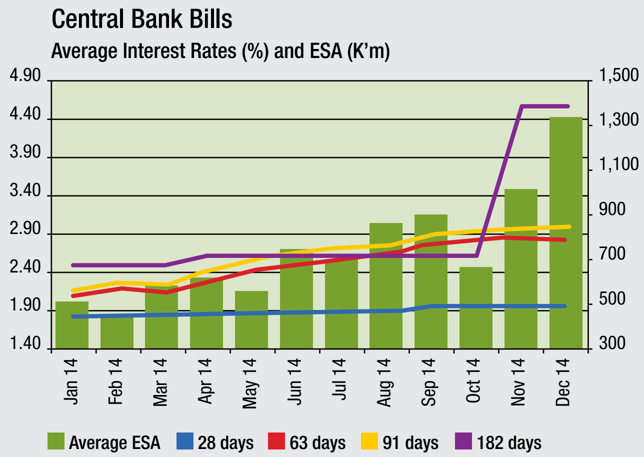
Central Bank Bills

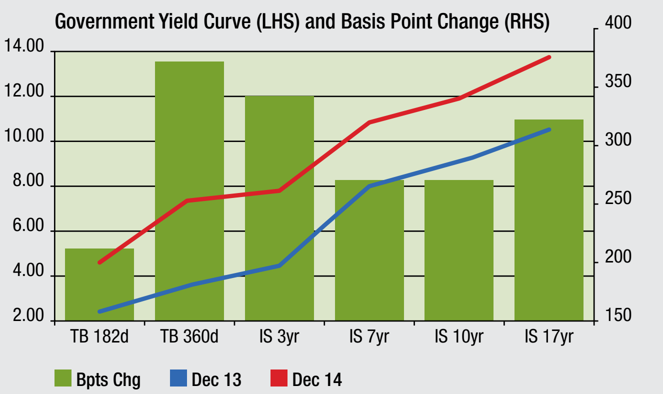
In 2014 the CBB interest rate curve steepened, as yields on the longer dated bills increased more than for shorter maturities.

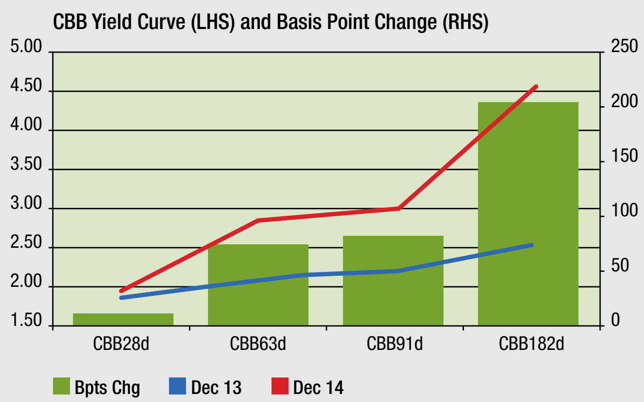
The Bank's strategy to encourage investment in government securities by maturing CBBs kept interest rates in the 28 day term well anchored. In comparison, interest rates on the 63 and 91 day CBB increased by approximately 75 basis points over the year, while the 182 day bill increased by 200 basis points.

The Bank allowed most of its 182 day CBBs to mature, with limited auctions of these securities, to encourage market participants to invest in government Treasury bills offered in the same term. This resulted in a sharp increase in the interest rate during the final quarter of 2014, as they moved in line with the Treasury bill interest rates.









Tap Facility

During the year the Bank recorded a net maturity of K7.3 million in CBBs through the Tap facility. Demand for Tap investments grew over the course of 2014 as interest rates rose. The CBB-Tap was offered in maturities of 63 and 91 days, with strong demand for the 91 days term.

Repurchase Agreement (Repo)

The Repo market, operating under the unsecured arrangement, was utilised only during the first quarter of 2014, when liquidity was tight. Throughout the rest of the year commercial banks used the interbank market to lend and borrow from each other.

At the end of 2014 the Bank sent a draft Repo Agreement to commercial banks for their review.

KATS Facilitates Securities Deals

During the year the Kina Automated Transfer System (KATS) was used to facilitate interbank deals as well as settlement of some CBB Tap deals, Treasury bills and Inscribed Stock auctions.

Slack Arrangement introduced

In August 2014 the Bank proposed several financing options to the Department of Treasury, so the State could meet its financing needs and reduce its borrowing costs, at the same time enabling the Bank to meet liquidity management objectives. The resulting 'Slack Arrangement' was implemented in September, with a proposed finish date of March 2015.

The Slack Arrangement allowed the Bank to take up the under-subscription of Treasury bill and Inscribed stock auctions and on-sell them to potential investors outside the normal auctions.

In 2014 BPNG purchased K1,530.9 million in Treasury bills from the Government under the arrangement and on-sold K1,209.8 million in CBB to the market, to control the impact of this liquidity injection. The difference was usually sold in the weekly auction.

Government Debt

At the end of 2014 total borrowing by the Government from the public amounted to K11,828 million, an increase of K2,983 million from the end of 2013. Total debt comprised K1,207 million in Inscribed stock and K1,420 million in Treasury bills.

Inscribed Stock

Inscribed stock issued in 2014	K1,873 million
Inscribed stock Slack issued	K47 million
Total Inscribed stock issued in 2014	K1,920 million
Maturities in 2014	K357 million
Net issuance	K1,207 million
Total holdings 31 December 2014	K6,207 million
Balance as at 31 December 2013	K4,644 million
Increase/(decrease) in balance	K1,563 million
BPNG portfolio holdings December 2014	K1,013 million
BPNG portfolio holdings December 2013	K674 million
Increase/(decrease) in total holding	K338 million

Treasury Bills

Outstanding at 31 December 2013	K4,201 million
Treasury bills issued in 2014	K5,253 million
Treasury bills Slack issued in 2014	K1,531 million
Total Treasury bills issued in 2014	K6,784 million
Maturities in 2014	K5,364 million
Outstanding at 31 December 2014	K5,621 million

Central Bank Bills

Outstanding at 31 December 2013	K3,174 million
Central Bank Bills issued in 2014	K1,210 million
Central Bank Bills Slack issued in 2014	K16,998 million
Total issued in 2014	K18,208 million
Maturities in 2014	K19,096 million
Outstanding at 31 December 2014	K2,287 million

Central Bank Bill Tap Facility

Available for sale 2014	K200 million
Balance at 31 December 2013	K37 million
Total issued in 2014	K145 million
Maturities in 2014	K152 million
Outstanding at 31 December 2014	K29 million

Foreign Reserves Operations

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

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

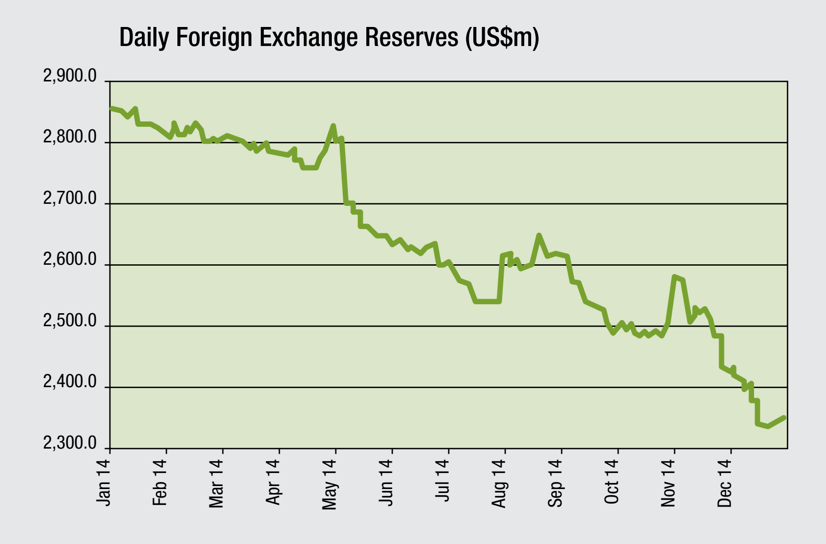
- support the price stability objective
- service the State's foreign debt
- protect the domestic economy from external shocks.

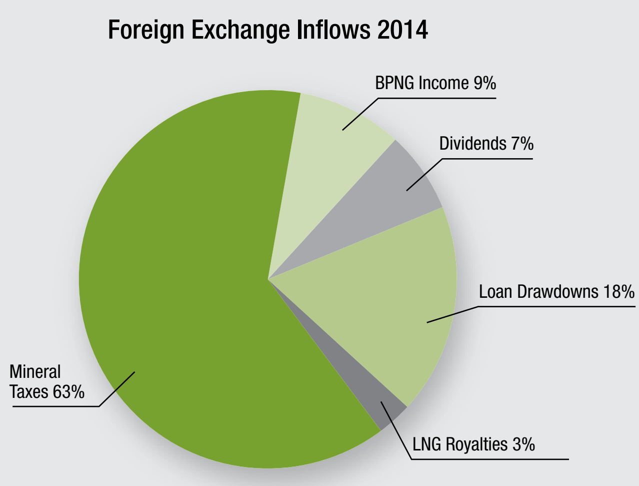
In terms of investing foreign exchange reserves, the Bank's primary objectives are to:

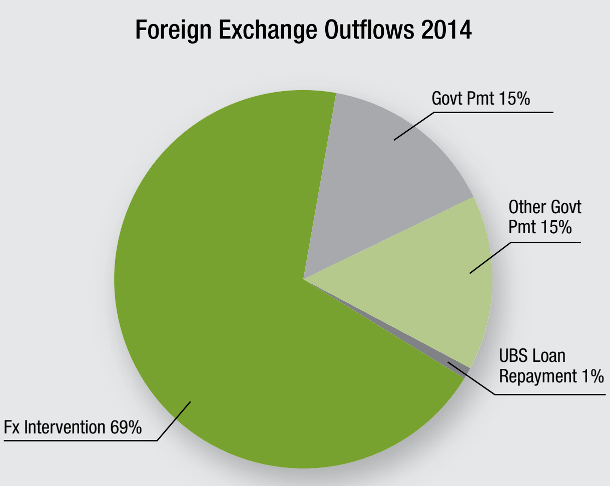
- preserve the capital value of the foreign exchange reserves
- maintain adequate liquidity
- manage credit risk conservatively
- earn an acceptable rate of return on the assets

At the end of December 2014 the level of foreign exchange reserves declined by US$0.51 billion to US$2.35 (K6.01) billion. The decline was mainly attributed to the Bank's intervention to support the domestic foreign exchange market and the Government's foreign debt service payments.

Foreign exchange inflows during 2014 totalled US$511.5 million, compared to outflows of US$941.8 million. Inflows mainly comprised mineral taxes of US$321.0 million, government concessional loans of US$89.8 million, income from foreign investments of US$44.4 million and dividends of US$36.8 million. The outflows mainly comprised the Bank's intervention in the foreign exchange market of US$647.7 million, Government foreign debt service payments of US$139.1 million and a payment for the Government's interest in the Solwara (Deep Sea Mining) project totalling US$113 million.







Domestic Foreign Exchange Market

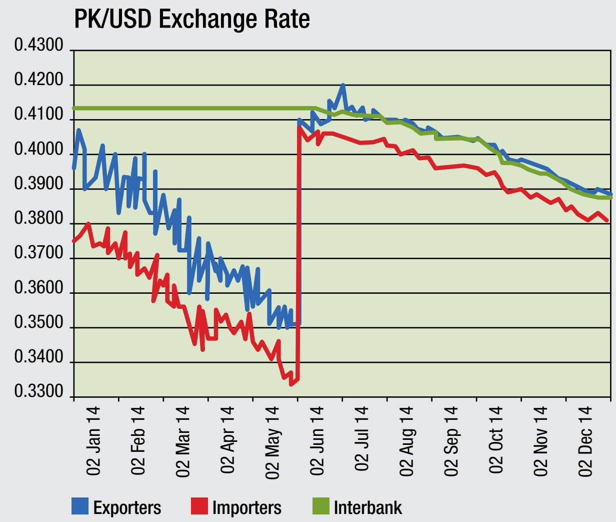
Throughout 2014 demand for foreign exchange dominated trade in the domestic interbank market, causing an imbalance in the flow of foreign currency into the market. The excess demand for foreign exchange was mainly due to high government expenditure and high economic growth.

The excess demand for foreign exchange in the market resulted in a decline in the turnover of foreign exchange transactions in 2014, compared to the previous year. Demand for foreign currency continued to be dominated by the Finance & Business and Retail sectors.

Major Sector Contributions to Foreign Exchange Flows

	2013 K'm	2014 K'm	Change
Inflows			
Mining	4,623.6	3,695.9	-20%
Finance & Business	2,707.9	2,435.4	-10%
Gas	2,341.9	1,419.0	-39%
Agriculture	1,519.6	1,813.3	19%
Total Fx Inflows	**16,161.3**	**14.136.5**	**-13%**
Outflows			
Finance & Business	3,546.6	3,102.2	-13%
Retail	3,925.1	3,210.3	-18%
Manufacturing	2,393.9	1,647.5	-31%
Petroleum	2,440.8	2,075.7	-15%
Total Fx Outflows	**18,077.7**	**14,885.3**	**-18%**

Despite this imbalance, the kina remained steady against the US dollar during the first half of the year. While the interbank exchange rate remained steady at US$0.4130, authorised foreign exchange dealers (AFEDs) were trading the kina with their clients in the retail market well below the interbank rate. By May 2014 the gap between the interbank exchange rate and the retail exchange rate offered by AFEDs to their clients widened to around 600 points (around US$0.3500).

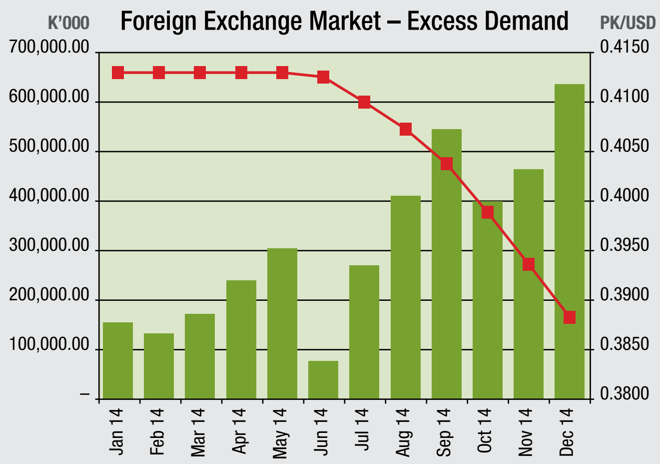


The Bank considered this to be a market failure and introduced a kina trading band in June 2014. The trading band was set at 150 points, with foreign currency inflows to be between the interbank rate and 75 points above that rate and outflows to be between the interbank rate and 75 points below that rate.

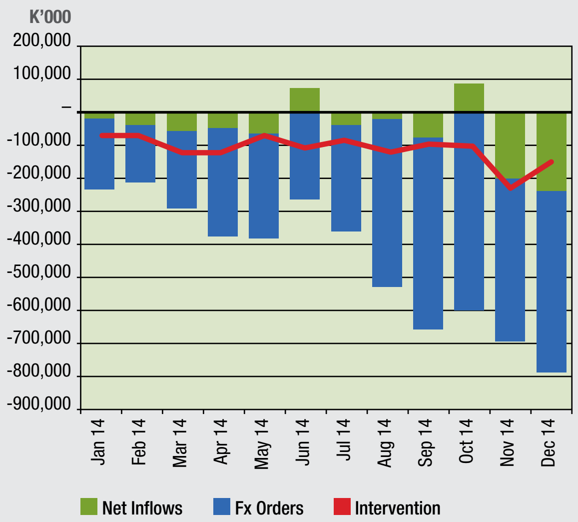
The Bank introduced the trading band to improve the price setting mechanism on exchange rates offered by AFEDs to their clients, by establishing the interbank rate as a reference point, to reduce margins charged by the commercial banks and to bring discipline back in the market.

Less successful was a directive from the Bank for AFEDs to fund foreign exchange forward contracts without the use of intervention proceeds, which aimed to encourage AFEDs to supply foreign currency to clients in the spot market. This however resulted in a reduction in forward market activity.

The ongoing imbalance in the flow of foreign exchange into the domestic market continued during the second half of 2014, resulting in a 7 percent depreciation of the kina to US$0.3855 by the end of 2014. During that period outstanding demand for foreign currency increased to an average of K507 million, up from K254 million in the first half of 2014. This prompted the Bank to intervene regularly in the market throughout the year to encourage a smooth depreciation in the kina exchange rate. In 2014 the Bank intervened by selling a total of US$571 (K1,410) million in the domestic foreign exchange market. The Bank's intervention during the last quarter of 2014 was targeted at major importers important to the national economy.



The increasing excess demand for foreign exchange in the market resulted in the depreciation of the kina.



The net inflow of foreign exchange, magnitude of unfilled orders for foreign exchange and the Bank's intervention.

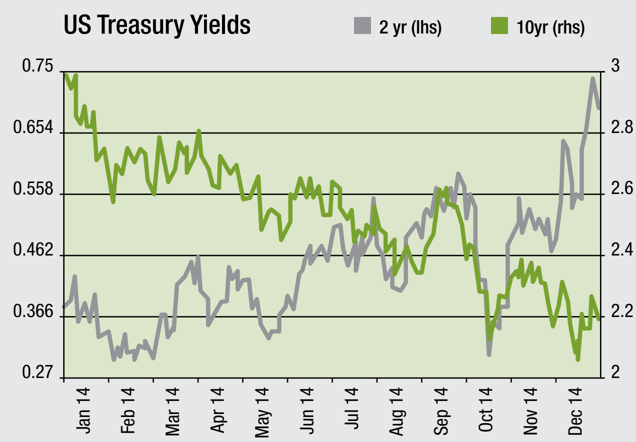
Exchange Rate

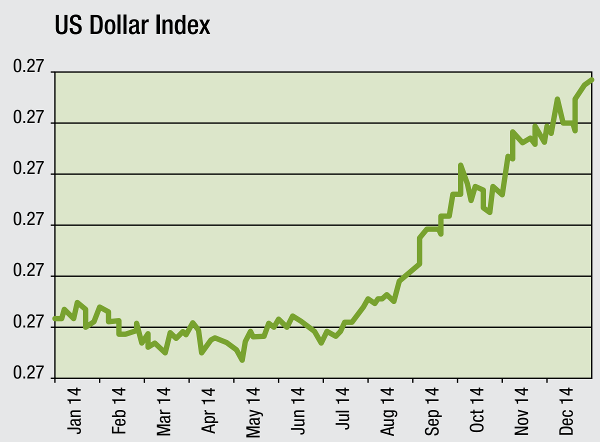
	End of Dec 2013	End of Dec 2014	YTD (%Change)
PGK/USD	0.4130	0.3855	-6.66
PGK/AUD	0.4630	0.4708	1.86
PGK/EUR	0.3032	0.3172	5.91
PGK/GBP	0.2519	0.2477	-1.16
PGK/JPY	43.17	46.17	6.43
PGK TWI	35.89	35.93	0.11

Foreign Currency and Interest Rates Risks

The major factors influencing global financial markets in 2014 were falling commodity prices, persistently low interest rates, weak global demand and diverging monetary policies across major economies. In particular, the sharp decline in oil prices from June 2014 had a significant impact, hurting oil-exporting economies while supporting the growth of energy-importing economies. The drop in oil prices resulted from a combination of softening demand in China, Europe and Japan, combined with a surge in U.S. production and over supply by OPEC countries.

Among the advanced economies, the United States and the United Kingdom continued to grow at a moderate rate, mainly reflecting improvements in their respective labour markets. In contrast, the economic recovery in the Eurozone and Japan was dampened by ongoing fiscal concerns. In the emerging market sector, a slowing level of growth in China affected other emerging economies.





Monetary policies in the United States, Eurozone and Japan diverged over the course of 2014. The Bank of Japan and European Central Bank continued to undertake further policy stimulus, while the US Federal Reserve ended its quantitative easing program in October 2014. As a result, the 10 year government bond yields for the major economies declined, while the US dollar appreciated against other major currencies. In contrast, 2 year government bond yields in the US increased, reflecting expectations of an interest rate increase by the US Federal Reserve.

In response to these market developments, the Bank maintained a cautious approach to its investments throughout 2014. Over the course of the year the Bank maintained short portfolio durations and a long US dollar currency exposure against other currencies.

Fund Performance

The Bank's in-house managed reserves generated portfolio returns of 2.22 percent over the year to December 2014, compared with 1.8 percent to the end of 2013. More than half the returns generated from the in-house funds were due to Australian dollar money market and bond investments.

The Bank's outsourced funds increased to a total value of US$1,114.16 million, equivalent to an average return of 1.10 percent. This compares to the Citi Group 1-3 year fully hedged World Government Bond Benchmark return of 0.96 percent.

Source	2014	2013
In house funds management	2.22%	1.80%
External funds managers		
Pictet	0.91%	0.37%
Schroders	1.34%	0.24%
Deutsche Bank	1.08%	0.71%
Lombard	1.19%	0.46%
BlackRock	1.00%	0.46%
Benchmark Citi Group 1-3 year World Government Bond	0.96%	0.76%

Composition of Foreign Exchange Reserves as at 31 December 2014

The total foreign exchange reserve level as at 31 December 2014 stood at USD2,381.20 million (PGK5,975.40 million). The table below shows the break-up of the reserves by mandate and changes in the levels during 2014.

	Inhouse Managed Reserves ('m)		Externally Managed Reserves ('m)		Total Foreign Exchange Reserves ('m)	
Date	USD	PGK	USD	PGK	USD	PGK
31 Dec 13	1,770.40	4,235.40	1,099.30	2,630.00	**2,869.70**	**6,865.40**
31 Dec 14	1,249.50	3,135.40	1,131.70	2,840.00	**2,381.20**	**5,975.40**
Change	-520.90	-1100.00	32.40	210.00	**-488.50**	**-890.00**

The decline in the foreign exchange reserves during 2014 was mainly due to intervention in the domestic foreign exchange market and payments for government debt overseas.

International Transactions Monitoring

Foreign Currency Accounts

The Bank received and reviewed four applications to open foreign currency accounts (FCAs) outside PNG during 2014. Two of the applications 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 compliance with the conditions of the licence, the licence is renewable on application each year.

Applications received in 2014	16
Applications approved and renewed – Gold Exports Limited – Golden Valley Enterprises Limited – Issacc Lete Lumbu Gold Buyers Ltd – Italpreziosi South Pacific Limited – Vertic Ltd – Wanaka Gold Limited	6
Applications requiring more information	9
Applications cancelled	1

Domestic Lending in Foreign Currency

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

Applications approved in 2014	2*
Value of transactions (US$7.122 million)	K18.571 million

** One application was submitted in late December 2014 and approved in January 2015.*

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 2014	13
Applications approved	10*

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

Cash Taken Out of PNG

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

Applications received and reviewed in 2014	28
Applications approved	28
Value of approved transactions	K1.768 million
Value of approved numismatic notes export	K0.780 million

PNG LNG Project Exemption

Companies engaged in or transactions related to the PNG LNG Project led 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 is primarily for the PNG LNG Project or Project Operations. The same applies to a transaction.

In 2014 one new exemption was granted to a contractor.

Research Activities

The Bank undertakes a number of tasks necessary to aid policy analysis and decision-making. In 2014 these included:

Surveys

Business Liaison and Employment Surveys

The Bank surveys 380 companies in the private sector across different sectors and regions on an ongoing basis.

Business Liaison Survey: 94 companies are surveyed quarterly while the other 286 companies are surveyed annually.

Employment Survey: all 380 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;
- provide information to the private sector on employment trends and sales data by industry;
- 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 Bank continued the Monetary and Financial Statistics project through 2014.

Balance of Payments System

Work on recommendations arising from the IMF 2013 Technical Assistance (TA) mission continued through the year. These recommendations aimed to improve the compilation and coverage of BOP, to enable the Bank to upgrade to BMP 5, the latest IMF BOP reporting standard. A follow up IMF TA visit in January 2014 reviewed the Bank's progress.

During 2014 progress was made on company selection for an International Investment Survey for improved estimates on foreign direct investment, as well as accessing data from PNG Customs through its ASYCUDA system.

Audit of Financial Competency Survey

The Bank conducted an audit to validate and verify the field data compiled from the Financial Competency Survey and to ensure the Survey was consistent with the guidelines of the sampling exercise.

During 2014 selected villages in the Morobe and Madang provinces in the Momase region were surveyed.

Kina Facility Rate (KFR) Review

The Bank conducted a review to identify why the effectiveness of the KFR's influence on domestic market interest rates appears to have declined since 2009 and to consider its ongoing relevance in determining the stance of monetary policy.

The initial findings of the KFR Review confirmed other research conducted by the Bank, indicating that high liquidity levels are the primary cause of weak transmission of monetary policy.

Research Papers

The Bank published one research paper in 2014, *Natural Resources Extraction and Dutch Disease: Application to Papua New Guinea*, as part of its Research Working Paper series.

Core Functions

FINANCIAL SYSTEM STABILITY

The financial system covers institutions authorised, regulated and supervised by the Bank of Papua New Guinea. In broader terms the nation's financial system also 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 licensing requirements

– promoting proper standards of conduct

– setting prudential standards and guidelines for sound and prudent business practices, and

– ensuring compliance of authorised institutions consistent with the relevant legislation and prudential standards, through effective supervisory activities.

The Financial System

Type of institution	31 Dec 2014	31 Dec 2013
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	13	11
Savings & loans societies (SLSs)	22	22
Authorised superannuation funds (ASFs)	4	4
Licensed investment managers (LIMs)	3	3
Licensed fund administrators (LFAs)	3	3
Life insurance companies (LICs)	5	5
Life insurance brokers (LIBs)	4	4
Authorised money changers	8	6
Money remitter	1	1
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operator	1	1
Total assets	**K40.1 billion**	**K37.5 billion**
Banking industry	75.5%	77.0%
ASFs	23.3%	21.8%
LICs	1.2%	1.2%
Total deposits	**K23.1 billion**	**K21.9 billion**
Commercial banks	93.6%	93.8%
LFIs	3.5%	3.5%
SLSs	2.1%	2.0%
Micro-banks	0.8%	0.7%
Total loans outstanding	**K13.6 billion**	**K11.3 billion**

Licences and Approvals

In 2014 the Bank considered and made decisions on applications received regarding expansion, closure, relocation of operations and new licences.

During the year the Bank:

- granted 8 new licences (LFI, IM, money remitter, money changer)
- assessed an additional 4 new licences (LFI, AFED)
- rejected one application (LFI).

Prudential Standards

Banking

Following industry consultation, the Bank issued prudential standards on Operational Risk in July 2014. The Bank engaged in industry consultation on Corporate Governance standards.

Superannuation

The revised *Superannuation Prudential Standard on Investments*, which was circulated for industry consultation at the end of 2013 and through 2014, was issued at the end of 2014.

The revised Investment Standard requires all funds to have a crediting rate policy, a review procedure for investment proposals, liquidity management and provide clarity on existing requirements relating to investment objectives, investment strategies, offshore investments, large exposures, asset titles and regular review of funds' assets.

The new prudential standard on *Risk Management*, also circulated to the industry at the end of 2013 and through 2014, was issued at the end of 2014.

Legislative Reviews

Savings & Loans Societies

The draft Bill to amend the *Savings and Loan Society (Amendment) Act 1995*, containing the Policy Paper, Draft Bill, the Regulations and the Certificate of Necessity from the Office of the Public Solicitor, was submitted to the Minister for Treasury during 2014.

In the meantime the Bank commenced extensive industry consultation on the transition arrangements in anticipation of the new Act. As part of this process the Bank conducted an industry workshop in October 2014 in association with the Federation of Savings and Loans Societies.

Superannuation

The Bank is yet to receive from the Department of Treasury a signed copy of the amendments to the *Superannuation (General Provisions) Act 2000*, passed by Parliament in mid 2013.

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 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 2014. These included 8 full scope reviews and 2 targeted reviews on credit risks.

The Bank conducted reviews, including target reviews, on 1 bank, 4 licensed financial institutions, 5 savings and loan societies, 3 superannuation funds, one of which was visited twice, 2 banking applicant, 3 money changers, 1 licensed investment manager, 1 life insurance company, 2 licensed investment managers, one of which was visited twice and 1 licensed fund administrator.

The Bank also conducted prudential consultations with 2 banks, 4 licensed financial institutions, 3 savings and loan societies,1 life insurance company and 2 life insurance brokers.

On-site Review Program

Under the Pacific Technical Exchange Program (PTEP), with technical assistance from the Australian Prudential Regulatory Authority (APRA), the Bank conducted a full scope review on National Superannuation Fund (Nasfund) in Port Moresby in April 2014. This also included a review of Aon Hewitt (PNG) Ltd as Nasfund's Licensed Fund Administrator and PacWealth Capital Ltd as Nasfund's Licensed Investment Manager. The review team involved participants from the Bank, Reserve Bank of Fiji, Reserve Bank of Tonga, Reserve Bank of Vanuatu and Central Bank of Solomon Islands.

Under this program, the Bank also participated in the onsite review of Fiji National Provident Fund.

Statutory Administration, Management and Liquidation Activities

The liquidation process continued through 2014 for Workers Mutual Insurance (PNG) Limited (WMI) and Eastern Highlands Savings & Loans Society Limited.

Key Developments in 2014

Cheque Truncation

Phase 2 of KATS, cheque truncation, was successfully launched in September 2014. The cheque truncation phase eliminates most of the manual processing previously involved in clearing cheques. In so doing clearance time is substantially reduced, in many cases allowing customer access to the proceeds of cheques in 4 days, rather than the 9 days taken under the old system.

Implementation of the cheque truncation system involved collaboration by dedicated project teams at BPNG and the four commercial banks. It also required a significant investment in technology, with each commercial bank upgrading their core banking systems and installing the KATS software to facilitate the changes.

Additional security measures were also introduced to cheques, such as coded numbers printed on the cheque form, in readiness for future KATS developments, including electronic imaging, data capturing and interbank exchanges.

Banking Services System

September also saw the launch of the second phase of BPNG's Banking Services System, designed to improve the Bank's provision of banking services to the National Government and other statutory authorities and enhance the Bank's internal payment and accounting processes.

Cross-border Currency Repatriation

A joint survey conducted by the Bank of Papua New Guinea and Bank Indonesia in 2013 reviewed currency usage in the northern land border between Papua New Guinea and Indonesia. As an outcome of that study, the two countries signed a Memorandum of Understanding in January 2014 in Jakarta to promote economic cooperation by encouraging the repatriation of kina from Indonesia to PNG and rupiah from PNG to Indonesia.

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 other statutory authorities;
- the National Government with the Temporary Advance Facility to cater for short term mismatches in cashflow;
- cheque matching and cheque clearance services; and
- 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 departmental drawing and trust accounts, provincial Government and statutory authority accounts. The revenue collections by PNG Customs and Internal Revenue Commission (IRC) are also deposited at the Bank of Papua New Guinea.

In 2014 financial institutions commenced making payments to IRC accounts with the Bank through KATS. Government and other statutory authorities' cheques were cleared through the Automated Clearing House (ACH), part of the KATS Cheque Truncation project. The ACH and other improvements to cheque processing procedures demonstrated their effectiveness, with no major incident of fraud reported in Government accounts during 2014.

The National Government maintained a total of 80 trust accounts held at Bank of PNG during 2014. The trust accounts balance as at 31 December 2014 was K227.7 million, compared with K392.4 million at the end of 2013. During the year, large transactions processed were for Tuition Fee Free Education and Autonomous Bougainville Government Grant.

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. The limit under the TAF has been maintained at K112 million since 2001.

In 2014 the Government sought financing under the TAF, which the Bank approved on 10 January 2014. A total of K81.5 million was drawn down and fully repaid on 15 January 2014. For the second and third quarter of 2014 the Government's cash position was in net credit. During the last quarter of the year the Government drew down around K100 million, which was fully repaid before the end of December.

Telling Services

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

Cash Handled by Tellers

2014	2013	2012
Inward receipts K105.7 m	Inward receipts K110.7 m	Inward receipts K128.2 m
Outward payments K102.4 m	Outward payments K108.5 m	Outward payments K126.5 m

Cheque Processing

During the year no major incidents of fraud in Government accounts were 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

2014	2013	2012
204,825	337,405	352,843

Note: Data for 2014 is prior to the implementation of ACH.

Presented Cheques

Source	2014	2013
Government drawing accounts	105,242	186,223
Commercial bank cheques	36,602	109,628
Staff accounts	23,775	34,551
BPNG cheques	1,975	7,003

Note: Data for 2014 is prior to the implementation of ACH.

Total Value of Cheques Processed

2014	K16,614,483,476
2013	K24,284,292,067
2012	K23,871,962,947

Note: Data for 2014 is prior to the implementation of ACH.

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.

As has been the case since the introduction of polymer notes in 1991, no counterfeit polymer note was detected in 2014. The security of the Papua New Guinea currency note issue remains very high.

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

During 2014 the program involved public presentations conducted by Bank staff, including sessions at the Garamut Show in Wewak, West New Britain Show, Morobe Agricultural Show, Milne Bay Show and the Financial Inclusion Expo in Kokopo. Bank staff also conducted training presentations to cashiers from the commercial banks.

Withdrawal of Paper Banknotes

The two year process of de-monetarising paper banknotes, which ceased to be legal tender in 2013, concluded on 31 December 2014, on which date the Bank stopped accepting the paper notes.

The Bank continues to accept the return of the de-monetarised K2 coin, which also ceased to be legal tender in 2013.

Recycling Polymer Waste

The Bank supports a clean and green environment, which includes managing polymer waste from destroyed banknotes. In July 2014 the Bank sent its first shipment of granulated polymer waste to a specialist recycling company. The polymer waste will be recycled into polypropylene pellets, which can then be used in the manufacture of other plastic products.

Banknote Disintegration Machine

During the year the Bank commissioned a new machine to disintegrate and shred banknotes.

Notes and Coins in Circulation as at 31 December 2013

Notes Denomination	Value K'm 2014	Value K'm 2013	Value K'm 2012
K2	49.9	46.3	45.8
K5	51.4	45.6	44.4
K10	69.0	65.5	66.3
K20	207.4	209.8	213.9
K50	445.6	433.6	417.0
K100	953.5	877.1	822.7
Sub Total	**1,776.8**	**1,677.9**	**1,610.1**
Coins Denomination			
K2	0.2	0.2	0.3
K1	23.2	21.3	19.9
50 Toea	6.5	6.4	6.5
20 Toea	20.1	19.3	18.6
10 Toea	19.4	18.8	18.0
05 Toea	6.2	6.1	5.9
Sub Total	**75.6**	**72.1**	**69.2**
Total	**1,852.4**	**1,750.0**	**1,679.3**

Supporting Economic Growth

New Notes and Coins Issued in 2014

Notes Denomination	Value K'm 2014	Value K'm 2013	Value K'm 2012
K2	23.7	21.1	21.3
K5	24.9	22.8	19.8
K10	33.5	31.0	28.0
K20	92.6	106.0	86.6
K50	145.7	215.0	114.0
K100	269.9	250.0	280.0
Sub Total	**590.3**	**645.8**	**549.7**
Coins Denomination			
K2	0.00	0.00	0.00
K1	1.70	1.50	3.20
50 Toea	0.00	0.00	0.36
20 Toea	0.80	0.70	1.57
10 Toea	0.60	0.83	1.51
05 Toea	0.07	0.21	0.33
Sub Total	**3.17**	**3.24**	**6.97**
Total	**593.47**	**556.67**	**693.67**

Destruction of Soiled Banknotes

Note Denomination	Value of soiled notes destroyed in 2014 (K'm)	Value of soiled notes destroyed in 2013 (K'm)	Value of soiled notes destroyed in 2012 (K'm)
K2	23.4	23.6	19.8
K5	24.7	18.3	22.4
K10	46.0	30.9	43.1
K20	102.6	120.4	101.1
K50	144.1	198.1	171.9
K100	199.9	189.1	134.5
Total	**540.7**	**580.4**	**492.8**

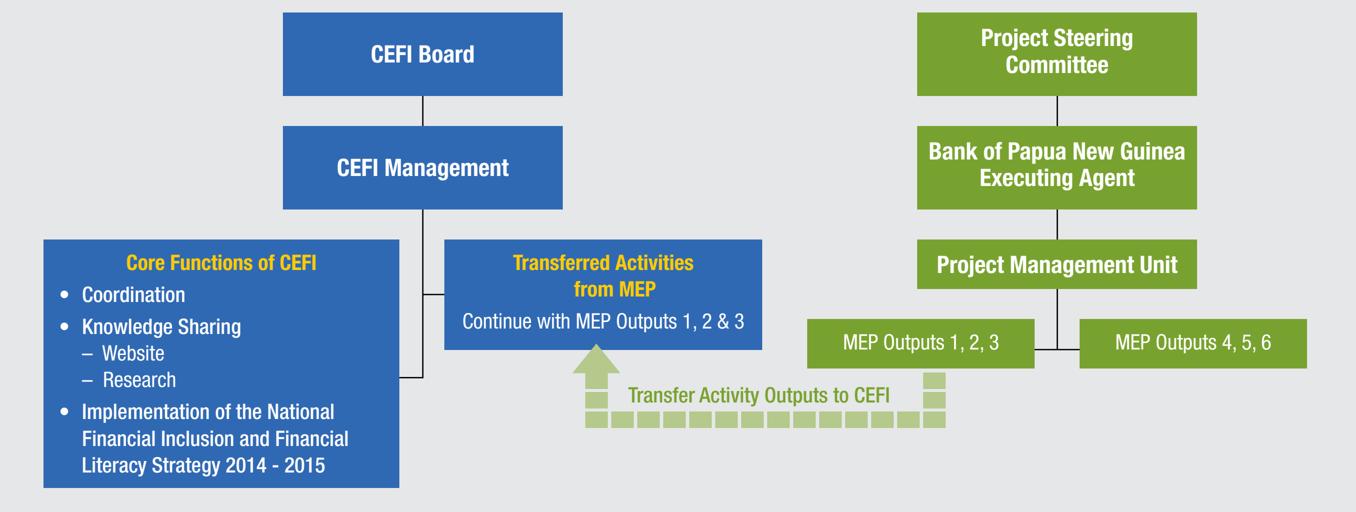
As well as carrying out its three core functions, the Bank of Papua New Guinea actively supports and contributes to the nation's economic growth.

Financial Inclusion & Financial Literacy

The Bank's position is that financial inclusion and financial literacy is essential for Papua New Guinea to achieve sustainable economic growth. Commitment to financial inclusion takes a number of forms, such as inclusion objectives that form part of the Bank's strategic plan and membership of the global network Alliance for Financial Inclusion (AFI).

The Bank is actively committed to the objectives and targets that form part of the Maya Declaration, signed in 2013. As part of this commitment, the Bank moved forward on inclusive financial services initiatives in 2014, contributing to a number of important achievements. The Bank's leadership role with the Centre of Excellence for Financial Inclusion (CEFI) provides a strong platform for promoting and achieving financial inclusion goals.

Financial Inclusion Management Structure



Centre of Excellence for Financial Inclusion (CEFI)

Co-established by the Bank of PNG and launched in December 2013, CEFI is the National Executive Council-approved apex organisation responsible for co-ordinating all financial inclusion activities in PNG, including the implementation of the *National Financial Inclusion and Financial Literacy Strategy 2014-2015* ("NFIFL Strategy").

CEFI's Board was formally established in 2014, comprised of the Bank of Papua New Guinea (Chairman and Founding Member), Department of National Planning and Monitoring (Co-chair and Founding Member), Members from the Department for Community Development and Religion and the Department of Treasury, Members representing the microfinance industry, financial training institutions and the savings & loans societies. In April 2014 Mr Cristian Shoemaker was appointed Executive Director of CEFI.

During the year, in consultation with all financial inclusion stakeholders, CEFI developed industry standards on operational ratios, transparency, client protection and credit assessment.

In April the establishment of 6 working groups to address Maya Declaration priorities represented another important milestone for CEFI and its NFIFL Strategy partners BPNG and the Pacific Financial Inclusion Programme (PFIP).

The Working Group on Consumer Protection (MEP Output 1) focused on developing a draft consumer protection code during the year.

In 2014 the Working Group on Financial Education and Financial Literacy (MEP Output 2) assessed the offerings available from financial literary training providers to identify core competencies and a consistent approach to teaching them. The Group also considered including financial education in the school curriculum for primary and secondary schools in PNG.

The Working Group on Electronic Banking (MEP Output 3) focused on finding innovative technology solutions to give more people access to financial services, particularly for low income and remote communities.

A key focus of the Working Group on Data and Measurement (MEP Output 4) is to collect and share information about the progress of financial inclusion. During 2014 the Group designed and implemented an effective format that enables the Bank to collect relevant financial inclusion data each quarter.

The Working Group on Inclusive Insurance (MEP Output 5) was established to create the right environment for policy development and an effective regulatory system to foster an inclusive insurance market.

Over the course of 2014 the Working Group on Government Coordination on Financial Inclusion (MEP Output 6) held a series of workshops with the Provincial governments of Madang, East New Britain, Eastern Highland, Simbu and Jiwaka to identify challenges and opportunities available in those provinces for increased access to financial services.

As at the end of 2014 MEP outputs 1, 2 and 3 had been transferred to CEFI from MEP.

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 2014 the Bank recorded a number of significant achievements, including:

- Admitted 2 new microfinance institutions as Partner Financial Institutions (PFIs). By the end of 2014 there were 10 PFIs – 5 microbanks and 5 provincial-based savings and loans societies.
- Conducted reviews of the management information systems of 8 PFIs;

– 96,426 new accounts opened, with deposits totalling K33 million;

– Improved Operational Self Sufficiency (OSS) from 88 percent to 116 percent. This increase indicates a significant improvement in the viability of the institutions in the PNG microfinance industry.

– Improved compliance with BPNG regulatory requirements to 83 percent. This achievement is an endorsement of the role of the Business Mentor model in encouraging proper attention to legal and fiduciary responsibilities.

– Conducted 10 market research studies for PFIs;

– Established the risk share facility. This facility is designed to reduce the lending risk of LICs by providing access to an initial US$5 million injection.

– Facilitated product development and roll out. During 2014 an additional 4 products were designed, building on the 20 products being either pilot tested or in development by the end of 2013. By the end of the year 6 products had been rolled out commercially, pilot tests were being conducted on 9 products and a further 9 products were in development and moving towards the pilot testing stage.

– Facilitated extensive training

  - Market research, product development and compliance training for PFIs conducted by MEP staff;
  - On the job and institution-specific training provided by Business Mentors, including issues such as corporate governance, business planning, operations, risk management and liquidity management, monitoring systems and reporting;
  - Staff training provided by IBBM.

– Delivered financial education

The Financial Education (FE) program has 6 modules (Savings, Budgeting, Bank Services, Mobile Money, Debt Management and Financial Negotiations) designed by MEP using international best practice and adopting the material to suit the PNG environment.

During 2014 the MEP FE program reached 28,123 people, including 13,723 women (49% of total participants). The FE training participants opened 6,567 bank accounts during 2014.

By 31 December 2014 the FE campaign had reached a total of 34,869 people, including 17,242 women (49%) since the commencement of the program in 2013.

Moving Forward on Financial Inclusion

One of the key Maya Declaration targets for financial inclusiveness is *"to reach 1 million more unbanked and under-served low-income people in Papua New Guinea, 50% of whom will be women"*.

Working collaboratively with a number of licensed financial institutions, the Bank rolled out a series of awareness-building activities designed to reach people without access to banking services. These included Financial Inclusion Expos, the Young Minds Savings Campaign and workshops with a number of Provincial governments.

Over 50 percent of the *1 million people reached* target was achieved by the end of September 2014. Of the 509,005 new accounts opened during that period, 34 percent were opened by women.

Support Services and Other Activities

Financial Inclusion Expos

Financial Inclusion Expos were staged in 2014 to showcase new developments in financial services, including innovative ways for people to access services, and to focus on financial education.

The Expos were held in Kokopo in July, in Goroka in September and in Alotau in November. Well over 40 institutions participated in the three Expos, which attracted a total of more than 42,000 visitors.

As well as effective awareness-building, the Expos successfully attracted new financial services customers. Around 1,500 new savings accounts were opened at the Expos and over 650 people subscribed to mobile banking services.

Young Minds Savings Campaign

The Young Minds Savings Campaign encourages young people from 6 to 25 years old to learn financial responsibility by opening savings accounts and embracing a savings habit.

Global Money Week in March 2014 provided the stage for the first public activity of the campaign in PNG, with 6 financial institutions participating with the Bank. Over the course of 2014 the Campaign roadshow visited 46 primary and secondary schools, raising awareness of the benefits of savings. By the end of September around 78,000 students had opened new savings accounts.

National Survey on Financial Capability

During the year the activities of the National Survey on Financial Capability (NSFC) concentrated on the Momase region of PNG as a regional case study. The NSFC investigated decision-making on money management, financial planning habits, use of information and formal financial services focusing on gender, location, income levels and livelihood and age groups.

Data collection was successfully completed in 2014, from which a comprehensive data set comprising location, household and financial information was compiled for analysis.

The resulting analysis will be used to help develop a national financial capability base line for PNG, to support the nation's development of financial inclusion, financial education and literacy and consumer protection programs.

Focus on Systems Enhancement

In 2014 the Bank's information technology services were strengthened to support its core functions and strategic initiatives.

The Bank implemented several significant systems developments over the course of the year.

Improvements related to the Bank's core functions included:

- Implemented KATS Phase 2 cheque truncation and the full Banking Services System (BSS);
- Streamlined internal accounting systems by migrating government accounts to BSS;
- Migrated data from the registry and money markets systems to achieve straight-through processing of government securities.
- Completed the data warehouse and business intelligence reporting solution for the superannuation and life insurance industries.
- Commenced the development of the banking sector solution

Infrastructure improvements included:

- Increased network capacity to handle higher demand for data transfer and communications;
- Increased storage capacity, particularly to take into account the impact of KATS and BSS, improving data recovery time;
- Minimised downtime for critical business systems by outsourcing support services to create remote and online virtual private networks;
- Installed extra power supply and cooling systems to protect hardware.

Other achievements included a strengthening of IT governance under the oversight of the IT Governance Committee, comprised of the four Assistant Governors, a focus on risk management, with the completion of the Bank's IT business impact analysis documentation and progress towards finalising its disaster recovery plan.

Support Services and Other Activities

Anniversary Celebrations

The Bank launched a commemorative stamp issue and souvenir sheets for collectors in 2014 as part of celebrations marking its 40th year of operations, which commenced in November 2013. The stamps issue depicted Governors of the Bank since its establishment.

Online Communication

The Bank started to shift the emphasis of its public information from hard copy or printed information format to website publishing, recognising the growing demand for online accessible information. The website www.bankpng.gov.pg was given a facelift during the year to enhance the user friendliness of the site.

Numismatic Issues

The Bank sells commemorative items to the public and currency collectors worldwide. Total sales for 2014 were K0.1 million, compared to K0.54 million in 2013. Demand was mainly for the Deluxe and Premium banknote albums and the K100 gold coin issued in 2012 to mark Queen Elizabeth's Diamond Jubilee.

BPNG in the Community

The Bank of PNG supports a number of national, cultural, educational, sporting and health-related activities, in line with its leadership position in the PNG business sector and broader community.

During 2014 the Bank made significant contributions to the PNG Paralympic sports team, the 5th Melanesian Festival of Arts and World Environment Day.

The Bank's support of schools and universities during the year fostered literacy and numeracy skills.

Health, medical research and welfare charities and initiatives continued to receive support from the Bank, including the Sir Theophilus Constantinou Foundation, the Cancer Foundation in PNG and World Tuberculosis Day. The Sir Buri Kidu Heart Foundation continued to receive support from the Bank in the form of management assistance and coordination of fund raising activities.

The Bank also continued to support staff participation in corporate sporting challenges.

Staffing

Staff Numbers as at 31 December 2014

Staff Category	2014	2013
General staff members	310	293
Management	48	48
Executive	6	6
Total employees	364	347

Organisation Restructure

During 2014 the Bank restructured its financial system supervision and licensing functions to meet the increasing challenges of a rapidly growing financial sector.

The resulting Financial System Development Department holds responsibility for financial system policy research and development, licensing and compliance enforcement, including enforcement of payment of superannuation contributions by employers, macro-prudential supervision and financial inclusion advocacy.

Staff Capacity Development

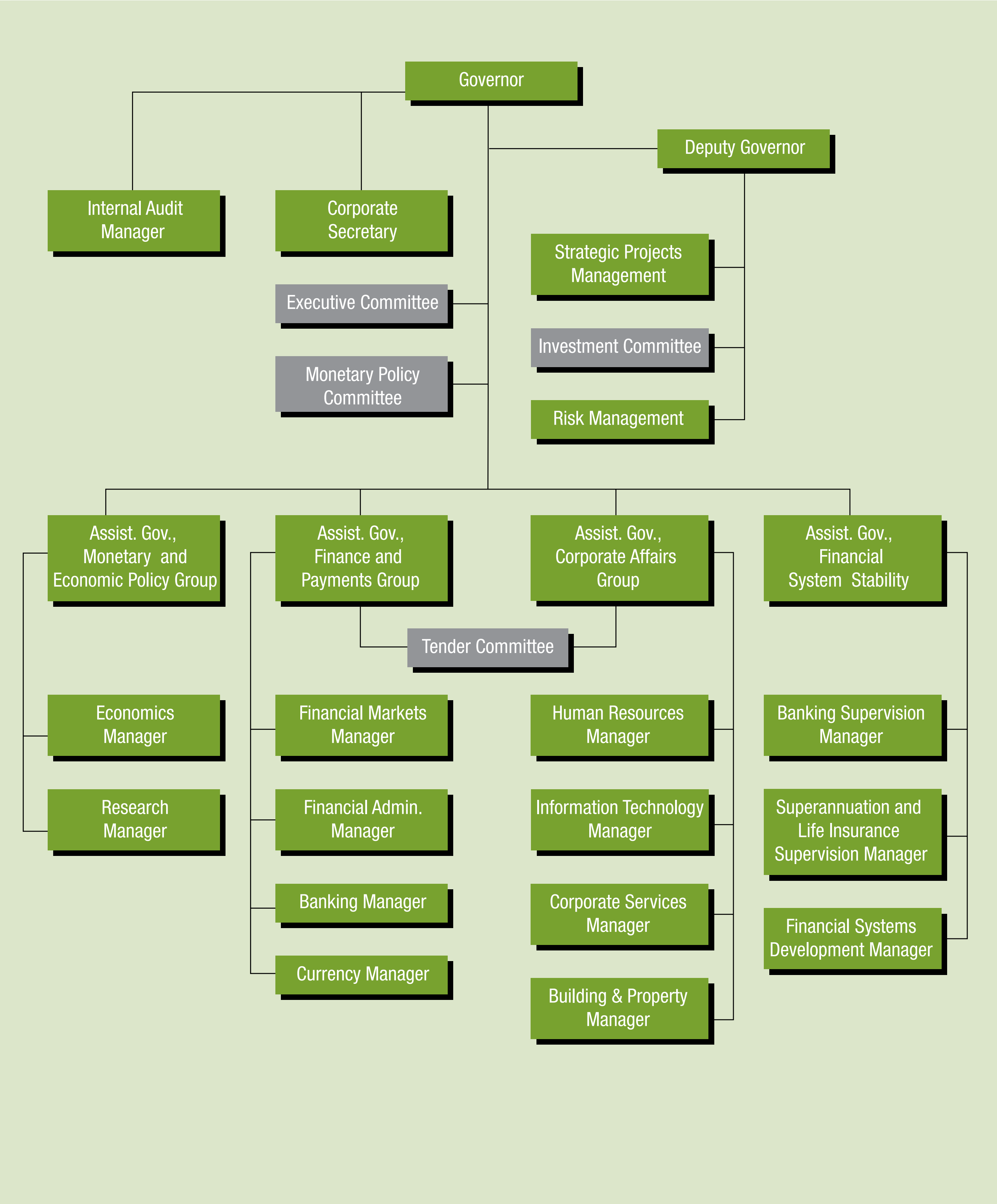
As well as ongoing formal and informal training activities, including workshops, seminars, conferences and study towards formal qualifications both in PNG and overseas, the Bank also sponsors staff to attend a range of capacity and skills development activities. 253 employees undertook some form of training or study during 2014.

During the year the Bank continued its Graduate Development Program. Five graduates were selected to work across a variety of areas within the Bank on a formal rotation program.

Other capacity building activities supported by the Bank in 2014 included:

- on-site reviews of financial institutions under the Pacific Technical Exchange Program (PTEP)
- hosting and participating in 'supervisory college' with international colleagues to discuss supervision matters
- encouraging Bank staff to hold memberships and seek professional qualifications and participate in ongoing education from relevant industry associations, including CPA PNG and Institute of Directors.

Organisation Chart as at 31 December 2014



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	Thomas Jiki
Manager, Public Information	Maryanne Kani
Manager, International Transactions Monitoring Unit	Elim Kiang
Research	
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
Manager, Money Markets	Winnie Linken
Manager, Registry	Marie Martin
Manager, Middle Office	Vacant

Senior Officers *(continued)*	
Financial Administration	
Department Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Oliver Kludapalo
Manager, Settlements	Soms Yankey
Banking	
Department Manager	Robert Kule
Manager, Customer Service	So'on Drewei
Manager, Payment Systems	Gaona Gwaibo
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
Human Resources	
Department Manager	Naomi Kedea
Manager, Planning & Strategic	Patrick Kwiwa
Manager, Administration	Mairi Mathew
Manager, Client Support	Vagi Gareitz
Information Technology	
Department Manager	Naime Kilamanu
Manager, Corporate System	Brian Semoso
Manager, Operations	Aileen Watangia

Senior Officers *(continued)*	
Corporate Services	
Department Manager	Jerome Peniasi
Manager, Building & Property Management	Richard Angeli
Manager, General Services	William Tiki
Manager, Communications & Publications	Jon Kombeng
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
Manager, Life Insurance	Peter Samuel

Bank of Papua New Guinea

FINANCIAL STATEMENTS
FOR THE YEAR ENDING
31 DECEMBER 2014

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Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 December 2014

	Notes	2014 K'000	2013 K'000
Revenue from foreign currency investments			
Interest revenue	**2**	103,369	138,011
Realised gain/(loss) on financial assets		25,658	50,203
Foreign exchange gains and commissions		12,377	9,034
Total revenue from foreign currency investments		**141,404**	**197,248**
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(452)	(521)
Custodian and investment management fees		(4,422)	(3,878)
Total expenses from foreign currency investments		**(4,874)**	**(4,399)**
Net foreign currency income		**136,530**	**192,849**
Revenue from domestic investments			
Interest revenue	**3**	114,103	69,706
Other income	**4**	14,887	13,034
Total revenue from domestic investments		**128,990**	**82,740**
Expense on domestic liabilities			
Interest expense	**5**	(62,077)	(83,791)
Total expenses on domestic liabilities		**(62,077)**	**(83,791)**
Net domestic expense		**66,913**	**(1,051)**
Total net operating income		**203,443**	**191,798**
Operating expenses			
General and administration expenses	**6**	(113,784)	(88,890)
		89,659	**102,908**
Other unrealised income and (expense)			
Fair value and foreign exchange revaluation gain on foreign currency investments		139,614	546,338
Fair value revaluation loss on domestic investments		(97,385)	(28,743)
Profit for the year		**131,888**	**620,503**
Other comprehensive income			
Items that may be subsequently reclassified to profit and loss			
Gain/(loss) on gold asset revaluation		7,617	(27,963)
Items that will not be subsequently reclassified to profit and loss			
Gain on property revaluation		–	15,606
Other comprehensive income/(loss) for the year		**7,617**	**(12,357)**
Total comprehensive income for the year		**139,505**	**608,146**

The financial statements are to be read in conjunction with the notes on pages 6 to 26.

Statement of Financial Position

For the year ended 31 December 2014

	Notes	2014 K'000	2013 K'000
Assets			
Foreign currency financial assets			
Cash and cash equivalents	8	745,812	651,334
Gold		129,817	123,169
Financial assets at fair value	9	5,038,553	6,013,046
Assets held with IMF and other financial organisations	7	35,098	34,791
Accrued interest		26,080	43,015
Total foreign currency financial assets		**5,975,360**	**6,865,355**
Local currency financial assets			
Government of Papua New Guinea securities	10	2,413,811	939,984
Loans and advances	11	10,076	11,520
Accrued interest and other receivables		39,345	15,406
Total local currency financial assets		**2,463,232**	**966,910**
Total Financial Assets		**8,438,592**	**7,832,265**
Non-financial assets			
Property, plant & equipment	13	117,475	150,837
Investment properties	14	38,740	–
Other non-financial assets	12	52,790	48,868
Total non-financial assets		**209,005**	**199,705**
Total Assets		**8,647,597**	**8,031,970**
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF	7	472,985	469,056
Other financial liabilities	19	2,074	16,042
Total foreign currency financial liabilities		**475,059**	**485,098**
Local currency financial liabilities			
Deposits from banks and third parties	15	3,432,690	2,151,184
Deposits from Government and Government entities	16	1,064,491	980,172
Debt securities issued	17	2,306,685	3,190,336
Accrued interest payable on debt securities		5,031	8,650
Currency in circulation	18	1,850,629	1,749,226
Other financial liabilities	19	51,517	45,076
Total local currency financial liabilities		**8,711,043**	**8,124,644**
Total financial liabilities		**9,186,102**	**8,609,742**
Non-financial liabilities			
Provisions for employee entitlements	20	16,847	15,085
Total non-financial liabilities		**16,847**	**15,085**
Total Liabilities		**9,202,949**	**8,624,827**

Statement of Financial Position

	Notes	2014 K'000	2013 K'000
Equity			
Capital	**21**	145,540	145,540
Gold revaluation reserve	**21**	109,170	101,553
Property revaluation reserve	**21**	93,452	98,680
Unrealised loss reserve	**21**	(1,082,678)	(1,124,907)
Retained earnings	**21**	179,164	186,277
Total Equity		**(555,352)**	**(592,857)**
Total Liabilities and Equity		**8,647,597**	**8,031,970**

The financial statements are to be read in conjunction with the notes on pages 6 to 26.

Statement of Changes in Equity

For the year ended 31 December 2014

In Kina (K'000)	Property Revaluation Reserve	Unrealised Profit/(loss) Reserve	Gold Reserve	Capital	Retained earnings	Total
Balance at 1 January 2013	**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)**
Profit for the year	–	42,229	–	–	89,659	131,888
Other comprehensive income/(loss) for the year	–	–	7,617	–	–	7,617
Transfers to equity	(5,228)	–	–	–	5,228	–
Dividend Paid to Government	–	–	–	–	(102,000)	(102,000)
Balance at 31 December 2014	**93,452**	**(1,082,678)**	**109,170**	**145,540**	**179,164**	**(555,352)**

The realised profit for the year is K89.7 million. The unrealised loss reserve and net asset deficiency at 31 December 2014 were K1,082.7 million and K555.4 million, respectively. In accordance with the *Central Bank 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.

The financial statements are to be read in conjunction with the notes on pages 6 to 26.

Statement of Cash Flows

For the year ended 31 December 2014

	Notes	2014 K'000	2013 K'000
Cash Flows from Operating Activities			
Interest received on foreign investments		120,360	138,751
Interest received on domestic investments		90,165	65,384
Fees, commissions and other income received		14,887	13,034
Interest paid on IMF liabilities		(452)	(521)
Interest paid on domestic liabilities		(65,695)	(92,384)
Payments to employees		(45,045)	(41,742)
Payments to suppliers		(55,506)	(61,876)
Fees and commissions paid		(4,422)	(3,878)
Net proceeds from foreign investments		1,139,144	2,334,974
Net payment for Government Securities		(1,571,211)	(172,188)
Net loans issued to staff		(125)	(4,148)
Net Cash Flow used in Operating Activities		**(377,900)**	**2,175,406**
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(11,344)	(9,091)
Proceeds from sale of property, plant and equipment		183	–
Net Cash Flow used in Investing Activities		**(11,161)**	**(9,091)**
Cash Flows from Financing Activities			
Net movement of currency in circulation		100,603	69,897
Net movement in debt securities issued		(883,651)	(2,138,367)
Distributions to the government		(102,000)	–
Net movement in deposits from government		84,319	(5,230)
Net movement in deposits from banks		1,281,506	561
Net movement in IMF liabilities		2,762	64,527
Net Cash Flow from Financing Activities		**483,539**	**(2,008,612)**
Net Increase in Cash and Cash Equivalents		**94,478**	**157,703**
Cash and cash equivalent at 1 January		651,334	493,631
Cash and Cash Equivalent at 31 December	**8**	**745,812**	**651,334**

The financial statements are to be read in conjunction with the notes on pages 6 to 26.

Notes to the Financial Statements

For the year ended 31 December 2014

Note 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

(a) Basis of preparation

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

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

Going concern

The 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 previous years. As a result the Bank is in a net asset deficiency position of K555.4 million (2013: net asset deficiency of K592.8 million). During the year ended 31 December 2014 the Bank recognised a profit (excluding fair value movements) of K89.7 million (2013: K102.9 million) and a net cash inflow of K 94.5 million (2013: K 157.7 million). However, despite improvement during the year, the continuing net asset deficiency condition results in a 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 Act provides that where the Bank incurs a loss due to a change in the value of assets or liabilities, the Minister shall cause to be paid to the Bank such amount out of the Consolidated Revenue Fund as is necessary to avoid the loss.

Subsection 50(4) of that Act further provides that the Minister may create and issue to the Central Bank non-interest bearing non-negotiable notes for an amount not exceeding any payment made by the Minister to the Central Bank out of the Consolidated Revenue Fund in accordance with Subsections (1) and (2) of the Act.

The above provisions of the Act effectively require the Government to provide financial support to the Bank and under the powers of the Act the Minister issued a Promissory Note on the 10th December 2014. Under the terms of the Promissory note the Independent State of Papua New Guinea promises to pay, on the demand of the Bank, PGK 1.12 billion without interest. This note is valid for as long as the Bank has a negative valuation reserve in its audited financial statements. 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.

(b) Functional and presentation currency

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

(c) Use of judgements and estimates

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

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

(i) Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ending 31 December 2014 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

(a) Note 10 & 17 – determination of the fair value of financial instruments with significant unobservable inputs;

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

(ii) Accounting estimates

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

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

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

Except for the changes below, the Bank has consistently applied the accounting policies as set out in notes 1(a) to 1(u). The Bank has adopted the following standard with a date of initial application of 1 January 2014.

Effective for	New standards or amendments	Summary of the requirements	Implications
Periods started 1 January 2014	*Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)*	The amendments to IAS 32 clarify the requirements relating to the offsetting of financial assets and financial liabilities. Specifically, the amendments clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realisation and settlement'. The amendments require retrospective application.	As a result of the amendments to IAS 32, the Bank has changed its accounting policy for offsetting financial assets and financial liabilities. The amendments clarify when an entity currently has a legally enforceable right to set-off and when gross settlement is equivalent to net settlement. The change did not have a material impact on the Bank's financial statements.

The following relevant standards and amendment are effective for periods beginning after 1 January 2014 and have not been early adopted for the year ended 31 December 2014:

Effective for	New standards or amendments	Implications
Periods started 1 July 2014	Defined Benefit Plans: Employee Contributions (Amendments to IAS 19)	Applicable in 2015
	Annual Improvements to IFRSs 2010-2012 Cycle	Applicable in 2015
	Annual Improvements to IFRSs 2011-2013 Cycle	Applicable in 2015
Periods started 1 January 2016	Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)	Applicable in 2016
	Annual Improvements to IFRSs 2012-2014 Cycle – various standards	Applicable in 2016
Periods started 1 January 2017	IFRS 15 Revenue from Contracts with Customers	Applicable in 2017
Periods started 1 January 2018	IFRS 9 Financial Instruments	Applicable in 2018

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.

(e) Financial assets and liabilities

Definition of financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The Bank's financial instruments are its domestic government securities, foreign government securities, 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 discounted present value valuation model, 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 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.

(v) 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.

(vi) 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 15.

(vii) 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.

(viii) Gold

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

(ix) 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.

(x) 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.

(xi) Currency in Circulation

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

(f) Determination of fair value

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

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

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

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

(g) Property, plant and equipment

Formal valuations of all the Banks 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. Management has assessed the fair value of all property and equipment as at year end and consider them to be appropriate.

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

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

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

(h) Investment properties

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

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

(i) Investment property rental income

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

(j) 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.

(k) 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.

(l) 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.

(m) 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.

(n) Other receivables

Other receivables are stated at amortised cost.

(o) 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.

(p) Other liabilities

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

(q) Reserves

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

(i) Bank of Papua New Guinea Reserve Fund

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

(ii) Property Revaluation Reserve

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

(iii) Unrealised Profits Reserve

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

(iv) Distributable Profit Reserve

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

(v) Gold Revaluation Reserve

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

(r) 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.

(s) Tax Exemption

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

(t) Comparatives

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

(u) Rounding

Financial information has been rounded to the nearest thousand Kina.

	2014 K'000	2013 K'000
Note 2: INTEREST REVENUE – FOREIGN CURRENCY OPERATIONS		
Foreign securities and bank deposits	103,369	138,011
	103,369	**138,011**

Interest income on foreign investments includes interest earned on foreign bonds, Treasury bills, nostro accounts and other foreign investments. Income of K40.5 million (2013: K40.9 million) is in relation to investments managed by external fund managers and the remainder of K62.9 million (2013: K97.1 million) relates to investments managed by the Bank. Coupon rates during the year varied between 01% and 6.25% (2013: 0.1% and 7.25%) and yields varied between (0.48)% and 5% (2013: 0.3% and 5%).

	2014 K'000	2013 K'000
Note 3: INTEREST INCOME – DOMESTIC OPERATIONS		
Inscribed stock and other Government securities	114,103	69,706
	114,103	**69,706**

Interest income on government Inscribed stock amounted to K92.5 million (2013: K63.9 million) during the year with the remainder of K21.6 million earned from government Treasury bills (2013: K5.8 million). During the year coupon rates on Inscribed stock varied between 6% and 14% (2013: 9% and 14%) while yields on Treasury bills varied between 4.5% and 7.42% (2013: 3.3%).

	2014 K'000	2013 K'000
Note 4: OTHER INCOME – DOMESTIC OPERATIONS		
Licensing and other fees	11,750	10,117
Numismatic currency	91	501
Property rent	2,246	2,416
Other	800	–
	14,887	**13,034**

	2014 K'000	2013 K'000
Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS		
Central Bank bills issued	62,077	82,370
Other deposit held	–	1,421
	62,077	**83,791**

Interest on securities issued varied between 1.83% and 4.55% during the year (2013: 1.84% and 3.17%)

	2014 K'000	2013 K'000
Note 6: GENERAL AND ADMINISTRATION EXPENSES		
Staff costs	46,807	38,529
Premises and equipment	18,525	13,305
Other expenses	11,054	9,622
Amortisation of notes and coins production expenses	10,982	6,579
Travel	6,178	4,833
Depreciation of property, plant and equipment	5,966	5,786
Legal & consultancy fees	5,944	5,284
Staff training and development	3,034	2,030
Provisioning of staff loans	2,705	–
Audit fee	1,172	1,063
Board & meeting expenses	952	930
Currency distribution expenses	465	929
	113,784	**88,890**

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

	2014 K'000	2013 K'000
Assets		
IMF SDR holdings and deposits with other organisations	35,098	34,791
	35,098	**34,791**
Liabilities		
IMF number 1 and 2 loan accounts	1,557	1,557
SDR allocation	471,428	467,499
	472,985	**469,056**

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

	2014 K'000	2013 K'000
Foreign currency holdings - Nostro accounts	745,812	651,334
	745,812	**651,334**

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

	2014 K'000	2013 K'000
Note 9: FINANCIAL ASSETS AT FAIR VALUE		
Foreign investments	5,015,566	5,998,148
Derivative assets	22,987	14,898
	5,038,553	**6,013,046**

Foreign investments include K2.84 billion (2013: 2.63 billion) of investments managed by external fund managers. The remainder of K2.20 billion (2013: K3.38 billion) is managed directly by the Bank. The investments comprise of foreign bank debt securities, sovereign debt securities and derivative currency contracts.

	2014 K'000	2013 K'000
Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES		
Inscribed stock	945,545	746,038
Treasury bills	1,468,266	193,946
	2,413,811	**939,984**
Note 11: LOANS AND ADVANCES		
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans	11,395	10,134
Allowance for doubtful loans	(2,705)	–
	10,076	**11,520**
Note 12: OTHER NON FINANCIAL ASSETS		
Inventory notes and coins	49,671	45,838
Commemorative notes & coins and other receivables	1,859	2,216
Other non-financial assets	1,260	814
	52,790	**48,868**

In Kina (K'000)	Land and Buildings	Equipment	Motor Vehicles	Computer Equipment	Computer Software	Total
Note 13: PROPERTY PLANT & EQUIPMENT						
Year ended 31 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 gains	15,66	–	–	–	–	15,606
Closing Book Amount	**126,348**	**3,007**	**1,256**	**1,359**	**18,867**	**150,837**
At 31 December 2013						
Cost or fair value	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**
Year ended 31 December 2014						
Opening net book amount	126,348	3,007	1,256	1,359	18,867	150,837
Additions 4,524	258	776	642	5,144	11,344	
Disposals –	–	(367)	–	–	(367)	
Write back depreciation	–	–	367	–	–	367
Transfer to investment property	(38,740)	–	–	–	–	(38,740)
Depreciation charges	(3,917)	(205)	(546)	(547)	(751)	(5,966)
Closing Book Amount	**88,215**	**3,060**	**1,486**	**1,454**	**23,260**	**117,475**
At 31 December 2014						
Cost or fair value	92,132	6,377	2,683	6,713	27,005	134,910
Accumulated Depreciation	(3,917)	(3,317)	(1,197)	(5,259)	(3,745)	(17,435)
Net Book Amount	**88,215**	**3,060**	**1,486**	**1,454**	**23,260**	**117,475**

In 2013, the Bank engaged the services of independent professional valuers for the valuation of its properties. 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(g), the Bank's policy is to carry its land and buildings at their fair market values determined every three years by independent professional valuers.

Additions to computer software during the year pertain primarily to capitalised cost incurred in relation to the Kina Automated Transfer System (KATS) and the Data Warehouse project. KATS was initially implemented in October 2013 and upgraded to stage 3 during the year. In conjunction with KATS, Banking Services System (BSS) went live in September 2014. KATS and BSS 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.

	2014 K'000	2013 K'000
Note 14: INVESTMENT PROPERTIES		
Balance at 1 January	–	–
Acquisitions	–	–
Reclassification from property, plant and equipment	38,740	–
Change in fair value	–	–
Balance at 31 December	**38,740**	**–**

Investment property comprises two commercial properties that are leased to third parties. The fair values of investment properties were determined by external, independent property valuers, having appropriate recognised professional qualifications and recent experience in location and category being valued. The independent valuers provide the fair value of the Bank's investment property every 3 years and the last valuations were performed in 2013. The fair value measurements for all of the investment properties have been categorised as level 3 fair value measurements. Rental income from investment properties is K2.2 million (2013: K2.4 million).

	2014 K'000	2013 K'000
Note 15: DEPOSITS FROM BANKS & THIRD PARTIES		
Banks		
Exchange settlement accounts	1,515,141	486,466
Cash reserve requirement	1,910,136	1,656,268
Other Deposits	7,413	8,450
	3,432,690	**2,151,184**
Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES		
Deposits from government and government entities	1,064,491	980,172
	1,064,491	**980,172**
Note 17: SECURITIES ISSUED		
Central Bank Bills issued	2,306,685	3,190,336
	2,306,685	**3,190,336**

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.

	2014 K'000	2013 K'000
Note 18: CURRENCY IN CIRCULATION		
Currency in circulation	1,850,629	1,749,226
	1,850,629	**1,749,226**

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.

	2014 K'000	2013 K'000
Note 19: OTHER FINANCIAL LIABILITIES		
Foreign Currency		
Derivative Liabilities	–	12,463
Foreign currency deposits	2,074	3,579
	2,074	**16,042**
Local Currency		
Expense creditors	51,557	40,772
Other liabilities	(40)	4,304
	51,517	**45,076**

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

Note 20: PROVISIONS FOR EMPLOYEE ENTITLEMENTS

	2014 K'000	2013 K'000
Provision for gratuity leave	1,828	1,621
Provision for annual leave	11,882	10,657
Provision for long service leave	3,137	2,807
	16,847	**15,085**
Reconciliation of leave provisions		
Balance at 1 January	15,085	13,457
Net charged to statement of comprehensive income	1,762	1,628
Balance at 31 December	**16,847**	**15,085**

Note 21: SHARE CAPITAL

At 31 December 2014, the authorised and subscribed capital of the Bank was K145.5 million (2013: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2014 K'000	2013 K'000
Share Capital		
At the beginning of the year	145,540	145,540
At the end of the year	**145,540**	**145,540**
Other Reserves		
Gold revaluation reserve	109,170	101,553
Property revaluation reserve	93,452	98,680
Unrealised loss reserve	(1,082,678)	(1,124,907)
Retained earnings	179,164	186,277
Total other reserves	(700,892)	**(738,397)**
Total owner's equity	**(555,352)**	**(592,857)**

Note 22: SEGMENT REPORTING

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

Note 23: RISK MANAGEMENT

Note 23(i): Financial Risk Management

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

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

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

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

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

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

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

Note 23(ii): Credit Risk

(a) Credit Risk Management

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

The Bank manages credit risk by employing the following strategies;

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

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

(b) Concentration of Credit Exposure

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

	2014 K'000	2013 K'000
Foreign Governments, Banks & Financial Organisations		
Foreign investments (note 23(ii)(c))	5,038,553	6,013,046
Accrued interest receivable	26,080	43,015
Nostro accounts	745,812	651,334
Gold	129,817	123,169
Assets held with IMF and other financial organisations	35,098	34,791
Papua New Guinea Government		
Government of Papua New Guinea securities (note 23(ii)(c))	2,413,811	939,984
Accrued interest receivable	39,345	15,406
Bank staff and employees (note 10)	11,395	10,134
Other Government Institutions (note 10)	1,386	1,386
	8,441,297	**7,832,265**

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

17% (2013:20%) of the total assets have a credit rating of A-1+ or above in short term investments and 29% (2013: 44%) 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. Other indicates the entity has not been rated by Standard and Poor's and Moody's.

Investment in Financial Assets	2014 K'000	% 2014 Financial Asset	2013 K'000	% 2013 Financial Asset
Short term foreign investments				
AAA	–	–	164,003	2
AA+	–	–	63,591	1
AA–	–	–	197,349	3
A	–	–	38,061	–
A-1+	1,241,340	17	992,144	15
A-1	426,060	6	299,539	4
A-2	447,227	6	418,872	6
A-3	14,223	–	197,954	3
B	–	–	23,390	–
NR	41,400	–	9,532	–
	2,170,250	**29**	**2,404,435**	**34**
Long term foreign investments				
AAA	873,888	12	1,530,481	22
AA+	151,732	2	251,147	4
AA	1,108,975	15	1,218,341	18
AA–	151,264	2	335,047	5
A+	46,942	–	18,364	–
A	195,001	3	15,429	–
A-1+	–	–	18,872	–
BBB	340,501	4	211,218	3
NR	–	–	9,712	–
	2,868,303	**38**	**3,608,611**	**52**
Total foreign investments	**5,038,553**	**67**	**6,013,046**	**86**
Short term domestic investments				
B	1,468,267	20	193,946	3
	1,468,267	**20**	**193,946**	**3**
Long term domestic investments				
B+	945,544	13	746,038	11
	945,544	**13**	**746,038**	**11**
Total domestic investments	**2,413,811**	**33**	**939,984**	**14**
Total investments	**7,452,364**	**100**	**6,953,030**	**100**

Note 23(iii): Market Risk

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

(a) Foreign Exchange Risk

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

As at 31 December 2014 Bank of Papua New Guinea's net exposure to major currencies in kina terms was as follows.

	CURRENCY OF DENOMINATION								
As at 31 December 2014	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	194,125	–	123,008	218,383	104,298	103,005	–	2,993	745,812
Gold holdings	–	129,817	–	–	–	–	–	–	129,817
Investments	2,914,038	–	767,551	991,476	192,317	150,274	–	–	5,015,656
Derivative assets	22,897	–	–	–	–	–	–	–	22,897
Assets held with IMF	–	–	–	–	–	–	35,098	–	35,098
Accrued interest	861	–	3,222	6,278	2,402	222	–	13,095	26,080
	3,131,921	**129,817**	**893,781**	**1,216,137**	**299,017**	**253,501**	**35,098**	**16,088**	**5,975,360**
Foreign Currency Financial Liabilities									
Liabilities with IMF	–	–	–	–	–	–	472,985	–	472,985
Foreign currency liabilities	2,074	–	–	–	–	–	–	–	2,074
	2,074	**–**	**–**	**–**	**–**	**–**	**472,985**	**–**	**475,059**
Net Foreign Currency Exposure	**3,129,847**	**129,817**	**893,781**	**1,216,137**	**299,017**	**253,501**	**(437,887)**	**16,088**	**5,500,301**

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
Gold holdings	–	123,169	–	–	–	–	–	–	123,169
Investments	1,658,678	–	1,732,698	1,623,882	292,801	558,793	–	131,296	5,998,148
Derivative assets	14,898	–	–	–	–	–	–	–	14,898
Assets held with IMF	–	–	–	–	–	–	34,791	–	34,791
Accrued interest	5,541	–	13,180	16,778	4,381	1,160	–	1,975	43,015
	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

The functional currency of all operations is Kina.

(b) Interest rate risk

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

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

(c) Liquidity Risk

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

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

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

		MATURITY PROFILE					
(K'000)	Balance Total	On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity
As at 31 December 2014							
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	745,812	–	745,812	–	–	–	–
Gold	129,817	–	–	–	–	–	129,817
Financial Assets at fair value	5,038,553	–	1,408,083	466,264	2,852,920	311,286	–
Assets held with IMF	35,098	–	–	–	–	–	35,098
Accrued interest	26,080	–	16,375	9,705	–	–	
	5,975,360	**–**	**2,170,270**	**475,969**	**2,852,920**	**311,286**	**164,915**
Local Currency Financial Assets:							
Government of Papua New Guinea Securities	2,413,811	–	86,465	1,376,767	151,534	799,045	–
Loans and advances	10,076	–	–	–	–	10,076	–
Accrued interest	39,345	–	9,442	29,903	–	–	–
	2,463,232	**–**	**95,907**	**1,406,670**	**151,534**	**809,121**	**–**
Non-financial assets:							
Property plant and equipment	117,475	–	–	–	–	–	117,475
Investment properties	38,740	–	–	–	–	–	38,740
Other non-financial assets	52,790	–	–	–	–	–	52,790
	209,005	**–**	**–**	**–**	**–**	**–**	**209,005**
Total Assets	**8,647,597**	**–**	**2,266,177**	**1,882,639**	**3,004,454**	**1,120,407**	**373,920**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	472,985	–	–	–	–	–	472,985
Other financial liabilities	2,074	–	2,074	–	–	–	–
	475,059	**–**	**2,074**	**–**	**–**	**–**	**472,985**
Local Currency Financial Liabilities:							
Deposits from bank and third parties	3,432,690	3,432,690	–	–	–	–	
Deposits from Government	1,064,491	1,064,491	–	–	–	–	
Securities issued	2,306,685	–	2,298,862	7,823	–	–	–
Accrued interest payable	5,031	–	4,973	58	–	–	–
Currency in Circulation	1,850,629	–	–	–	–	–	1,850,629
Other financial liabilities	51,517	–	51,517	–	–	–	–
	8,711,043	**4,497,181**	**2,355,352**	**7,881**	**–**	**–**	**1,850,629**
Total Liabilities	**9,186,102**	**4,497,181**	**2,357,426**	**7,881**	**–**	**–**	**2,323,614**

(K'000)	Balance Total	MATURITY PROFILE On demand	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity
As at 31 December 2013							
Assets							
Foreign Currency Financial Assets:							
Cash and cash equivalents	651,334	–	651,334	–	–	–	–
Gold	123,169	–	–	–	–	–	123,169
Financial Assets at fair value	6,013,046	–	1,527,520	797,661	3,233,439	454,426	–
Assets held with IMF	34,791	–	–	–	–	–	34,791
Accrued interest	43,015	–	29,976	13,039	–	–	–
	6,865,355	**–**	**2,208,830**	**810,700**	**3,233,439**	**454,426**	**157,960**
Local Currency Financial Assets:							
Government of Papua New Guinea Securities	939,984	–	–	193,946	53,893	692,145	–
Loans and advances	11,520	–	–	–	–	11,520	–
Accrued interest	15,406	–	5,731	9,675	–	–	–
	966,910	**–**	**5,731**	**203,621**	**53,893**	**703,665**	**–**
Non-financial assets:							
Property plant and equipment	150,837	–	–	–	–	–	150,837
Other non-financial assets	48,868	–	–	–	–	–	48,868
	199,705	**–**	**–**	**–**	**–**	**–**	**199,705**
Total Assets	**8,031,970**	**–**	**2,214,561**	**1,014,321**	**3,287,332**	**1,158,091**	**357,665**
Liabilities							
Foreign Currency Financial Liabilities:							
Liabilities with IMF	469,056	–	–	–	–	–	469,056
Other financial liabilities	16,042	–	16,042	–	–	–	–
	485,098	**–**	**16,042**	**–**	**–**	**–**	**469,056**
Local Currency Financial Liabilities:							
Deposits from bank and third parties	2,151,184	2,151,184	–	–	–	–	–
Deposits from Government	980,172	980,172	–	–	–	–	–
Securities issued	3,190,336	–	1,120,478	2,069,858	–	–	–
Accrued interest payable	8,650	–	3,033	5,617	–	–	–
Currency in Circulation	1,749,226	–	–	–	–	–	1,749,226
Other financial liabilities	45,076	–	45,076	–	–	–	–
	8,124,644	**3,131,356**	**1,168,587**	**2,075,475**	**–**	**–**	**1,749,226**
Total Liabilities	**8,609,742**	**3,131,356**	**1,184,629**	**2,075,475**	**–**	**–**	**2,218,282**

Note 23(iv): Fair Value

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

	2014 K'000	2013 K'000
Financial Assets		
Cash and cash equivalents	745,812	651,334
At fair value through profit/(loss)	7,656,019	7,110,990
Loans & receivables	75,501	69,941
Assets accounted for under other standards	170,265	199,705
	8,647,597	**8,031,970**
Financial Liabilities		
At fair value through profit/(loss)	475,059	485,098
At amortised cost	8,711,043	8,124,644
Provisions	16,847	15,085
	9,202,949	**8,624,827**

Fair values 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.

The table below shows the Bank's assets and liabilities in their applicable fair value level. Investments managed by external fund managers include foreign Government bonds and other debt instruments for which quoted prices are available as well as derivatives which are valued with reference to observable market data. Accordingly, these are classified under level 1 and 2 respectively.

In Kina (K'000)	Level 1	Level 2	Level 3	Total
31 December 2014				
Financial assets held at fair value through profit or loss				
– Domestic Government Securities - inscribed stock and treasury bills	–	–	2,413,811	2,413,811
– Foreign Government and semi-Government bonds	2,041,250	–	–	2,041,250
– Money market instruments	–	519,268	–	519,268
– Derivatives managed by external fund managers	–	22,897	–	22,897
– Investments in bonds and other instruments managed by external fund managers	2,455,138	–	–	2,455,138
– Gold	129,817	–	–	129,817
– Assets held with IMF	35,098	–	–	35,098
– Investment property	–	–	38,740	38,740
Total assets at fair value through profit or loss	**4,661,303**	**542,165**	**2,452,551**	**7,656,019**
Non financial assets at fair value				
– Property plant and equipment	–	–	117,475	117,475
Total assets at fair value	**4,661,303**	**542,165**	**2,570,026**	**7,773,494**
Financial liabilities held at fair value through profit & loss				
– Derivatives	–	2,074	–	2,074
– Liabilities with IMF	472,985	–	–	472,985
Total liabilities at fair value through profit or loss	**472,985**	**2,074**	**–**	**475,059**
31 December 2013				
Financial assets held at fair value through profit or 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 at fair value through profit or loss	**4,828,659**	**1,342,347**	**939,984**	**7,110,990**
Non financial assets				
– Property plant and equipment	–	–	150,837	150,837
Total assets at fair value	**4,828,659**	**1,342,347**	**1,090,821**	**7,261,827**
Financial liabilities held at fair value through profit & loss				
– Derivatives	–	16,042	–	16,042
– Liabilities with IMF	469,056	–	–	469,056
Total liabilities at fair value through profit or loss	**469,056**	**16,042**	**–**	**485,098**

The following table presents the changes in Level 3 instruments (excluding the accrued interest) for year ended 31 December 2014:

	Level 3 K'000
Opening balance	939,984
Investment net of maturities	1,571,212
Fair value revaluation gains/(losses) on level 3 instruments	(97,385)
Closing balance	**2,413,811**
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.	**(97,385)**

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

	Level 3 K'000
Opening balance	796,539
Investment net of maturities	172,148
Fair value revaluation gains/(losses) on level 3 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)**

Note 23(v): Sensitivity Analysis

The sensitivity of the Bank's profit and equity to a movement of +/- 10 per cent in the value of the Kina as at 31 December 2014 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2014 K'000	2013 K'000
Changes in profit/equity due to a 10 per cent appreciation in the value of the Kina	(567,847)	(625,700)
Changes in profit/equity due to a 10 per cent depreciation in the value of the Kina	694,035	625,700

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

	2014 K'000	2013 K'000
Changes in profit/equity due to an increase of 1 percentage point	51,647	65,100
Changes in profit/equity due to a decrease of 1 percentage point	(51,647)	(60,900)

Note 24: EVENTS AFTER THE BALANCE DATE

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

Note 25: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2014 (2013: nil) and there are no transactions or events that will have material impact on the financial report during the preparation of this report.

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

Note 26: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

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

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank: this group comprises 25 in total (2013: 25), 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 *Central Banking Act 2000*. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

	2014 K'000	2013 K'000
Short term benefits	7,691	6,693
Post employment benefits	862	832
Other long term benefits	3,017	2,709
	11,570	**10,234**

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

As at 31 December 2014, the loans owed by the key management personnel to the Bank were K1,800,652 (2013: K1,716,077)

Note 28: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,171,775 (2013: K1,063,500). This represents the total statutory audit fee paid to the Auditor General's Office and other auditors in relation to external fund manager operations. These transactions are performed at arm's length.

Note 29: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

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

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

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

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

Declaration by Management

In our opinion the foregoing Statement of Profit or Loss and other Comprehensive Income and Statement of Financial Position, including the Notes to and forming part thereof, have been drawn up to give a true and fair view of the matters to which they relate for the year ended 31 December 2014.

Going concern

The Bank recorded a total comprehensive profit of K139.5 million in 2014 compared to a profit of K608 million in 2013 and recorded a negative operating cash flow of K377.9 million compared to a positive cash flow of K2,175 million in 2013. In addition, total liabilities of the bank exceeded its total assets by K555.3 million compared to a net liabilities of K592.8 million in 2013. The Bank envisages this net deficiency position to improve slightly as a result of the recent depreciation of the PNG Kina which will partly offset the high cost of monetary policy management stemming from high domestic liquidity.

Safeguard available to the Bank

Section 50(2) of the *Central Banking Act 2000* (the CBA Act) provides that where the Bank incurs a loss due to a change in the value of assets or liabilities, the Minister shall cause to be paid to the Bank such amount out of the Consolidated Revenue Fund as is necessary to avoid the loss. 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 of the Act effectively require the Government to provide financial support to the Bank and under the powers of the Act the Minister issued a Promissory Note on the 10th December 2014. Under the terms of the promissory note the Independent State of Papua New Guinea promises to pay on demand to the Bank, K1.12 billion without interest. This note is valid for as long as the Bank has a negative valuation reserve in its audited financial statements.

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.

The Bank reported a distributable profit of K102.9 million for the 2013 financial year. The Board recommended retaining that profit as part of the Bank's Capital and Reserves. Subsequent to the Board's endorsement, the Bank wrote to then the Minister for Treasury to retain the 2013 profit citing the Bank's net asset deficiency and that any dividend would be in contravention of the Act. However, the Bank was subsequently directed by the National Executive Council (NEC) Decision in December 2013 to pay the dividend of K102 million and NEC further proceeded in issuing the Promissory Note to Bank of Papua New Guinea.

Operation of TAP facility on behalf of the Government

In 2011 the Bank agreed on a memorandum of understanding (MOU) with the Treasury Department to offer Kina 200 million through a tap facility. The MOU enable the Bank to acquire Kina 200 million of Treasury Bills and on- sold to the public as Central Bank Bills. The facility was used for monetary policy purposes.

Declaration by Management

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 has approached the Government to consider moving all trust accounts in commercial banks back to Bank of PNG.

Resources Sector gain 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. An outcome of this dialogue together with discussion on sovereign wealth fund is still on going.

The Bank will continue the dialogue with the appropriate Government authorities to ensure the Bank's net asset 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 2015

Benny B.M. Popoitai MBE
Deputy Governor

Report of the Auditor-General

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

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Our Reference: 30-13-4

The Honourable Patrick Pruaitch, MP
Minister for Treasury
Office of the Minister
Vulupindi Haus – Level 4
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WAIGANI, NCD

INDEPENDENT AUDITOR'S REPORT ON THE
BANK OF PAPUA NEW GUINEA
FOR THE YEAR ENDED 31 DECEMBER 2014

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2014** as set out on pages **2** to **26** which comprise the Statement of Financial Position as at 31 December, 2014, the Statement of Profit or Loss and Other 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.

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

The Bank's management 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, selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

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.

– 2 –

The procedures selected depend on my judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, I considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 made by management, 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, 2014 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.

Nauga

PHILIP NAUGA
Auditor-General

16 June, 2015

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

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Our Reference: 30-13-4

The Honourable Patrick Pruaitch, MP
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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, 2014**.

My report on the financial statements of the Bank together with a copy of the financial statements was forwarded to you on 12 June, 2015. 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.

Compliance with the Central Banking Act, 2000

During the year the Bank made a PGK102 million dividend payment to the Independent State of Papua New Guinea. This payment was in contravention of *Section 49 (3)* of the *Papua New Guinea Central Banking Act, 2000* which states that no amount shall be paid into the Consolidated Revenue Fund where in the opinion of the Bank, the assets of the Bank are, or after payment would be, less than the sum of its liabilities and paid-up capital.

PHILIP NAUGA
Auditor-General

16 June, 2015

Notes


BANK OF PAPUA NEW GUINEA