



Bank of Papua New Guinea



**ANNUAL
REPORT AND
FINANCIAL
STATEMENTS**

31 DECEMBER 2016



Bank of Papua New Guinea

ANNUAL REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDING 31 DECEMBER 2016

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 CMG, Governor and Chairman of the Board

2016 was a challenging year for Papua New Guinea (PNG). While the country recovered from the El Niño drought, low international commodity prices continued to affect foreign exchange inflows, Government revenue and economic activity, resulting in lower economic growth. The National Government introduced a Supplementary Budget in response to the lower revenue. 2016 also saw PNG at the front of the international stage with the successful hosting of the 8th African-Caribbean-Pacific (ACP) Head of State summit and the Under-20 FIFA Women's World Cup.

These developments, while challenging, also created opportunities for the Bank of PNG in carrying out its functions during the year. The Bank continued to undertake various initiatives to enhance the way it conducts its responsibilities of formulating and conducting monetary policy, supervising the financial system and improving the national payments system. The Bank's 5 year strategic plan for 2016-2020 also came into operation.

I am pleased to present in this Annual Report a summary of our activities and achievements as the Central Bank of PNG during the year 2016.

PNG continued to experience a challenging domestic environment in 2016, compounded by developments abroad. The economy grew for the 15th consecutive year, but at a slower rate. Inflation was at manageable levels of around 6 percent and there was a turnaround with the balance of payments recording a surplus. This reflected the recovery in agriculture production after the El Niño drought and resumption of operations by two mines. In the second half of the year, favourable foreign exchange inflows from the agriculture and mining sectors and external financing for the Government's budget resulted in stability in the exchange rate.

Our 2016–2020 Strategic Plan was launched in April 2016. It lays out our goals and initiatives for the next 5 years, covering strategic initiatives and programs as well as business-as-usual activities. The Plan encourages a 'one-bank' approach with improved planning and reporting frameworks.

The supply of foreign currency, including Central Bank intervention, did not clear the outstanding orders in the foreign exchange market, due to various practices by the Authorised Foreign Exchange Dealers (AFEDs). The Bank therefore announced several foreign exchange control directives in September and November 2016. The directives included requiring holders of onshore foreign currency accounts to reapply to the Bank for assessment, restricting trade finance and forwards transacted in foreign currencies that used spot market proceeds, and stopping the rationing of foreign exchange transactions.

The high level of liquidity in the banking system continued into 2016 due to high Government expenditure. While not inflationary, it weakened the monetary policy transmission mechanism. Plans to introduce changes to the monetary policy signalling rate, the Kina Facility Rate (KFR), were put on hold pending further assessment.

On-going supervision of the financial system continued in 2016 with the issuance of prudential standards on corporate governance for banks and risk management for life insurance companies. *The Savings & Loan Societies Act 2015* became operational, and four supervisory colleges were held for cross-border banks.

Work on developing the payment system continued. More agencies were linked to it. The Department of Finance trialled and tested its electronic funds transfer facility, while PNG

Customs Service conducted a successful trial with customs agents. Work continued on interfacing KATS with the Internal Revenue Commission's (IRC's) SIGTAS system. The dishonour period of bank cheques was reduced from 4 business days to 3 business days.

In 2016 the Financial Action Task Force (FATF) removed PNG from the 'grey list'. This important milestone followed the passing of the anti-money laundering and counter-terrorist financing legislation in 2015 and the establishment of the necessary agencies. In 2016 these actions included appointing the director for the Financial Analysis and Supervision Unit (FASU). I am delighted to report that FATF acknowledged PNG as the fastest reforming country in the Asia Pacific group, a testament to our commitment to ridding PNG of money laundering and terrorism financing

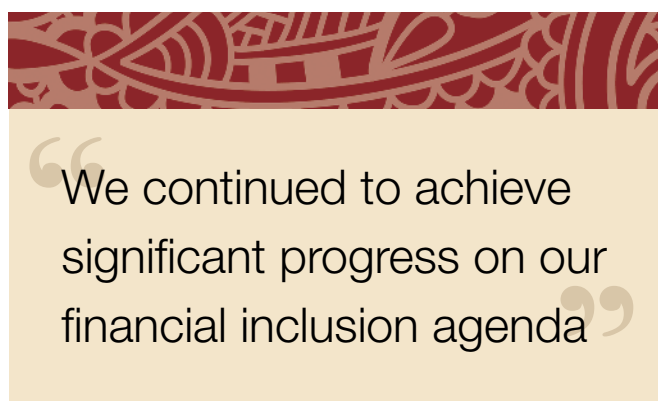
Work continued during the year on establishing the operations of the Sovereign Wealth Fund (SWF) of PNG. The Bank sought external technical assistance to assist in setting up the SWF administrative secretariat.

We continued to achieve significant progress on our financial inclusion agenda, conducting public awareness at provincial cultural shows and achieving most targets under the first National Strategy for Financial Inclusion and Financial Literacy. Our collaboration with the Centre for Excellence in Financial Inclusion (CEFI) saw the launch of the second National Strategy for Financial Inclusion and Financial Literacy 2016 – 2020 during the year.

The financial services sector review undertaken jointly by Department of Treasury and the Bank of PNG, with additional support from the World Bank, led to the drafting of a financial sector development strategy. The draft strategy was presented at workshops around the country for review and comments from the public.

In currency-related matters, the Bank continued to enhance the Nation's currency by adjusting the banknotes so each can be differentiated by size. While the paper banknotes are no longer legal tender, the Bank extended the period to return the notes to December 2016. Work on the construction of our currency distribution facility in Lae progressed well during 2016.

We completed the new purpose-built data centre in the Bank. The computer servers supporting our computer systems and associated information technology facilities are now housed in a secure and appropriate venue.



Following on from our successful hosting of the several significant South East Asian Central Banks (SEACEN) activities in previous years, in August 2016 the Bank hosted the 38th Meeting of SEACEN Directors of Research and Training, attended by research directors and human resource managers of SEACEN member central banks.

Building and maintaining the capacity of our people is always an organisational priority. I acknowledge the assistance we received in training and capacity building from the many institutions and organisations in PNG and abroad during 2016. These included the universities and colleges, the International Monetary Fund (IMF), the Pacific Financial Technical Assistance Centre (PFTAC), SEACEN Centre, Alliance for Financial Inclusion, Austrac and Australian Business Volunteers (ABV).

In closing, I extend my sincere thanks to my fellow Board members, newly appointed Deputy Governor Dr Gae Kauzi, staff members and management for your commitment and support in 2016, in so doing demonstrating clearly the Bank's ability to manage and deliver in testing economic times.

I look forward to the promise of 2017 being another productive year as we continue to work towards achieving our vision of being 'a contemporary central bank and regulator excelling in performing its core functions and making a distinct and valuable contribution to the financial stability and economic prosperity of Papua New Guinea'.

Loi M. Bakani CMG

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

Highlights

National Payment System enhancements

- Cheque clearing time improved by 25%, 4 business days down to 3 business days. (See page 25)
- PNG Customs Service payments automated, ready for launch. (See page 27)
- Department of Finance electronic funds transfer facility activated. (See page 27)



Governor Bakani re-appointed

Loi M. Bakani CMG was reappointed as Governor of the Bank for a further seven year term. (See page 10)

PNG removed from 'grey list'

Real progress has been achieved in the area of Anti-Money Laundering and Counter-Terrorist Financing (AML/CTF). The Financial Action Task Force (FATF) delisted PNG from the 'grey list' and acknowledged the nation as the fastest reforming Asian-Pacific country. (See page 32)

CDF foundations laid at Lae

The construction of the Currency Distribution Facility at Lae moved forward with the laying of the foundations. (See page 25)



The Bank launches new Strategic Plan 2016-2020



Members of the Board celebrating the launch of the Bank's Strategic Plan 2016-2020. (See page 33)



Change for K5 banknote

During the year the K5 banknote was resized and additional security features were added, as part of the Bank's banknote reform program. (See page 25)

Financial inclusion activities



Financial Expos were held successfully in Mount Hagen, Western Province and Vanimo, Sandaun Province during the year.



Dr Gae Kauzi appointed Deputy Governor.

Government securities investment development

During 2016 the Bank made solid progress towards building a secondary market for Government securities, replacing the manual registry system with a web-based Registry and Market System (RMS). (See page 29)

SEACEN activities

The Bank continued to be an active participant in South East Asian Central Banks (SEACEN) programs and activities. The Bank of Papua New Guinea hosted the 38th Meeting of SEACEN Directors of Research and Training in August 2016.



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.



*Front L to R: Mr Simon Tosali, Mr Loi M. Bakani CMG, Bishop Denny Bray Guka, Mr John Leahy.
Back L to R: Dr Gae Kauzi, Mr Richard Kuna, Mr Alex Tongayu MBE.*

Members of the Board of the Bank of Papua New Guinea

31 December 2016

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

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

The Governor is the Chief Executive Officer and the Chairman of the Board of the Bank, a practice not uncommon in central banks around the world.

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

Composition of the Board

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

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

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

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

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

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

Management Structure

The Bank has an established management structure and clear management reporting lines, in line with principles of good corporate governance. Four Assistant Governors are responsible for the different functional areas and report directly to the Governor. The Corporate Secretary, Internal Audit Department and Financial Analysis and Supervision Unit also report directly to the Governor.

Each functional group is headed by an Assistant Governor responsible for related Departments comprised of various units. A number of inter-departmental management committees are established to perform various functional and management responsibilities for and on behalf of the Governor.

Funding

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

The Board Governors

Governor and Chairman

Loi M. Bakani CMG

Mr Loi M. Bakani CMG was appointed Governor and Chairman of the Board of the Bank in December 2009. He is also the Registrar of Savings and Loan Societies in PNG.

He was reappointed for a further 7 year term in December 2016. Mr Bakani's reappointment followed a rigorous assessment of his performance by the Board. This process marked a strengthening of the Bank's governance practices.

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

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

Deputy Governor

Dr Gae Kauzi

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

Dr Kauzi has been employed with the Central Bank since May 1993. In 2011 he was appointed Assistant Governor responsible for the Monetary & Economic Policy group.

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

Members of the Board

Mr John Leahy

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

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

He has been on the Boards of several large companies and organisations including Bougainville Copper Limited, BNG Trading Company Limited and the Pacific Islands Private Sector Organisation (PIPSO), as well as numerous smaller privately owned companies and subsidiaries of overseas companies.

Mr Leahy 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

Bishop Denny Bray Guka

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

Bishop Guka is the Anglican Bishop of Port Moresby. He is the Chairman of Anglicare Board and the PNG Council of Churches. He is also a board member of Wai Tri Trust in the Western Province and a member of Release on Licence Committee and Lawyers Statutory Committee.

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

Mr Alex Tongayu MBE

Mr Tongayu was appointed Acting Chairman of the Securities Commission of PNG in November 2012 and by virtue of that position is an *ex officio* member of the Board.

As the Acting Chairman of the Securities Commission of PNG, Mr Tongayu is also the Registrar of Companies. Mr Tongayu's other responsibilities include Registrar of Personal Properties Securities Registry and the Chairman of the Accounting Standard Board of PNG. He is also a member of the National Coordinating Committee on Anti Money Laundering & Counter Terrorism Financing.

Mr Tongayu holds a Bachelor of Laws degree from University of Papua New Guinea, a Masters degree in Public Administration from Divine Word University and a Certificate in Global Leadership in the Financial Markets from the Toronto Center in Canada.

Mr Bart Philemon

Mr Philemon was appointed to the Board on 26 June 2013. His term as a member of the Board ended on 26 June 2016.

Ms Betty Palaso

Ms Palaso was appointed to the Board on 26 June 2013. Her term as a member of the Board ended on 26 June 2016.

Mr Simon Tosali

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

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

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

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

Mr Richard Kuna

Mr Kuna was appointed President of CPA PNG in November 2015.

Mr Kuna is a Certified Practising Accountant, qualified to practise in Australia and PNG. He is currently in private practice with Kuna Taberia Kiruwi Accountants & Advisors. Mr Kuna is also a member of the Oil Search Board Audit & Financial Risk Committee, Kumul Minerals Holdings Limited, Central Supply & Tenders Board and the Accountants Registration Board of Papua New Guinea.

He holds a Bachelor of Business in Accounting degree from the University of Technology, Sydney, Australia.

Board Meetings

The Board meets at least once in every three months, in March, June, September and December each year. The March 2016 meeting was held in Alotau, Milne Bay province while the other three were held in Port Moresby.

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

Board Member	Meetings Eligible to Attend	Meetings Attended
Mr Loi M. Bakani CMG	4	4
Dr Gae Kauzi	2	2
Mr John Leahy	4	2
Bishop Denny Guka	4	3
Mr Alex Tongayu MBE	4	4
Mr Bart Philemon	2	1
Ms Betty Palaso	2	1
Mr Simon Tosali	4	4
Mr Richard Kuna	4	4

Board Committees

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

Two Board Committees operated in 2016.

Board Audit & Governance Committee

The Board Audit & Governance Committee comprised of Mr Alex Tongayu MBE as Chairman and Mr John Leahy and Mr Richard Kuna as members.

The Committee's role is to provide the Board with a level of understanding of the Bank's operations and management and assurance that the Bank's performance in financial reporting, internal controls, risk management, compliance and other governance practices and processes meet the required standards and expectations.

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

Board Remuneration & Succession Planning Committee

The Board Remuneration & Succession Planning Committee comprised Mr John Leahy as the Chairman and Bishop Denny Guka and Ms Betty Palaso as members. Mr Simon Tosali replaced Ms Palaso at the end of her term as Board member.

The Committee's primary responsibility is to assist the Board to determine the Bank's staff employment terms and conditions in consultation with other relevant government agencies.

This Committee is also responsible for succession planning and for assessing the performance and appointment of the Governor in accordance with the *Statutory Regulatory Authority (Appointment to Certain Offices) Act*.

The Committee meets twice a year and otherwise as required.

During the year the Committee was engaged in reviewing the Governor's performance over the course of his term to determine his suitability for reappointment.

Internal Management Committees

Several management committees continued to function throughout 2016, each with specific roles and responsibilities set out in individual charters. These included the Executive Committee, the Monetary Policy Committee, the Investment Committee, the National Payment System Committee, the Tender Committee and the Information Technology Governance Committee.

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

Internal Audit

A strong, independent and objective internal audit function is a key part of the Bank's overall commitment to good corporate governance practice. Over the course of 2016 the Bank's internal audit team undertook an ongoing program of routine audits as well as a number of specific reviews.

Risk Management

The Bank continued its program of establishing an effective risk management policy and framework during 2016. Risk management activities conducted during the year included risk assessment for strategic projects, development of a fraud risk management protocol and conducting risk assessments for the Currency Distribution Centres (CDCs).

External Checks and Balances

The Bank continues to ensure that there are external verification measures in its operations as part of its commitment to good governance. These include:

Annual Financial Statements Audit

A requirement under the CBA 2000, the Auditor-General audits the Bank's financial statements every year.

Staff Employment Terms and Conditions

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

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

Peer Review

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

Co-operation with Government Agencies

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

Setting the Right Example

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

Financial Management

The Bank uses comprehensive financial accounting systems to record, monitor and report on all operational transactions in a timely and reliable manner.

The Board of the Bank of Papua New Guinea, in consultation with the Minister for Treasury, determines the allocation of the Bank's operating profit, under the terms of the CBA 2000.

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 2016 was K351.6 million, compared with K322 million in 2015. The income was derived from interest on investment in Government securities as well as fees and commissions on foreign exchange trading and realised gain on financial assets.

Operating Expenditure

Total operating expenditure, comprising interest expense and general administration costs, was K181 million.

Net Operating Profit

The Bank recorded a net operating profit of K170.5 million for 2016, compared to an operating profit of K139.5 million for the 2015 year.

Unrealised Gain/(Loss)

The Bank recorded a net foreign and domestic financial assets revaluation gain of K251.5 million for the year ended 31 December 2016, which was transferred to the Unrealised Profits/(Loss) Reserves. This resulted mainly from the depreciation of the kina against the major currencies during the financial year. Gold valuation gain of K19 million was transferred to the Gold Reserve.

Appropriation

The Bank's Board determines the amount available for distribution to the Government from the Bank's realised profits, in line with the provisions of the CBA 2000. These provisions require the Bank to consult with the Treasury Minister on the amount to be allocated to the Bank's Retained Earnings and any balance of net profits to be paid into the Government's Consolidated Revenue Fund (CRF).

However, if the assets of the Bank are less than the sum of its liabilities and paid up capital, or would be if a payment were made, the Board can decide that no amount is to be paid into the CRF. Furthermore, under the terms of Section 50(1) of the CBA 2000, net profits arising from revaluations of the Bank's assets and liabilities and/or from foreign exchange movements shall not be available for payment into the CRF.

Distribution of Profit

	2012 K'000	2013 K'000	2014 K'000	2015 K'000	2016 K'000
Total Comprehensive Income/(Loss)	39.7	608.1	139.5	680.7	441.2
Unrealised profit/(loss)	15.4	505.2	49.8	541.2	270.7
DISTRIBUTABLE PROFIT/(LOSS)	24.3	102.9	89.7	139.5	170.5
ALLOCATIONS MADE					
Currency Movement Reserve	-	-	-	-	-
Property Revaluation Reserve	-	15.6	-	-	0.2
Unrealised Profits Reserve	8.2	517.6	42.2	536.4	251.5
Gold Reserve	7.2	(28.0)	7.6	4.8	19.0
Retained Profit/(Loss)	24.3	102.9	89.7	139.5	70.5
Consolidated Revenue Fund (Government)	-	-	-	90.0	100.0*

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

2017 Budget Forecast

	Budget 2017 (K'000)	Actual 2016 (K'000)
Operating Income		
Interest received - overseas	87.3	85.1
Interest received - domestic	245.4	248.8
International trading/foreign exchange fees	10.0	10.1
Other income	10.6	7.5
TOTAL INCOME	353.3	351.5
Operating Payments		
Interest payments – domestic operations	69.3	24.4
Financial markets & external fund manager expenses	11.5	6.5
Staff costs	67.4	57.5
Staff training and development	8.9	4.9
Premises and equipment	19.7	25.0
Depreciation of property, plant and equipment	12.4	6.8
Amortisation of notes and coins production	14.4	15.1
Currency distribution expenses	1.8	0.9
Audit fee	1.5	1.2
Travel	11.7	8.4
Legal and consultancy fees	6.4	8.4
Board and meeting expenses	1.5	1.2
Information & communication technology	9.8	6.4
Special projects	14.2	1.7
Other expenses	22.4	12.6
TOTAL PAYMENTS	272.9	181.0
NET OPERATING PROFIT/LOSS	80.4	170.5

Core Functions

MONETARY POLICY

MONETARY POLICY FORMULATION

One of the objectives of the Bank under the CBA 2000 is to formulate and implement monetary policy with a view to achieving and maintaining price stability. In compliance with those requirements, the Bank formulated and released two monetary policy statements (MPS) during 2016, 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 during the year.

On a monthly basis, the Bank sets the Kina Facility Rate (KFR) based on developments and expectations of key macroeconomic indicators, including the quarterly Consumer Price Index (CPI) released by the National Statistical Office (NSO) and the monthly Retail Price Index (RPI) compiled by the Bank.

The Bank's estimates and projections of gross domestic product, 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 such as national and supplementary budgets, such as the Supplementary Budget introduced in August 2016 and for the preparation of the 2017 National Budget. The NSO also released the GDP data for 2007-2014 in 2016.

Inflation outcomes for 2016 were between 6 percent and 7 percent, within the Bank's inflation forecast for the year. Considering this, and consistent with the National Government's fiscal policy stance to stimulate economic activity to ensure positive economic growth, the Bank continued to take a cautious approach by maintaining its neutral stance of monetary policy in 2016.

The main considerations for monetary policy in 2016 were the low international commodity prices and effects of the El Nino drought, which affected foreign exchange flows.

MONETARY POLICY IMPLEMENTATION

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

Inflation was higher in 2016 than over the previous 12 months, with 6.5 percent in March, 6.8 percent in June, 6.8 percent in September and 6.6 percent in December 2016. However, this inflation level was considered manageable and within the Bank's forecast. Accordingly, the Bank maintained the KFR at 6.25 percent throughout the year. Commercial banks maintained their Indicator Lending Rates (ILRs) between 11.20 and 11.70 percent.

High levels of liquidity persisted in 2016. Banking system liquidity, as measured by the Exchange Settlement Account (ESA) balances, continued to remain high, around K1.0 billion. The high ESA level reflected the effect of two foreign commercial banks retiring some of their investments in CBBs and Government securities, due to credit exposure limits, and also from liquidity injected through Government spending.

Continuing its approach adopted in previous years to curb the liquidity level, the Bank continued to issue CBBs, complemented by the Government's issuing of Treasury bills and Treasury bonds to finance its budget.

Repurchase Agreement (Repo)

The Repo market, operating under the unsecured arrangement, was used only during the first and last quarters of 2016. Commercial banks held sufficient balances in their exchange settlement accounts, which resulted in the low demand for Repo and interbank trading.

The Secured Repo Agreement was completed in 2016 and circulated to commercial banks for final review.

Cash Reserve Requirement (CRR)

The CRR was maintained at 10.0 percent throughout the year.

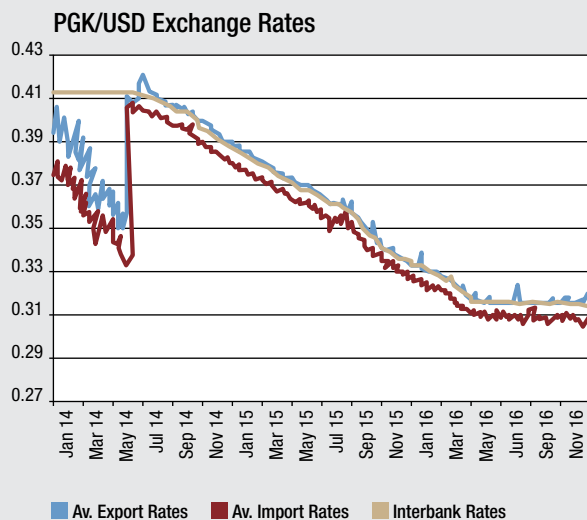
Minimum Liquid Asset Ratio (MLAR)

The MLAR remained at zero throughout 2016.

FOREIGN EXCHANGE MANAGEMENT

Demand for foreign exchange continued to dominate trade in the domestic market. Government expenditure and increased trade finance activities by Authorised Foreign Exchange Dealers (AFEDs) also influenced demand in 2016. Factors influencing the strong demand included the volume of small transactions, the action of AFEDs apportioning foreign currency to large importers and a build-up in unfilled foreign exchange payments.

The turnover in the foreign exchange market increased to K13.9 billion in 2016. The kina depreciated by 5 percent against the US dollar to US\$0.3150 at the end of the year.



During 2016 foreign currency inflows increased by 6 percent. However, this was more than offset by a 9 percent increase in outflows. This imbalance in foreign supply and demand in 2016 resulted in a net outflow of K953 million during the year.

Supply of foreign exchange improved from the second quarter of 2016 following the resumption of operations at the Ok Tedi mine, improvement in international prices of some export commodities and drawdown of overseas loans by the Government. Inflows from the agriculture sector increased sharply by 52 percent, due to high export receipts from oil palm, coffee and marine products. In contrast, inflows from the gas sector declined by 54 percent due to reduced inward remittance.

Major Sector Contributions to Foreign Exchange Flows

	2015 (r) K'm	2016 (p) K'm	Change
Inflows			
Mining	3,473.5	4,143.8	19%
Finance & Business	2,216.9	1,873.9	-15%
Gas	877.2	403.4	-54%
Agriculture	1,859.0	2,825.7	52%
Others*	4,717.8	4,623.8	-1.9%
Total Inflows	13,144.4	13,870.6	6%
Outflows			
Finance & Business	3,391.1	2,873.4	-15%
Retail	2,442.0	2,024.8	-17%
Manufacturing	1,569.5	1,538.6	-2%
Petroleum	1,740.7	1,471.3	-15%
Others**	4,443.7	6,915.2	56.0%
Total Outflows	13,587.0	14,823.3	9%

* 'Others' including Construction, Forestry, Manufacturing, Marine, Mining, Retail and Wholesale, were not included in previous Annual Reports.

** 'Others' including Agriculture, Construction, Forestry, Gas, Marine, Mining, Transport and Wholesale, were not included in previous Annual Reports.

Kina Trading Margin

In 2016 all AFEDs complied with the kina trading margin, maintaining the margins for quoting foreign exchange deals within the specified 75 basis points limit above and below the interbank mid-rate.

Intervention

The Bank intervened in the domestic foreign exchange market to provide foreign currency liquidity. In 2016 the Bank sold a total of US\$424.0 million in the domestic foreign exchange market, lower than US\$833.3 million in 2015. Due to the mismatch in foreign exchange flows, the Bank also provided US dollars to targeted sectors of the economy that are of national and strategic importance.

Core Functions

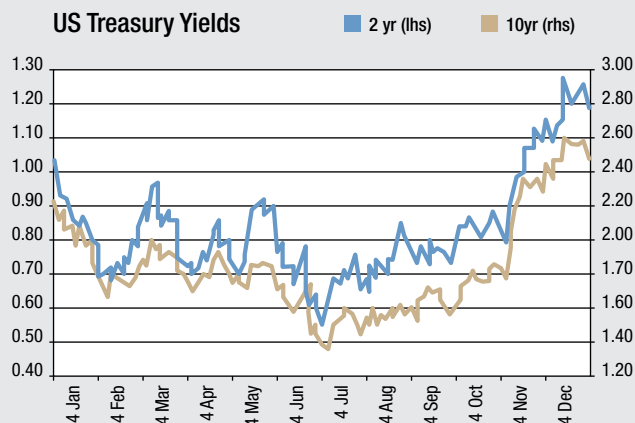
Exchange Rates

	End of Dec 2015	End of Dec 2016	YTD (% Change)
PGK/USD	0.3325	0.3150	-5.3%
PGK/AUD	0.4552	0.4354	-4.3%
PGK/EUR	0.3043	0.2989	-1.7%
PGK/GBP	0.2243	0.2564	14.3%
PGK/JPY	40.04	36.75	-8.2%
PGK TWI	33.27	32.00	-3.8%

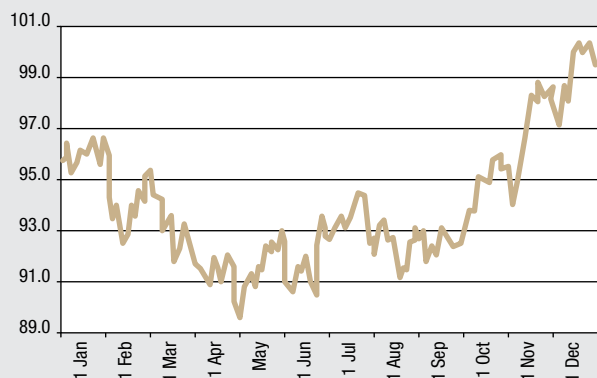
Foreign Currency and Interest Rates Risks

The US Federal Reserve (Fed) raised its benchmark interest rate in December 2016 by a quarter of percentage point to 0.75 percent. This increase followed a previous increase in 2015, as the Fed moved towards normalising its monetary policy following years of quantitative easing and in response to improved economic conditions in the US.

US Treasury Yields



US Dollar Index



In contrast, the European Central Bank and the Bank of Japan maintained their monetary policy stances. They provided liquidity into their respective domestic markets through their bond purchase programs.

In response to market developments, the Bank of Papua New Guinea maintained a neutral approach to its overseas investments in 2016. A strong US dollar and the need to support the domestic foreign exchange market resulted in the Bank holding a long US dollar position against other major investment currencies.

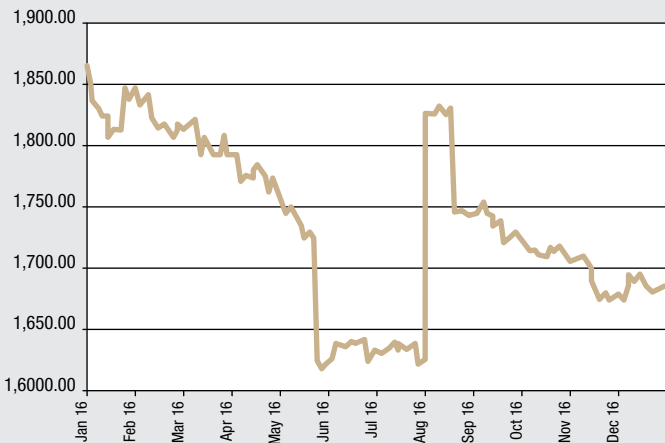
FOREIGN RESERVES MANAGEMENT

The Bank of Papua New Guinea is responsible for the management of the country's gold, foreign exchange and other international reserves. The main reasons for the Bank to hold foreign exchange reserves are to:

- support price stability (a core objective of the Bank's monetary policy)
 - service the State's foreign debt
 - minimise the impact of external shocks on the domestic economy.
- The Bank's primary objectives for managing foreign exchange reserves are to:
- preserve the capital value of the foreign exchange reserves
 - maintain adequate foreign currency liquidity
 - manage credit risk conservatively
 - earn an acceptable rate of return on the investment of reserves.

In 2016 the level of foreign reserves declined to US\$1.7 billion (K5.3 billion) from US\$1.86 billion (K5.52 billion) in 2015. The main factors associated with the decline were the Bank's intervention in the domestic foreign exchange market and payment of Government overseas debt.

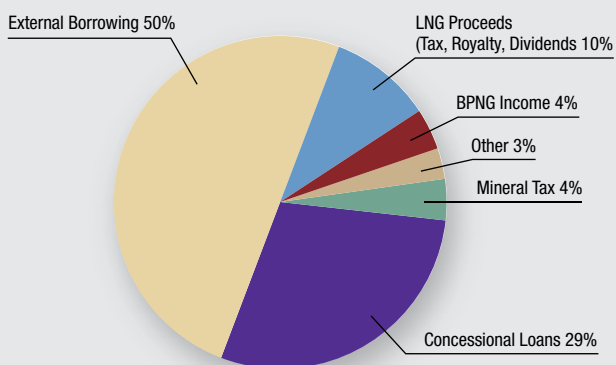
Daily Foreign Exchange Reserves (US\$m)



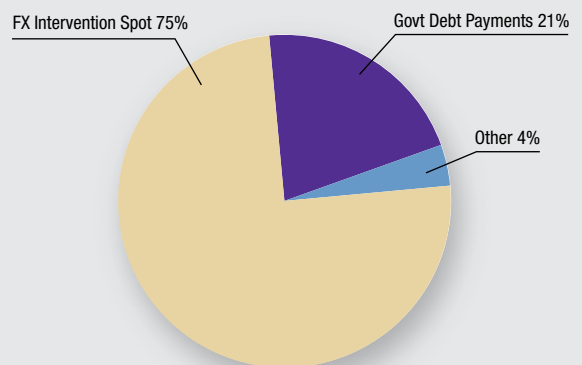
Inflows into the foreign exchange reserves in 2016 totalled US\$380.7 million, compared to outflows of US\$565.9 million. Inflows comprised overseas loans totalling US\$298.8 million (concessional and commercial), Mineral Tax of US\$24.5 million, LNG proceeds of US\$29.5 million (royalties and development levy) and investment income of US\$17.0 million.

Outflows from the foreign exchange reserves during the year totalled US\$565.9 million. The outflows mainly comprised the Bank's intervention in the domestic foreign exchange spot market of US\$424.0 million and Government foreign debt repayments of US\$118.3 million.

Inflows into Foreign Exchange Reserves 2016



Outflows from Foreign Exchange Reserves 2016



Fund Performance

In-house managed funds

The Bank's in-house managed reserves generated returns of 1.20 percent over the year to December 2016, compared to 0.97 percent in 2015. The return was generated mainly from investment in Australian money market instruments and bonds.

Outsourced funds

The Bank's outsourced funds in 2016 increased to a total value of US\$1,138.2 million (US\$1,122.6 million in 2015), yielding an average return of 1.59 percent. This return exceeded the 1.18 percent return of the benchmark, the fully hedged Citi Group 1-3 year World Government Bond Index.

Average Annual Return (%)

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

Composition of Foreign Exchange Reserves

The total foreign exchange reserve level as at 31 December 2016 was US\$1,685.4 million (K5,266.9 million).

Foreign Exchange Reserves 2016

Date	Inhouse Managed Reserves ('m)		Outsourced Funds ('m)		Gold		Total Invested Foreign Exchange Reserves ('m)		IBRD		Total Foreign Exchange Reserves ('m)	
	USD	PGK	USD	PGK	USD	PGK	USD	PGK	USD	PGK	USD	PGK
31-Dec-16	496.81	1,552.53	1,138.48	3,557.75	49.86	155.80	1,685.14	5,266.07	0.25	0.78	1,685.39	5,266.85
31-Dec-15	696.60	2,054.01	1,122.64	3,326.35	45.59	135.09	1,864.84	5,525.45	0.25	0.74	1,865.09	5,526.19
Change	-199.79	-511.48	15.84	231.40	4.27	20.71	-179.70	-259.38	0.00	0.04	-179.70	-259.34
Change (%)	-29%	-25%	1%	7%	9%	15%	-10%	-5%	0%	5%	-10%	-5%

International Transactions Monitoring

Foreign Exchange Control Directives

Following on from the release of directives relating to foreign exchange in March 2015, the Bank issued a further series of directives to the AFEDs in September, October and November 2016 to improve the functioning of the domestic foreign exchange market. The 2016 Directives re-emphasised that settlement of contracts between residents are required to be made in kina and prescribed the conditions for operating onshore foreign currency accounts (FCAs), as well as for trading in trade finance and the spot foreign exchange market. Such issues had affected the efficient functioning of the spot foreign exchange market, increasing transaction costs for business and allocation of foreign currency.

The key requirements of the Directives included:

- Holders of onshore FCAs were required to re-apply to the Bank for assessment and approval, showing proof of sources of foreign currency as well as ongoing offshore commitments for 3 months. Holders of both onshore and offshore FCAs in the same currency were instructed to close down one and to limit their onshore FCA to one currency per bank.

- Trade finance loans in foreign currencies were to be funded by AFEDs from their own funds and not from the spot market
- AFEDs were to use their own funds to clear forward orders rather than using proceeds from the Central Bank's interventions
- Improved reporting from AFEDs, separating out their spot orders from the forwards and trade finance.

Foreign Currency Accounts

In response to the Directives, the Bank received 14 FCA applications. The Bank approved 2 out of the 14 applications.

Following the September 2016 Directives, all onshore FCAs that had not been approved after the March 2015 Directives or had not been opened under a Project Development Agreement were required to be resubmitted to the Bank for assessment.

Gold Export Licences

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

Applications received in 2016	21
Applications approved in 2016	
– Gold Exports Limited	
– Golden Valley Enterprises Limited	
– Issacc Lete Lumbu Gold Buyers Ltd	
– Itaipreziosi South Pacific Limited	
– Vertic Ltd	
– Meekom Minerals Ltd	
– Transpacific Metals Ltd (licence cancelled during the year)	
– Precious Metals Mining and Refining Ltd	8
New applications approved	2
– Aviga Impex	
– Niella Au Limited	
Applications requiring more information	5
Applications cancelled	6

Domestic Lending in Foreign Currency

Contracts between residents denominated in foreign currency require prior approval of the Bank. Their settlements must be in kina.

Applications approved and renewed in 2016	11
Value of transactions (K'm)	668.9

Contingent Guarantees in Favour of Non-Residents

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

Applications received in 2016	5
Applications approved	5

Cash taken out of PNG

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

Applications received and reviewed in 2016	17
Applications approved	17
Value of approved transactions (K'm)	1.0
Value of physical cash removed or taken out of PNG (K'm)	0.9
Value of approved numismatic notes exported (K'm)	0.05

FINANCIAL SYSTEM

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

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

This is achieved through:

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

Core Functions

The Financial System

Type of institution	31 Dec 2016	31 Dec 2015
Commercial banks	4	4
Licensed financial institutions including micro-banks (LFIs)	12	14
Savings & loan societies (SLSs)	22	22
Authorised Trustees (ASFs)	4	4
Licensed investment managers (LIMs)	5	5
Licensed fund administrators (LFAs)	3	3
Life insurance companies (LICs)	4	4
Life insurance brokers (LIBs)	4	4
Authorised money changes	9	8
Money remitter	1	1
Foreign exchange dealers (AFEDs)	2	2
Authorised mobile network operator	1	1
Total assets (K billion)	47.9	44.0
Banking industry (%)	76.0	76.0
Authorised Trustees (ASFs) (%)	23.2	23.1
LICs (%)	0.8	0.9
Total deposits (K billion)	27.9	25.2
Commercial banks (%)	94.8	94.2
LFIs (%)	2.1	3.1
SLSs (%)	2.4	2.0
Micro-banks (%)	0.7	0.7
Total loans outstanding (K billion)	17.5	15.8

NB: The figures stated for 2015 in the table above are from the audited accounts and vary from those reported in the 2015 Annual Report.

REGULATION AND SUPERVISION

Licences and Approvals

In 2016 the Bank considered and made decisions on several applications regarding expansion, closure, relocation of operations and new licences.

During the year the Bank:

- assessed 3 applications (granted 1 licence, rejected 2 applications)
- revoked 3 licences
- granted 5 branch openings and 2 relocations.

Kina Securities Limited's acquisition of Maybank PNG Limited in 2015 and subsequent establishment of Kina Bank Limited (KBL) required a number of licensing actions by the Central Bank in 2016. The Bank revoked the licence of Maybank wholly-owned subsidiary PNG Home Finance Limited (PNGHF) in June, and with Kina Finance Limited (KFL) merged into KBL, the Bank revoked KFL's licence in December 2016.

In September 2016 the Bank gave approval to Credit Corporation Limited to establish a branch in Timor-Leste.

Prudential Standards

Banking

The Bank issued the Corporate Governance Prudential Standards for banks and licensed financial institutions in September 2016. There were three prudential standards which covered corporate governance, fit and proper requirements and compliance function requirements. The Standards will be effective from 1 January 2017, with full compliance expected by 1 January 2018.

Superannuation and Life Insurance

The Bank issued the Risk Management Prudential Standard for the Life Insurance industry in September 2016. The Standard prescribes the requirements of systems to identify, assess, manage, mitigate and monitor material risks that may affect the life insurance company's ability to meet their obligations to their policyholders.

The systems required in the Standard form part of a life insurance company's Risk Management Framework.

The Standard will become effective on 1 January 2017, with full compliance expected by 1 January 2018.

Legislative Issues

Savings and Loan Societies Act 2015

The Savings & Loan Societies Act 2015 was certified in 2016. The Act will become operational when gazetted.

Supervisory Enforcement Actions

Reviews

As part of its supervisory role in strengthening the risk management systems and compliance capacities of regulated institutions, the Bank undertakes prudential reviews or examinations.

During 2016 the Bank conducted 21 on-site prudential reviews or examinations, including reviews on 3 banks (1 of which was visited twice), 5 licensed financial institutions, (one LFI was visited twice), 10 savings & loan societies, 2 trustee companies, 1 fund administrator and 2 life insurance companies.

The Bank also held ten prudential consultations with 3 licensed financial institutions, 1 bank and 3 savings & loan societies.

Core Functions

Supervisory Colleges

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

The Bank participated in 4 supervisory colleges in 2016, 2 with BSP and 2 with ANZ Bank.

Employee Superannuation Contribution Enforcement

The Bank received 83 complaints against 130 employers during the year. Of the complaints made, 61 involved unresolved problems in remitting contributions between the employer and an Authorised Superannuation Fund (ASF). The remaining 69 employee complaints related to employers failing to remit contributions to an ASF.

The Bank commenced action to ensure the employers comply with the superannuation laws, contacting the employers in writing in the first instance.

Statutory Administration, Management and Liquidation Activities

The liquidation process of Workers Mutual Insurance (PNG) and Eastern Highlands Savings and Loans Society Limited continued in 2016.

Regulation and Supervision Development

Online reporting

The transition to online quarterly reporting by regulated institutions moved forward in 2016. The Bank consulted with all regulated institutions to address areas of concern with online reporting before the December quarter returns fell due.

The process was successful, with all 4 commercial banks, 7 of the 9 LFIs, 4 of the 5 microfinance institutions, 2 of the 4 ASFs and 2 of the 4 LICs lodging their December report online.

Reform of the Savings and Loan Societies Industry

In anticipation of the new *Savings & Loan Societies Act 2015* coming into operation, the Bank conducted a number of workshops during 2016. The workshops covered requirements under the new Act and guidance for developing strategic business plans and good governance practices.

ASF Board Governance Reviews

In 2016 the Bank conducted reviews of board governance and performance of ASFs Nambawan Super Limited, National Superannuation Fund Limited (Nasfund) and Defence Force Retirement Benefit Fund. The resulting reports were provided to the ASFs with recommendations for improvements.

Financial Services Sector Review

The Financial Services Sector Review (FSSR), supported by the World Bank and undertaken by a technical working group drawn from the Department of Treasury and the Bank of PNG, commenced in 2016.

The FSSR was established to develop a Financial Sector Development Strategy (FSDS).

The first phase of the process involved presenting the draft FSDS to the participants of public consultative workshops held in 8 provinces. The workshops encouraged discussion of recommendations for developing the National Payments System, the Government bond and capital market, financial inclusion and the financial sector regulatory framework.

As at the end of the year the final draft of the FSDS had been completed. When endorsed by the Bank and Department of Treasury, the draft will be presented to the Minister for Treasury for submission to the National Executive Council for approval and subsequent implementation.

PAYMENT SYSTEM

NATIONAL PAYMENT SYSTEM RESPONSIBILITIES

In line with the *National Payment System Act 2013*, the Bank has responsibility for the National Payment System, which aims to transfer money from payer to payee, effectively and efficiently. The NPS is part of the core financial infrastructure that supports the PNG economy. KATS was developed to implement the NPS and has proven to be reliable and resilient.

During 2016 the Bank continued to enhance and improve the NPS, including:

- implementing the Anti-Money Laundering (AML) module in KATS, to screen all high value Real Time Gross Settlement payments against a list of suspected persons. KATS has the capacity to suspend and hold such transactions until they are scrutinised and cleared
- reducing the cheque clearing period from 4 business days to 3 business days. If a bank does not dishonour the cheque within 3 days of its deposit, it is automatically cleared by ACH and funds made available to the payee's account.

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

Currency management

One of the core functions of the Bank is to issue currency notes and coins. This entails ensuring an adequate supply of quality currency in circulation, withdrawing damaged and soiled banknotes from circulation and monitoring the overall supply of currency.

In line with its commitment to risk management, during the year the Bank secured an alternative supplier to the Bank's longterm banknote supplier.

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

Cash Distribution Centres

With the Bank's increased focus on providing access to financial services to the broader population of Papua New Guinea, re-establishing an effective decentralised cash distribution system has received particular attention in the past few years.

In 2016 the Bank re-opened the cash distribution centre (CDC) in Kokopo in East New Britain province, to facilitate a prompt supply of banknotes and coins for the region.

During the year the Bank also commenced upgrading its CDC in Port Moresby in 2016.

Lae Currency Distribution Facility

The construction of the Lae Currency Distribution Facility (CDF) continued to progress in 2016, with the laying of the foundations. The CDF building is scheduled to be completed in 2018.

K5 Banknote Re-sized

As part of the banknote reform program to differentiate the sizes of each denomination, the K5 banknote was re-sized in 2016 to 70mm x 130mm. While the original design elements and security features of the banknote were retained, an additional security feature, Optical Variable Image, which changes colour when tilted, was added to the banknote.



Core Functions

Banknotes and Coins in Circulation

Total currency in circulation increased to K2.1 billion in 2016 from K1.8 billion in 2015. The increase was due to demand for K20, K50 and K100 banknotes, which are used in Automatic Telling Machines (ATMs).

Notes and Coins in Circulation

Notes Denomination	Value K'm 2016	Value K'm 2015	Value K'm 2014	Value K'm 2013
K2	56.2	52.7	49.9	46.3
K5	59.1	52.4	51.4	45.6
K10	85.1	72.6	69.0	65.5
K20	210.2	185.0	207.4	209.8
K50	491.1	407.2	445.6	433.6
K100	1,132.4	969.0	953.5	877.1
Sub Total	2,034.1	1,738.9	1,776.8	1,677.9
Coins Denomination				
K2	0.2	0.2	0.2	0.2
K1	25.4	24.3	23.2	21.3
50 Toea	7.1	6.8	6.5	6.4
20 Toea	20.9	20.1	20.1	19.3
10 Toea	21.1	20.1	19.4	18.8
05 Toea	6.6	6.4	6.2	6.1
Sub Total	81.3	77.9	75.6	72.1
Total	2,115.4	1,816.8	1,852.4	1,750.0

New Notes and Coins issued in 2016

Notes Denomination	Value K'm 2016	Value K'm 2015	Value K'm 2014	Value K'm 2013
K2	21.3	21.7	23.7	21.1
K5	25.6	24.9	24.9	22.8
K10	37.7	34.5	33.5	31.0
K20	93.7	74.8	92.6	106.0
K50	171.8	142.5	145.7	215.0
K100	256.8	215.0	269.9	250.0
Sub Total	606.9	513.4	590.3	645.8
Coins Denomination				
K1	1.00	1.20	1.70	1.50
50 Toea	0.34	0.40	0.00	0.00
20 Toea	0.59	0.14	0.80	0.70
10 Toea	0.86	0.83	0.60	0.83
05 Toea	0.20	0.28	0.07	0.21
Sub Total	2.99	2.85	3.17	3.24
Total	609.89	516.25	593.47	556.67

Destruction of Soiled Banknotes

Notes Denomination	VALUE OF SOILED NOTES DESTROYED			
	K'm 2016	K'm 2015	K'm 2014	K'm 2013
K2	19.7	16.9	23.4	23.6
K5	18.5	22.7	24.7	18.3
K10	23.6	31.7	46.0	30.9
K20	67.9	99.5	102.6	120.4
K50	109.8	152.5	144.1	198.1
K100	142.7	157.5	199.9	189.1
Total	382.2	480.8	540.8	580.4

Paper Banknotes

Paper banknotes (K2, K5, K10, K20, K50 and K100) ceased to be legal tender on 30 June 2013 and from that date cannot be used as money. In the lead up to the de-monetisation of the paper banknotes, the Bank gave notice to the public to exchange the paper banknotes for polymer notes, which they could do at the Bank or the commercial banks.

The exchange period was extended to the end of December 2016 to allow people in the rural areas to exchange any paper banknotes for polymer notes, this time only at the Central Bank. After this period, paper banknotes will not be accepted by the Bank for exchange for the polymer notes.

When the paper banknotes were de-monetised the uncirculated stock was sold to a recycler in Europe. In 2016 the Bank found evidence that some of these paper notes were returning to PNG, mainly from Asia. The Bank released public notices warning the public not to accept any paper banknotes as they are not legal tender.

Numismatic Items

The Bank sells commemorative items to the public and currency collectors worldwide. Total sales in 2016 were K14,024.32. The most popular items were the PNG currency albums and the coin sets commemorating the 2015 XV Pacific Games and University of PNG Golden Jubilee.

GOVERNMENT BANKING AND AGENCY SERVICES

Government Banking

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

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

In 2016 financial institutions and other organisations continued making tax payments through KATS to IRC accounts maintained at the Bank. Government and other statutory authorities' cheques were cleared through the Automated Clearing House (ACH).

The National Government maintained 86 trust accounts with the Bank during 2016. At the end of the year the total held in these accounts was K319.8 million (end 2015: K362.2 million).

Significant achievements to government banking arrangements in 2016 included:

- automation of PNG Customs Service payments, to enable electronic payments to Custom's account, timely clearance of goods and the wharves and electronic reconciliation against Custom's ASYCUDA system. A group of brokers participated in the successful testing of the electronic payments. The Customs e-payments system is scheduled for launch in January 2017
- implementation of the Department of Finance's electronic funds transfer facility.

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 TAF is renewable every six months on request by the Minister for Treasury after the outstanding balance is repaid.

The TAF limit remained at K200 million during 2016. The Government utilised the facility frequently in 2016 to meet temporary mismatches in its cashflow.

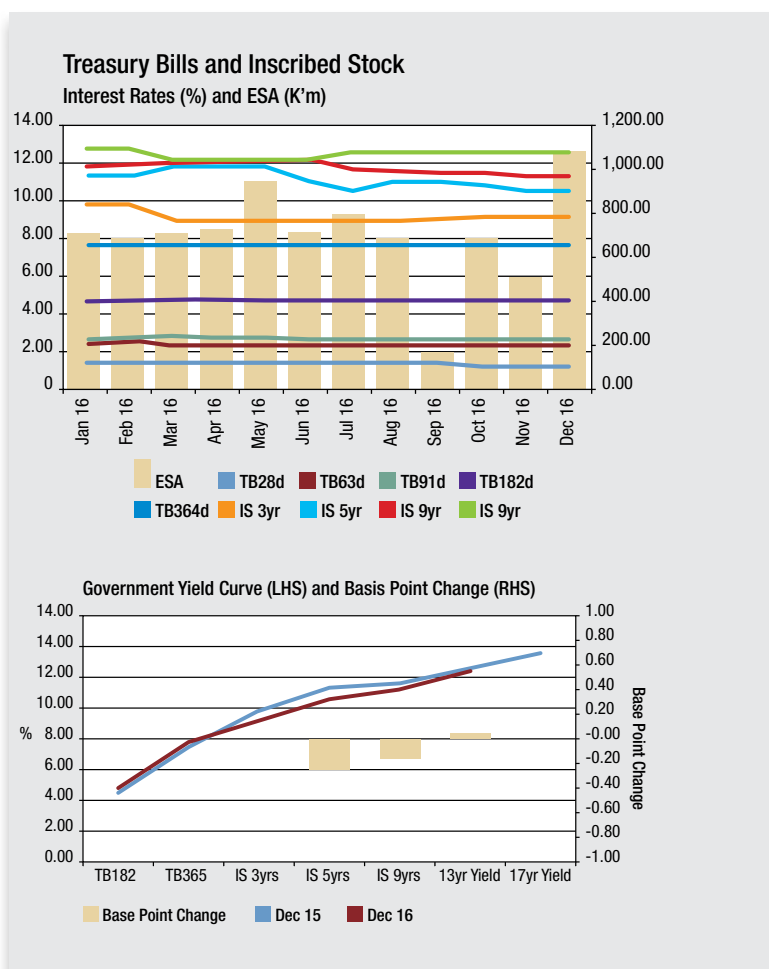
Government Agent Operations

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

Treasury Bills and Treasury Bonds (Inscribed Stock)

In 2016 the Government issued its Treasury bills in 91, 182 and 364 day terms. Government Treasury bonds were issued in 3, 5, 9 and 13 year terms.

The interest rates for Treasury bills increased slightly in 2016, while interest rates for Treasury bonds declined slightly. Treasury bills and Treasury bonds auctions during the year were mostly under-subscribed, reflecting low demand.



Core Functions

'SLACK Arrangement'

During 2016 the Bank took up some of the under-subscriptions of Treasury bills, under a 'SLACK Arrangement' agreed with the Department of Treasury. Since this 'SLACK Arrangement' can produce an injection of kina liquidity into the banking system, the Bank needed to sterilise this liquidity by on-selling these stocks of Government securities to the commercial banks and the public, and selling considerable amounts of CBBs to the commercial banks.

Central Bank Bills

The Bank issued its CBBs mainly in the shorter-dated terms of 28, 63 and 91 days. In 2016 the CBB interest rates declined slightly and continued to remain low due to high liquidity in the banking system.

Tap facility

The CBB Tap facility aims to encourage investment by individuals to help develop a savings culture within PNG society.

The CBB Tap facility continued to be offered in the 63 and 91 day terms in 2016. Demand remained steady throughout the year compared to 2015. There was a net redemption of K1.1 million over the course of the year. Through the facility the Bank made a net retirement of K7.8 million CBBs from retail investors.

Government debt

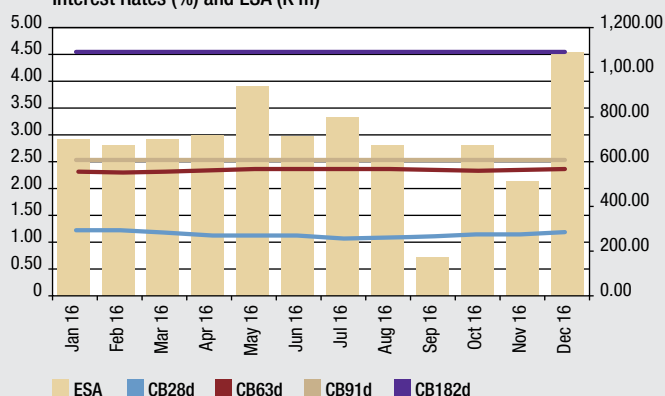
Total borrowing by the Government from the public at the end of 2016 amounted to K16.5 billion, an increase of K2.5 billion from the end of 2015.

Treasury bonds

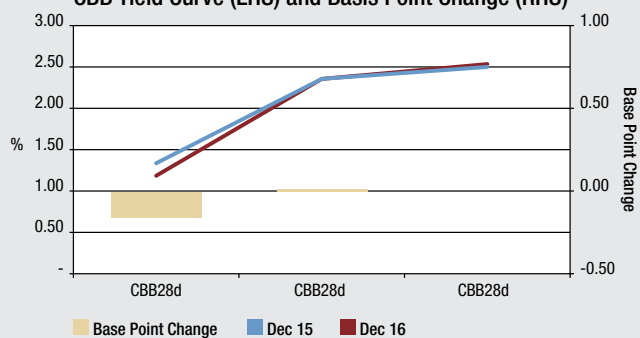
	K'm
Issued in 2016	1,024
Maturities in 2016	464
Net issuance	560
Outstanding as at 31 December 2016	7,773
Outstanding as at 31 December 2015	7,213
Increase in balance	560
BPNG holdings 31 December 2016	1,898
BPNG holdings 31 December 2015	1,531
Net increase in BPNG Holdings	367

Central Bank Bills

Interest Rates (%) and ESA (K'm)



CBB Yield Curve (LHS) and Basis Point Change (RHS)



Treasury bills

	K'm
Outstanding as at 31 Dec 2015	6,729
Issued in 2016	10,202
Slack issued in 2016	2,851
Maturities in 2016	9,525
Slack maturities in 2016	1,594
Net issuance	1,934
Outstanding as at 31 Dec 2016	8,663

Central Bank Bills

	K'm
Outstanding as at 31 Dec 2015	1,551
Issued in 2016	16,388
Slack on-sold in 2016	2,851
Maturities in 2016	17,854
Slack maturities in 2016	1,594
Net maturity	(209)
Outstanding as at 31 Dec 2016	1,342

Central Bank Bill Tap facility

	K'm
Available for sale 2016	200
Balance at 31 Dec 2015	178
Issued in 2016	95
Maturities in 2016	96
Net maturity	(1)
Outstanding as at 31 Dec 2016	179

Secondary market development

One of the Bank's strategic goals is to help develop the secondary market for Government securities. Having in place effective trading, custody and monitoring systems is important to achieving this goal.

In 2016 the new web-based Registry and Money Market System (RMS) became operational, replacing the manual registry system. The RMS has additional functions such as the Repurchase Agreement Facility and a secondary market trading facility for Bank stock.

During the year the Bank's Trade Order Management System (TOMS) became fully operational. The TOMS platform enabled the Bank to produce real time price calculations, use more interactive risk management tools, improve execution of trading strategies and trade capture, enhance reporting and strengthening of internal investment processes.

PAYMENT SYSTEMS SUPPORT AND DEVELOPMENT

Work commenced in 2016 on the business requirements for a National Switch to provide access and system compatibility to all payment service providers, including mobile banking service providers. Once the National Switch is in place, all providers would be able to exchange and use information across the National Payments System, thereby levelling the payment services playing field. The Switch concept fits in with the CEFI strategy to achieve digital financial services in all areas of PNG.

In the area of education and awareness, during the year the Bank published an education booklet on the NPS, explaining the payment products, system rules and responsibilities of participants. for schools, libraries and members of the public. The booklet is also used as a training tool for staff at the Bank and commercial banks.

Secondary Functions

ECONOMIC ADVICE TO GOVERNMENT

The Bank provides the National Government with economic advice to help optimise fiscal and economic policy. The Governor is required to advise the Treasurer of the effect on monetary policy as a result of policy of the government.

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

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

INCREASING ECONOMIC KNOWLEDGE

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

Research Papers

The Bank commenced work on a number of research papers in 2016:

- Macroeconomic Impact of Oil Price Shocks in PNG, using a SVAR model
- Effectiveness of Intervention in the Foreign Exchange Market, using a EGARCH model
- Impact of Excess Liquidity Shock on Monetary Policy in PNG
- Impact of Taxation on Employment in PNG.

Business Liaison and Employment Surveys

The Bank continued to conduct its Business Liaison and Employment Surveys in 2016, with 380 companies in the private sector representing various industries and regions. For the Business Liaison survey, 94 companies were surveyed quarterly, while 286 companies were surveyed annually. In the Employment Survey all 380 companies were surveyed quarterly.

The survey results are used to:

- inform the public on economic developments and trends through the Monthly Economic Review and the Quarterly Economic Bulletin
- provide inputs into the design and formulation of monetary policy
- estimate and forecast gross domestic product
- provide information to the private sector on trends in employment and business activity.

Strategic Research Activities

Expansion of Monetary and Financial Data Coverage

Work on the recommendations of the IMF technical assistance (TA) mission undertaken in 2013 for the Monetary and Financial Statistics project continued in 2016. Bank staff visited several financial institutions in Port Moresby and other centres to conduct awareness and follow up on the reporting requirements to improve data quality and coverage.

Review of the Kina Facility Rate (KFR)

This research reviewed the effectiveness of the KFR as a monetary policy signalling rate to transmit the Central Bank's policy stance to market interest rates. The review confirmed the weak transmission from the KFR to market interest rates, attributed to persistently high liquidity in the banking system. The Bank considered various options, including replacing the KFR with a market-determined interest rate and diffusing liquidity to make the KFR more effective. Further review and consultation relating to these and other options is warranted.

Balance of Payments System

A number of the recommendations from the IMF's follow-up TA mission in 2015 progressed in 2016. These additional recommendations aimed to improve the Balance of Payments compilation through coverage, reliability, data sourcing and frequency. Compilation of the International Investment Position also progressed during the year, through the completion of a register of company sample size and provision of data through ongoing surveys.

Further improvement on accessibility to the Customs System ASYCUDA for trade data was completed. Onshore foreign currency account reporting improved after a number of meetings and dialogue with the commercial banks and the account holders and the influence of Foreign Exchange Directives issued in 2015 and 2016.

FACILITATING FINANCIAL SERVICES DEVELOPMENT AND INCLUSION

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

Financial Inclusion and Financial Literacy

Following the successful completion of the first National Financial Inclusion Strategy, CEFI launched its second strategy for 2016-2020 in 2016.

The new strategy identified 9 priority areas:

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

The Centre of Excellence for Financial Inclusion (CEFI)

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

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

CEFI conducted a stakeholder workshop in April 2016 to streamline and improve the financial inclusion data collection and revise data collection formats. Its new website, www.thecefi.org, was launched in August 2016. CEFI forged a partnership with Mix Market (an international microfinance information exchange) for information dissemination on Microfinance institutions in PNG and to prepare a benchmark report. Nine microfinance institutions provided data to Mix Market.

Key results in 2016

Total deposit accounts	2,673,782
Number of access points	14,571
Number of branches	215
Number of ATMs	463
Number of EFTPOS merchants	13,460
Number of agents	573
Number of mobile financial service accounts	497,169



Governor Loi M. Bakani CMG (left) and Papua New Guinea Prime Minister Hon. Peter O'Neill CMG MP (right) mark the official launch of the second National Financial Inclusion Strategy 2016-2020.

Secondary Functions

Microfinance Expansion Project

'The Microfinance Expansion Project (MEP) directly assists in the development of the microfinance sector in Papua New Guinea through an integrated package of support. The MEP focuses on 6 objectives or Outputs to strengthen the capacity of the microfinance industry and to provide financial services to a broader cross-section of the community and strengthen the capacity of its clients and potential clients into utilising these financial services.' Source: <http://www.thecefi.org/>

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

A number of important key milestones were achieved in 2016, including:

- improved industry capacity
- more financial literacy education
- enhanced gender equality participation in the program
- continuation of the Young Minds Savings Campaign
- successful hosting of the Financial Inclusion Expositions in Mount Hagen, Western Highlands province and Vanimo, Sandaun province.



Financial Inclusion Exposition in Vanimo, Sandaun province

FINANCIAL INTELLIGENCE MONITORING

The Financial Analysis and Supervision Unit (FASU) was established under legislation as a specialist unit within the Bank and with direct responsibilities to the Attorney General and the Police.

FASU continued Anti-Money Laundering and Counter-Terrorist Financing (AML/CTF) activities throughout 2016. An onsite visit to PNG in April 2016 by the Financial Action Task Force (FATF) Asia/Pacific Regional Review Group reviewed the progress Papua New Guinea has made on AML/CFT activities.

AML/CTF highlights included:

- 5 AML/CTF laws gazetted
- compliance with FATF requirements
- PNG removed from FATF's 'grey list'
- FATF acknowledgment of PNG as the fastest reforming country in the Asia Pacific Group.

PNG continues to implement the AML/CTF legislation:

- by establishing a financial intelligence database to improve reporting by reporting entities, as required by law
- through awareness and education forums on the new laws
- through development of a comprehensive system for the declaration or disclosure of cross border transportation of cash and other valuables
- by developing legislative guidelines to assist reporting entities to comply with their obligations
- by having in place appropriate agreements, understandings and relationships with relevant stakeholders
- by developing the National Risk Assessment on money laundering and terrorist financing
- through the improvement of the bank identification SWIFT systems and processes.

SOVEREIGN WEALTH FUND SECRETARIAT

The Bank engaged a technical expert from the Central Bank of Timor-Leste to review the available capabilities of BPNG and to propose steps and requirements for the establishment of the Administrative Secretariat of the Sovereign Wealth Fund. A report on the review was completed and will be used as a blueprint to establish the Secretariat.

Institutional Support

STRATEGIC AND OPERATIONAL MANAGEMENT

Strategic Plan 2016 – 2020

The Bank's Strategic Plan 2016–2020 was launched in April 2016.

It encourages a 'one-bank' perspective and enhances the Bank's management system through improved planning and reporting frameworks.

Key management system achievements in 2016 included:

- a 3 level business planning framework
- a simplified 'traffic light' reporting framework
- a 'Champions Team' to lead and influence change
- a management manual outlining new processes.

Strategic Projects

Strategic projects and programs are based on the Bank's functional responsibilities: Monetary Policy, Financial System Stability, Payments System and Supporting Economic Growth. The Strategic Plan also deals with internal effectiveness and efficiency, including support areas of governance, management, information and communication technology, and other communications and infrastructure. This enables the Bank to operate effectively to meet its objectives.

Strategic projects and programs completed or progressed during 2016 included:

Monetary Policy:

- Develop a secondary market for Government securities.

Payments System:

- EFT facility
- Automation of PNG Customs Services payments
- Reduction of the cheque dishonour period
- Lae Cash Distribution Facility construction progress.

Supporting Economic Growth:

- Continued progress with financial inclusion and financial literacy programs
- Expansion of the microfinance sector.

Financial Intelligence Reporting:

- Appointment of Director of FASU
- Staff recruitment and training.

Data Centre:

- Establishment of a purpose-designed data centre, called the Bakani Data Centre, to house the Bank's critical systems.

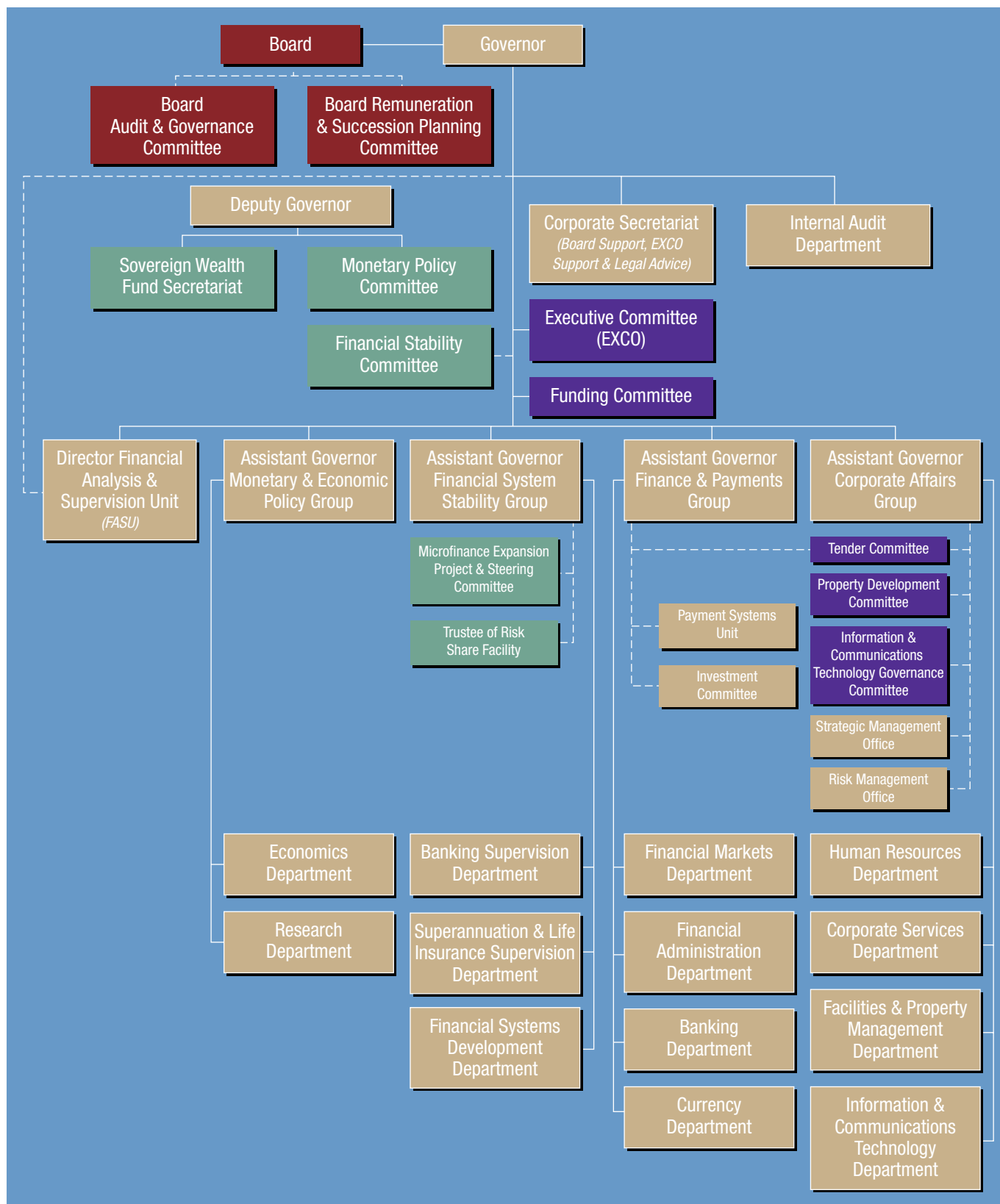
Business continuity:

- The offsite facility, from which the Bank's critical functions can be operated in a crisis, went live.



Governor Loi M. Bakani at the official opening of the Bank's new data centre named in his honour.

Organisation Chart as at 31 December 2016



HUMAN RESOURCE MANAGEMENT

Staff Numbers as at 31 December 2016

Staff Category	2016	2015	2014
General staff members	350	315	310
Management	57	58	48
Executive	5	6	6
Total employees	412	378	364

The Bank continued its focus on attracting, retaining and equipping its staff to strategically deliver on the Bank's Vision.

In 2016 the number of staff increased to 412 employees, with turnover less than 2 percent. The increase in staffing in 2016 was mainly due to expanding functions and workloads and strengthening of capacity in various areas of the Bank.

Projects

In 2016 the Bank undertook three significant human resource projects:

- restructuring and re-aligning positions within several functional areas
- implementing the improved performance management system
- commencing work on the automated time and attendance project.

Employee Capacity Development

The Bank sponsored employees to attend local and offshore training programs. These included workshops, conferences, short courses and long term studies. The Bank re-introduced the Sir ToRobert Scholarship. The first recipient commenced study in Australia in June 2016.

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



The Bank introduced a fresh look with new uniforms for staff during the year.

Institutional Support

Senior officers (as at 31 December 2016)	
Governor	Loi M. Bakani CMG
Deputy Governor	Dr Gae Kauzi
Secretariat	
Corporate Secretary	Tau Vini
Internal Audit	
Manager	Benek Beriso
Financial Analysis and Supervision Unit	
Director	Benny Popoitai MBE
Deputy Director	Wilson Onea
Monetary & Economic Policy Group	
Assistant Governor	Vacant
Economics	
Department Manager	Sali David
Manager, Monetary Policy and Analysis	Wilson Jonathan
Manager, Balance of Payments	Thomas Jiki
Manager, Library	Polycarp Reu
Manager, International Transactions Monitoring	Elim Kiang
Research	
Department Manager	Jeffrey Yabom
Manager, Economic Analysis	Williamina Hubert
Manager, Projects	Boniface Aipi
Financial System & Stability Group	
Assistant Governor	Ellison Pidik
Banking Supervision	
Department Manager	Sabina Deklin
Manager, Banks & Finance Companies	Boas Irima
Manager, Savings & Loan Societies	Nickson Kunjil
Superannuation & Life Insurance Supervision	
Department Manager	Elizabeth Gima
Manager, Superannuation	Tom Milamala
Manager, Life Insurance	Peter Samuel
Manager, Employer Contributions Enforcement	Nonza Makip

Senior officers continued	
Financial System Development	
Department Manager	George Awap
Manager, Macro-Prudential Supervision	Maria Kanari
Manager, Financial System Policy	Tanu Irau
Manager, Licensing and Compliance	Walio Gamini
Finance & Payments Group	
Assistant Governor	Joe Teria
Financial Markets	
Department Manager	Rowan Rupa (Acting)
Manager, Foreign Reserves	Rowan Rupa
Manager, Money Markets	Winnie Linken
Manager, Registry	Marie Martin
Manager, Middle Office	Ambrose Papis
Financial Administration	
Department Manager	Danny Ganak
Manager, Management Reporting	Noine Noine
Manager, Accounting & Payments	Oliver Kludapalo
Manager, Settlements	Soms Yankey
Banking	
Department Manager	Jason Tirime
Manager, Customer Services	So'on Drewei
Manager, Clearing Accounts	Aiva Aku
Manager, Government Accounts	Priscilla Ipu (Acting)
Currency	
Department Manager	David Lakatani
Manager, Control	John Yenas
Manager, Processing	Edward Kisakau
Payments	
Manager, Payments System	Gaona Gwaibo
Manager, Payments Oversight & Compliance	Alfred Napun

Institutional Support

Senior officers continued	
Corporate Affairs Group	
Assistant Governor	Elizabeth Genia
Strategic Management	
Manager	Nathan Maire
Risk Management	
Manager	Ron Sikar
Human Resources	
Department Manager	Naomi Kedeia
Manager, Strategy Planning and Development	Patrick Kwiwa
Manager, Administrative Support	Jennifer Tokome
Manager, Client Support	Vagi Gareitz
HR Projects	Mairi Matthew
Information & Communications Technology	
Chief Information Officer	Naima Kilamanu
Manager, Corporate Systems	Elvis Haoda (Acting)
Manager, Operations	Manea Joseph
Corporate Services	
Department Manager	Jerome Peniasi
Manager, Media and E-Communications	Brian Semoso
Manager, General Services	William Tiki
Manager, Events, Marketing and Publications	Jon Kombeng
Facilities & Property	
Department Manager	Bruce Kitchen
Manager, Building	Gibson Param
Manager, Security	Slim Rupusina

INFORMATION AND COMMUNICATIONS TECHNOLOGY SERVICES

Information and Communications Technology (ICT) is an essential support function for the Bank. It continues to provide oversight, management and delivery of enterprise-wide ICT services. Three strategic projects were completed in 2016:

- a modern purpose-built data centre, the Bakani Data Centre
- a unified communications solution
- enhancement of the ICT governance framework.

Data Warehouse and Business Intelligence Reporting project

The Bank continued the rollout of the Data Warehouse and Business Intelligence Reporting project for the Banking Supervision and Superannuation and Life Insurance Supervision Departments in 2016.

COMMUNICATION SERVICES

The Bank recognises that communication is a key operational tool for its functions. Accordingly, the Bank supports a range of communications activities and resources to improve the delivery of information to the Bank's various audiences. During the year the Bank's website continued to play a vital role in maintaining the timely flow of up-to-date information from the Bank, including comprehensive coverage of the Bank's publications and public announcements.

INFRASTRUCTURE SERVICES AND SYSTEMS

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

COMMUNITY SUPPORT

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

During 2016 the Bank continued to support fundraising for the Sir Buri Kidu Heart Foundation.

Other recipients of the Bank's community support included PNG Life Care, Laloki Public Psychiatric Hospital, the PNG Human Resource Institute, Transparency International (PNG), the PNG Children's Foundation, PNG Women in Business, the PNG Sport Foundation, the PNG Administrative Professionals Association, the Business & Professional Women's Club and the PNG Institute of Directors.



The Bank continued to support the work of Transparency International (PNG) during the year, encouraging staff to participate in the Sir Anthony Siaguru Walk Against Corruption.



The Bank's staff took part in a community clean up of Port Moresby.



Bank of Papua New Guinea

FINANCIAL STATEMENTS
FOR THE YEAR ENDING
31 DECEMBER 2016

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Statement of Profit or Loss and Other Comprehensive Income

For the year ended
31 December 2016

	Notes	2016 K'000	2015 K'000
Revenue from foreign currency investments			
Interest revenue	2	71,408	92,572
Realised gain/(loss) on financial assets		13,784	(26,224)
Foreign exchange gains and commissions		10,185	9,442
Total revenue from foreign currency investments		95,377	75,790
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		(169)	(261)
Custodian and investment management fees		(6,350)	(5,772)
Total expenses from foreign currency investments		(6,519)	(6,033)
Net foreign currency income		88,858	69,757
Revenue from domestic investments			
Interest revenue	3	248,777	234,606
Other income	4	7,483	11,575
Total revenue from domestic investments		256,260	246,181
Expense on domestic liabilities			
Interest expense	5	(24,386)	(53,615)
Total expense on domestic liabilities		(24,386)	(53,615)
Net domestic income		231,874	192,566
Total net operating income			
Operating expenses			
General and administration expenses	6	(150,246)	(122,828)
Profit excluding unrealised income		170,486	139,495
Other unrealised income and (expense)			
Fair value and foreign exchange revaluation gain on foreign currency investments		250,898	515,629
Fair value revaluation (loss) / gain on domestic investments		619	20,791
Profit for the year		422,003	675,915
Other comprehensive income			
Items that may be subsequently reclassified to profit and loss			
Gain/(loss) on gold asset revaluation		18,992	4,822
Items that will not be subsequently reclassified to profit and loss			
Gain on property valuation		163	-
Other comprehensive income for the year		19,155	4,822
Total comprehensive income for the year		441,158	680,737

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

Statement of Financial Position

For the year ended
31 December 2016

	Notes	2016 K'000	2015 K'000
Assets			
Foreign currency financial assets			
Cash and cash equivalents	8	296,105	455,935
Financial assets at fair value	9	4,753,986	4,890,468
Assets held with IMF and other financial organisations	7	39,190	38,630
Accrued interest		18,158	23,126
Total foreign currency financial assets		5,107,439	5,408,159
Local currency financial assets			
Government of Papua New Guinea securities	10	3,787,129	2,220,380
Loans and advances	11	82,919	184,516
Accrued interest and other receivables		92,588	59,039
Total local currency financial assets		3,962,636	2,463,935
Total financial assets		9,070,075	7,872,094
Non-financial assets			
Gold		153,593	134,639
Property, plant & equipment	13	180,404	136,170
Investment properties	14	41,460	38,740
Other non-financial assets	12	39,738	50,917
Total non-financial assets		415,195	360,466
Total Assets		9,485,270	8,232,560
Liabilities			
Foreign currency financial liabilities			
Liabilities to IMF	7	539,722	529,260
Other financial liabilities	19	1,973	1,233
Total foreign currency financial liabilities		541,695	530,493
Local currency financial liabilities			
Deposits from banks and third parties	15	4,324,346	3,211,773
Deposits from Government and Government entities	16	711,738	871,407
Debt securities issued	17	1,358,923	1,566,893
Accrued interest payable on debt securities		1,574	2,881
Currency in circulation	18	2,114,210	1,883,089
Other financial liabilities	19	34,076	111,531
Total local currency financial liabilities		8,544,867	7,647,574
Total financial liabilities		9,086,562	8,178,067
Non-financial liabilities			
Provisions for employee entitlements	20	22,165	19,108
Total non-financial liabilities		22,165	19,108
Total Liabilities		9,108,727	8,197,175

Statement of Financial Position

	Notes	2016 K'000	2015 K'000
Equity			
Capital	21	145,540	145,540
Gold Revaluation Reserve	21	132,984	113,992
Property Revaluation Reserve	21	58,474	93,452
Unrealised Loss Reserve	21	(293,526)	(558,013)
Retained Earnings	21	333,071	240,414
Total Equity		376,543	35,385
TOTAL LIABILITIES AND EQUITY		9,485,270	8,232,560

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

Statement of Changes in Equity

For the year ended
31 December 2016

	Capital K'000	Gold Revaluation Reserve K'000	Property Revaluation Reserve K'000	Unrealised Loss Reserve K'000	Retained Earnings K'000	Total K'000
Balance at 1 January 2015	145,540	109,170	93,452	(1,082,678)	179,164	(555,352)
Profit for the year	-	-	-	536,420	139,495	675,915
Other Comprehensive Income	-	4,822	-	-	-	4,822
Transfers to Equity	-	-	-	-	-	-
Retained Earnings on realised sale of securities	-	-	-	(11,755)	11,755	-
Dividend declared	-	-	-	-	(90,000)	(90,000)
Balance at 31 December 2015	145,540	113,992	93,452	(558,013)	240,414	35,385
Profit for the year	-	-	-	251,517	170,486	422,003
Other Comprehensive Income	-	18,992	163	-	-	19,155
Net transfers from Unrealised Loss Reserve to Retained Earnings	-	-	-	12,970	(12,970)	-
Net transfers from Property Revaluation Reserve to Retained Earnings	-	-	(35,141)	-	35,141	-
Dividend declared and paid	-	-	-	-	(100,000)	(100,000)
Balance at 31 December 2016	145,540	132,984	58,474	(293,526)	333,071	376,543

The realised profit for the year is K170 million. The unrealised loss reserve and net asset balance at 31 December 2016 are K293.5 million and K376.5 million, respectively. The CBA 2000 states that no distribution will be made where, in the opinion of the Central Bank, the assets of the Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital.

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

Statement of Cash Flows

For the year ended
31 December 2016

	Notes	2016 K'000	2015 K'000
Cash Flows from Operating Activities			
Interest received on foreign investments		76,376	95,526
Interest received on domestic investments		215,228	214,912
Fees, commissions and other income received		17,669	21,017
Interest paid on IMF liabilities		(168)	(261)
Interest paid on domestic liabilities		(25,693)	(55,765)
Payments to employees		(54,460)	(41,879)
Payments to suppliers		(58,772)	(53,383)
Fees and commissions paid		(6,350)	(5,772)
Net proceeds from sale of foreign investments		414,267	641,489
Net payment for Government securities		(1,566,749)	214,222
Net loans repaid / (issued)		101,597	(174,440)
Net Cash Flow (used in) / provided by Operating Activities		(887,055)	855,666
Cash Flows from Investing Activities			
Purchase of property, plant and equipment		(58,893)	(25,038)
Proceeds from sale of property, plant and equipment		62	577
Net Cash Flow used in Investing Activities		(58,830)	(24,461)
Cash Flows from Financing Activities			
Net movement of currency in circulation		231,121	32,711
Net movement in debt securities issued		(207,970)	(739,792)
Distributions to the Government		(190,000)	-
Net movement in deposits from Government		(159,669)	(193,084)
Net movement in deposits from banks		1,112,573	(220,917)
Net Cash Flow provided / (used in) by Financing Activities		786,055	(1,121,082)
Net (Decrease)/Increase in Cash and Cash Equivalents		(159,830)	(289,877)
Cash and cash equivalent at 1 January		455,935	745,812
Cash and Cash Equivalent at 31 December	8	296,105	455,935

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

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 assets as a result of appreciation of the kina against other major currencies in previous years. As a result, the Bank has an unrealised loss reserve of K293.5 million (2015: K558 million).

Although in a net asset position of K376.5 million at 31 December 2016 (2015: net asset position of K35.3 million), a relatively small (less than 3%) foreign exchange or fair value movement in the Bank's assets would result in the Bank returning to a net liability position. Accordingly, despite improvement during the year, there is 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, 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. 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 2016 is set out below in relation to the impairment of financial instruments and in the following notes in relation to other areas:

- (a) Note 23 (d) – determination of the fair value of financial instruments with significant unobservable inputs;
- (b) Note 14 – fair value of investment properties.

(ii) Accounting estimates

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

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

(d) New standards issued but not yet effective

The relevant standards and interpretation that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below.

IFRS 9 Financial Instruments

IFRS 9, published in 2014, replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39. This amendment is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Bank does not plan to adopt this standard early and the extent of the impact has not been determined.

IFRS 15 Revenue from Contracts with Customers

The IASB issued IFRS 15 in 2014. The standard is effective for the annual periods beginning on or after 1 January 2018, with early adoption permitted. IFRS 15 contains new requirements for the recognition of revenue and additional disclosures about revenue. The Bank is assessing the potential impact on its financial statements resulting from the application of this standard. The Bank does not plan to adopt this standard early and the extent of the impact has not been determined.

IFRS 16 Leases

The final version of IFRS 16 was issued in February 2016. IFRS 16 requires a lessee to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019, with early adoption permitted.

Other standards and interpretation that are not deemed to have a significant effect on the Bank are:

- Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations
- Amendments to IAS 1 Disclosure Initiative
- Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets Between an Investor and its Associate or Joint Venture
- Annual Improvements to IFRS 2012-2014 Cycle

(e) Financial assets and liabilities

Definition of financial instruments

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

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

(i) Domestic Government securities

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

(ii) Foreign exchange holdings

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

(iii) Foreign exchange translation

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

(iv) Foreign government securities

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

(v) Foreign deposits

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

(vi) Foreign currency forward contracts

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

(vii) 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.

(viii) 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.

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

Annual depreciation is based on fair 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) Computer Software

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

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

(i) Gold

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

(j) Investment properties

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

When the use of a property changes such that it is within *Property, Plant & Equipment*, its fair value at the date of reclassification becomes its cost for subsequent accounting.

(k) Investment property rental income

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

(l) De-recognition

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

(m) Offsetting financial instruments

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

(n) Inventory – Notes & Coins

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

(o) Cash and cash equivalents

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

(p) Other receivables

Other receivables are stated at amortised cost.

(q) Employee benefits

(i) Pension Fund

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

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

(ii) Provision For Leave Entitlement

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

(r) Other liabilities

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

(s) Reserves

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

(i) Bank of Papua New Guinea Reserve Fund

The Bank of Papua New Guinea Reserve Fund was created under the *Central Banking Act 2000* Section 42. It 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 that may be distributed to the Government of Papua New Guinea after ensuring that the current financial position of the Bank meets the requirements under the *Central Banking Act 2000* Section 49(3). No reserves have been put aside in the financial year.

(v) Gold Revaluation Reserve

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

(t) Determination of distributable profit

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

- (i) Section 50 (1) states that net profit arising from revaluation and foreign currency movements shall not be available to be distributed to the Government or paid into the Consolidated Revenue Fund. Accordingly such unrealised profits are transferred to the Unrealised Profits Reserve.
- (ii) The Board of the Bank is required to determine the net profit of the Bank and then consult with the Minister for Treasury to determine the amount of profit that is to be placed to the credit of the Bank's reserves.
- (iii) The balance of net profit after any transfer in (i) and (ii) in accordance with Sections 49(2)(a) and 50(1) of the Act is paid to the Consolidated Revenue Fund.
- (iv) The amount shall not be paid into the Consolidated Revenue Fund under the above sections where, in the opinion of the Central Bank, the assets of the Central Bank are, or after the payment would be, less than the sum of its liabilities and paid-up capital.
- (v) The Unrealised Profit Reserve of the Bank represents gains or loss arising from the revaluation of gold, properties and other financial assets of the Bank. These gains and losses are separately classified under the respective reserves in the statement of changes in equity.

(u) Tax Exemption

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

(v) Comparatives

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

(w) Rounding

Financial information has been rounded to the nearest thousand kina.

	2016 K'000	2015 K'000
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Note 2: INTEREST REVENUE – FOREIGN CURRENCY OPERATIONS

Foreign securities and bank deposits

71,408	92,572
71,408	92,572

Interest income on foreign investments includes interest earned on foreign bonds, Treasury bills, nostro accounts and other foreign investments. Income of K43.0 million (2015: K51.1 million) is in relation to investments managed by external fund managers and the remainder of K28.4 million (2015: K41.5 million) relates to investments managed by the Bank. Coupon rates during the year varied between 0.05% and 6.5% (2015: 0.003% and 5.5%) and yields varied between (3)% and 6.3% (2015: (4.1) % and 5.2%).

Note 3: INTEREST INCOME – DOMESTIC OPERATIONS

Inscribed stock and other Government securities

248,777	234,606
248,777	234,606

Interest income on Government Inscribed stock amounted to K178.1 million (2015: K136.6 million) while K63.1 million was earned from Government Treasury bills (2015: K116.1 million). The remaining interest income is earned from the temporary advances to Government and overnight lending to commercial banks. During the year coupon rates on Inscribed stock varied between 6% and 14% (2015: 7.7% and 15%), while yields on Treasury bills varied between 2.4% and 7.7% (2015: 1.4% and 7.4%).

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

Licensing and other fees
Numismatic currency
Property rent
Other

3,151	6,966
14	1,396
3,526	2,636
792	577
7,483	11,575

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

Central Bank Bills issued
Other deposits held

24,157	53,275
229	340
24,386	53,615

Interest on securities issued varied between 1.2% and 3.5% during the year (2015: 1.3% and 3.5%).

Notes to the Financial Statements

	2016 K'000	2015 K'000
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Note 6: GENERAL AND ADMINISTRATION EXPENSES

Staff costs	57,517	44,140
Premises and equipment	25,001	23,320
Other expenses	17,579	11,946
Amortisation of notes and coins production expenses	15,081	11,540
Travel	8,468	7,013
Depreciation of property, plant and equipment	6,843	6,289
Legal & consultancy fees	8,361	8,973
Staff training and development	4,913	3,596
Provisioning of staff and other loans	2,650	2,918
Audit fee	1,698	1,406
Board & meeting expenses	1,202	1,174
Currency distribution expenses	935	513
	150,246	122,828

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

Assets

IMF SDR holdings and deposits and other organisations	39,190	38,630
	39,190	38,630

Liabilities

IMF number 1 and 2 loan accounts	5,931	5,931
SDR allocation	533,791	523,329
	539,722	529,260

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

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

Note 8: CASH & CASH EQUIVALENTS

Foreign currency holdings – nostro accounts	296,105	455,935
	296,105	455,935

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

	2016 K'000	2015 K'000
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Note 9: FINANCIAL ASSETS AT FAIR VALUE

Foreign investments	4,400,980	4,888,598
Derivative assets	353,006	1,870
	4,753,986	4,890,468

Foreign investments include K3.5 billion (2015: K3.3 billion) of investments managed by external fund managers. The remainder of K1.2 billion (2015: K1.5 billion) is managed directly by the Bank. The investments comprise foreign bank debt securities, sovereign debt securities and over the counter derivative currency contracts.

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

Inscribed stock	1,856,994	1,486,597
Treasury bills	1,930,135	733,783
	3,787,129	2,220,380

Note 11: LOANS AND ADVANCES

Loans to PNG commercial banks	-	174,825
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	20,492	13,928
Allowance for doubtful loans	(8,273)	(5,623)
Temporary Advance Facility to PNG Government	69,314	-
	82,919	184,516

As at 31 December 2016, no loan was issued to commercial banks. (2015: there were two loans issued to PNG commercial banks.) The Temporary Advance Facility is governed by the provisions of the *Central Banking Act 2000*. The interest rate charged is the 6 monthly Treasury bills rate, approximately 4.7% p.a. The TAF limit is K200 million.

Note 12: OTHER NON FINANCIAL ASSETS

Inventory notes and coins	36,219	47,586
Commemorative notes and coins and other receivables	594	1,358
Other non-financial assets	2,925	1,973
	39,738	50,917

Notes to the Financial Statements

	Land and Buildings at Fair Value K'000	Equipment K'000	Motor Vehicles K'000	Computer Equipment K'000	Computer Software K'000	Total K'000
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Note 13: PROPERTY, PLANT & EQUIPMENT

At 31 December 2015

Cost or fair value	103,103	6,644	2,619	8,485	38,518	159,367
Accumulated depreciation	(7,931)	(3,534)	(1,348)	(5,844)	(4,542)	(23,197)
Net Book Amount	95,172	3,110	1,271	2,641	33,976	136,170

Year ended

31 December 2016

Opening net book amount	95,172	3,110	1,271	2,641	33,976	136,170
Additions	44,935	9,169	444	904	3,441	58,893
Disposals	-	-	(62)	-	-	(62)
Depreciation charges	(3,721)	(291)	(203)	(640)	(1,315)	(6,170)
Revaluations of property	(8,427)	-	-	-	-	(8,427)
Closing Book Amount	127,959	11,988	1,450	2,905	36,102	180,404

At 31 December 2016

Cost or fair value	127,959	15,813	3,001	9,389	41,959	191,206
Accumulated depreciation	-	(3,825)	(1,551)	(6,484)	(5,857)	(18,032)
Net Book Amount	127,959	11,988	1,450	2,905	36,102	180,404

The Bank's increase in *Property, Plant & Equipment* during the year relates primarily to land and buildings and equipment additions.

The increase in land and buildings assets is driven mainly by the development of the Lae Currency Distribution Centre and improvements to ToRobert Haus. The Bank's properties were revalued as at 31 December 2016 by 3 accredited valuers. Due to the revaluation occurring as at 31 December 2016, accumulated depreciation on the land and building assets was fully reversed.

	2016 K'000	2015 K'000
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Note 14: INVESTMENT PROPERTIES

Balance at 1 January	38,740	-
Acquisitions	-	-
Reclassification from <i>Property, Plant & Equipment</i>	-	38,740
Change in fair value	2,720	-
Balance at 31 December	41,460	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 the location and the category being valued. The independent valuers provide the fair value of the Bank's investment property every 3 years and the last valuations were performed in 2016. The fair value measurements for all of the investment properties have been categorised as level 3 fair value measurements. Rental income from investment properties is K3.5 million (2015: K2.6 million).

Note 15: DEPOSITS FROM BANKS & THIRD PARTIES

Banks		
Exchange settlement accounts	2,190,931	1,182,360
Cash reserve requirement	2,124,963	2,023,079
Other Deposits	8,452	6,334
	4,324,346	3,211,773

Note 16: DEPOSITS FROM GOVERNMENT AND GOVERNMENT ENTITIES

Deposits from Government and government entities	711,738	871,407
	711,738	871,407

Note 17: SECURITIES ISSUED

Central Bank Bills issued	1,358,923	1,566,893
	1,358,923	1,566,893

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

Note 18: CURRENCY IN CIRCULATION

Currency in circulation	2,114,210	1,883,089
	2,114,210	1,883,089

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.

Notes to the Financial Statements

	2016 K'000	2015 K'000
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Note 19: OTHER FINANCIAL LIABILITIES

Foreign Currency

Foreign currency deposits	1,973	1,233
	1,973	1,233

Local Currency

Expense creditors	34,076	21,531
Distributions payable	-	90,000
	34,076	111,531

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

Provision for gratuity leave	2,375	2,026
Provision for annual leave	15,660	13,754
Provision for long service leave	4,130	3,328
	22,165	19,108

Reconciliation of leave provisions

Balance at 1 January	19,108	16,847
Net charged to Statement of Comprehensive Income	3,057	2,261
Balance at 31 December	22,165	19,108

Note 21: SHARE CAPITAL

At 31 December 2016 the authorised and subscribed capital of the Bank was K145.5 million (2015: K145.5 million). The capital is fully subscribed by the Government of Papua New Guinea.

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	132,984	113,992
Property Revaluation Reserve	58,473	93,452
Unrealised Loss Reserve	(293,526)	(558,013)
Retained Earnings	333,072	240,414
Total Other Reserves	231,004	(110,155)
Total Owner's Equity	376,544	35,385

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

(a) 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 the 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. The Bank's recognised instruments are carried at amortised cost or current market value.

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

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

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

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

(b) Credit Risk

(i) 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.

Notes to the Financial Statements

(ii) Concentration of credit exposure

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

	2016 K'000	2015 K'000
Foreign governments, banks and financial organisations		
Nostro accounts	296,105	455,935
Foreign investments (Note 9)	4,753,896	4,890,468
Assets held with IMF and other financial organisations	39,190	38,630
Accrued interest receivable	18,158	23,126
PNG Government		
Government securities (Note 10)	3,787,129	2,220,380
Accrued interest receivable	82,919	59,039
PNG commercial banks (Note 11)	-	174,825
Temporary advance to PNG Government (Note 11)	69,314	-
Bank staff and employees (Note 11)	20,492	13,928
Other Government institutions (Note 11)	1,386	1,386
	9,068,589	7,877,717

The Bank's maximum exposure to credit risk is limited to the amount of financial assets carried in the Statement of Financial Position. 10% (2015: 18%) of the total assets have a credit rating of A-1+ or above in short term investments and 36% (2015: 43%) of long term investments have a credit of A+ or above.

(iii) Credit exposure by credit rating

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

Investment in Financial Assets	2016 K'000	% 2016 Financial Assets	2015 K'000	% 2015 Financial Assets
Short term foreign investments				
A-1+	747,419	9	1,071,324	16
A-1	95,078	1	180,894	2
A-2	-	-	14,154	-
A-3	-	-	27,804	-
NR	485,749	6	111,883	2
	1,328,247	16	1,406,059	20
Long term foreign investments				
AAA	951,038	11	1,144,923	16
AA+	1,079,176	13	1,123,622	16
AA	386,476	5	376,026	5
AA-	189,319	2	190,164	3
A+	450,826	5	242,744	3
A	-	-	57,007	1
A-	12,290	-	8,400	-
BBB+	-	-	7,859	-
BBB	172,527	2	142,779	2
BBB-	184,088	2	190,885	3
	3,425,740	40	3,484,409	49
Total foreign investments	4,753,986	56	4,890,468	69
Short term domestic investments				
B	1,930,135	23	733,783	10
	1,930,135	23	733,783	10
Long term domestic investments				
B+	1,856,994	22	1,486,597	21
	1,856,994	22	1,486,597	21
Total domestic investments	3,787,129	44	2,220,380	31
Total investments	8,541,115	100	7,110,848	100

Notes to the Financial Statements

(c): 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.

(i) Foreign exchange risk

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

Net exposure to major currencies

As at 31 December 2016	CURRENCY OF DENOMINATION							Total K'000
	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	
Foreign Currency Assets:								
Foreign currency	131,380	53,783	46,773	-	45,154	-	19,014	296,105
Gold holdings	153,592	-	-	-	-	-	-	153,592
Investments	2,072,975	798,686	807,533	126,489	457,782	-	137,516	4,400,980
Derivative assets	353,006	-	-	-	-	-	-	353,006
Assets held with IMF	-	-	-	-	-	39,190	-	39,190
Accrued interest	7,846	4,168	4,266	728	477	-	673	18,158
	2,718,799	856,637	858,572	127,217	503,413	39,190	157,203	5,261,031
Foreign Currency Liabilities:								
Liabilities with IMF	-	-	-	-	-	539,722	-	539,722
Foreign currency liabilities	1,973	-	-	-	-	-	-	1,973
	1,973	-	-	-	-	539,722	-	541,695
Net Foreign Currency Exposure	2,716,826	856,637	858,572	127,217	503,413	(500,532)	157,203	4,719,336

As at 31 December 2015	CURRENCY OF DENOMINATION							Total K'000
	US Dollar K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	
Foreign Currency Assets:								
Foreign currency	111,889	222,990	46,951	48,849	22,004	-	3,252	455,935
Gold holdings	134,639	-	-	-	-	-	-	134,639
Investments	2,153,707	896,827	1,084,166	244,955	414,896	94,047	4,888,598	
Derivative assets	1,870	-	-	-	-	-	-	1,870
Assets held with IMF	-	-	-	-	-	38,630	-	38,630
Accrued interest	7,197	7,165	6,220	1,551	484	-	509	23,126
	2,409,302	1,126,982	1,137,337	295,355	437,384	38,630	97,808	5,542,798
Foreign Currency Liabilities:								
Liabilities with IMF	-	-	-	-	-	529,260	-	529,260
Foreign currency liabilities	1,233	-	-	-	-	-	-	1,233
	1,233	-	-	-	-	529,260	-	530,493
Net Foreign Currency Exposure	2,408,069	1,126,982	1,137,337	295,355	437,384	(490,630)	97,808	5,012,035

(ii) 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.

(iii) 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.

Notes to the Financial Statements

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.

As at 31 December 2016	MATURITY PROFILE							Weighted average effective rate %
	Balance Total K'000	On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specified maturity K'000	
Assets								
Foreign Currency								
Financial Assets:								
Cash and cash equivalents	296,105	296,105	-	-	-	-	-	0.44%
Financial assets at fair value	4,753,986	-	133,191	1,068,166	329,163	2,910,012	-	1.47%
Assets held with IMF	39,190	-	-	-	-	-	39,190	0.03%
Accrued interest	18,158	-	12,667	5,491	-	-	-	na
	5,107,439	296,105	145,858	1,073,657	329,163	2,910,012	39,190	
Local Currency								
Financial Assets:								
Government of Papua New Guinea securities	3,787,129	-	208,829	1,728,130	289,695	1,560,475	-	6.57%
Loans and advances	82,919	-	-	69,314	-	13,605	-	0.02%
Accrued interest and receivables	92,588	-	66,572	26,016	-	-	-	na
	3,962,636	-	275,401	1,823,460	289,695	1,574,080	-	
Non-financial assets:								
Gold	153,592	-	-	-	-	-	153,592	na
Property, plant & equipment	180,404	-	-	-	-	-	180,404	na
Investment properties	41,460	-	-	-	-	-	41,460	na
Other non-financial assets	39,738	-	-	-	-	-	39,738	na
	415,194	-	-	-	-	-	415,194	
Total Assets	9,485,270	296,105	421,259	2,897,117	618,858	4,484,092	454,384	
Liabilities								
Foreign Currency								
Financial Liabilities:								
Liabilities with IMF	539,722	-	-	-	-	-	539,722	0.03%
Other financial liabilities	1,973	-	1,973	-	-	-	-	na
	541,695	-	1,973	-	-	-	539,722	
Local Currency								
Financial Liabilities:								
Deposits from banks and third parties	4,324,346	4,324,346	-	-	-	-	-	0.01%
Deposits from Government	711,738	711,738	-	-	-	-	-	0.01%
Securities issued	1,358,923	-	1,358,923	-	-	-	-	2.54%
Accrued interest payable	1,574	-	1,574	-	-	-	-	na
Currency in circulation	2,114,210	2,114,210	-	-	-	-	-	na
Other financial liabilities	34,076	-	34,076	-	-	-	-	na
	8,544,866	7,150,294	1,394,573	-	-	-	-	
Total Liabilities	9,086,561	7,150,294	1,396,546	-	-	-	539,722	

As at 31 December 2015	MATURITY PROFILE							Weighted average effective rate %
	Balance Total K'000	On demand K'000	0 to 3 months K'000	3 to 12 months K'000	1 to 5 years K'000	Over 5 years K'000	No specified maturity K'000	
Assets								
Foreign Currency								
Financial Assets:								
Cash and cash equivalents	455,935	-	455,935	-	-	-	-	0.34%
Financial assets at fair value	4,890,468	80,193	826,088	533,943	3,056,518	393,726	-	1.89%
Assets held with IMF	38,630	-	-	-	-	-	38,630	0.03%
Accrued interest	23,126	-	14,901	8,088	137	-	-	na
	5,408,159	80,193	1,296,924	542,031	3,056,655	393,726	38,630	
Local Currency								
Financial Assets:								
Government of Papua New Guinea securities	2,220,380	-	465,865	321,947	306,656	1,125,912	-	10.56%
Loans and advances	184,516	-	174,825	-	-	9,691	-	0.07%
Accrued interest	59,039	-	37,856	21,183	-	-	-	na
	2,463,935	-	678,546	343,130	306,656	1,135,603	-	
Non-financial assets:								
Gold	134,639	-	-	-	-	-	134,639	0.23%
Property, plant & equipment	136,170	-	-	-	-	-	136,170	na
Investment properties	38,740	-	-	-	-	-	38,740	na
Other non-financial assets	50,917	-	-	-	-	-	50,917	na
	360,466	-	-	-	-	-	360,466	
Total Assets	8,232,560	80,193	1,975,470	885,161	3,363,311	1,529,329	399,096	
Liabilities								
Foreign Currency								
Financial Liabilities:								
Liabilities with IMF	529,260	-	-	-	-	-	529,260	0.05%
Other financial liabilities	1,233	-	1,233	-	-	-	-	na
	530,493	-	1,233	-	-	-	529,260	
Local Currency								
Financial Liabilities:								
Deposits from banks and third parties	3,211,773	3,211,773	-	-	-	-	-	0.01%
Deposits from Government	871,407	871,407	-	-	-	-	-	0.01%
Securities issued	1,566,893	-	1,566,893	-	-	-	-	3.42%
Accrued interest payable	2,881	-	2,881	-	-	-	-	na
Currency in circulation	1,883,089	1,883,089	-	-	-	-	-	na
Other financial liabilities	111,531	-	111,531	-	-	-	-	na
	7,647,574	5,966,269	1,681,305	-	-	-	-	
Total Liabilities	8,178,067	5,966,269	1,682,538	-	-	-	529,260	

(d) 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.

	2016 K'000	2015 K'000
Financial Assets		
Cash and cash equivalents	296,105	455,935
At fair value through profit/(loss)	8,621,765	7,188,218
Loans & receivables	193,665	266,681
Assets accounted for under other standards	373,734	321,726
	9,485,270	8,232,560
Financial Liabilities		
At fair value through profit/(loss)	541,695	530,493
At amortised cost	8,544,866	7,647,574
Provisions	22,165	19,108
	9,108,726	8,197,175

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 valued with reference to observable market data. Accordingly, these are classified under Levels 1 and 2 respectively.

	Level 1 K'000	Level 2 K'000	Level 3 K'000	Total K'000
31 December 2016				
Financial assets held at fair value through profit or loss				
Domestic Government securities – Inscribed stock and Treasury bills	-	-	3,787,129	3,787,129
Foreign government and semi-government bonds	-	-	-	1,110,177
Money market instruments	-	99,480	-	99,480
Derivatives managed by external fund managers	-	353,006	-	353,006
Investments in bonds and other instruments managed by external fund managers	3,191,323	-	-	3,191,323
Assets held with IMF	39,190	-	-	39,190
Investment property	-	-	41,460	41,460
Total assets at fair value through profit or loss	3,230,513	452,486	3,828,589	8,621,765
Non-financial assets at fair value				
Gold	153,592	-	-	153,592
Property, plant & equipment	-	-	180,404	180,404
Total assets at fair value	153,592	-	180,404	333,996
Financial liabilities held at fair value through profit or loss				
Derivatives	-	1,973	-	1,973
Liabilities with IMF	539,722	-	-	539,722
Total liabilities at fair value through profit or loss	539,722	1,973	-	541,695
31 December 2015				
Financial assets held at fair value through profit or loss				
Domestic Government securities – Inscribed stock and Treasury bills	-	-	2,220,380	2,220,380
Foreign government and semi-government bonds	1,474,848	-	-	1,474,848
Money market instruments	-	102,600	-	102,600
Derivatives managed by external fund managers	-	1,870	-	1,870
Investments in bonds and other instruments managed by external fund managers	3,311,150	-	-	3,311,150
Assets held with IMF	38,630	-	-	38,630
Investment property	-	-	38,740	38,740
Total assets at fair value through profit or loss	4,824,628	104,470	2,259,120	7,188,218
Non-financial assets at fair value				
Gold	134,639	-	-	134,639
Property, plant & equipment	-	-	136,170	136,170
Total assets at fair value	4,959,267	104,470	2,395,290	7,459,027
Financial liabilities held at fair value through profit or loss				
Derivatives	-	1,233	-	1,233
Liabilities with IMF	529,260	-	-	529,260
Total liabilities at fair value through profit or loss	529,260	1,233	-	530,493

Notes to the Financial Statements

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

	Level 3 K'000
Opening balance	2,220,380
Investment net of maturities	1,563,055
Fair value revaluation gains/(losses) on Level 3 instruments	3,694
Closing balance	3,787,129
Total gains and losses for the period included in the profit or loss for Level 3 assets held at the end of the reporting period.	3,694

The following table presents the changes in Level 3 financial instruments (excluding the accrued interest) for year ended 31 December 2015:

	Level 3 K'000
Opening balance	2,413,811
Investment net of maturities	(214,222)
Fair value revaluation gains/(losses) on Level 3 instruments	20,791
Closing balance	2,220,380
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.	20,791

	Valuation Technique	Unobservable Input	Range of Inputs		Fair value movement due to change in unobservable Input	
			2016	2015	Increase	Decrease
Domestic Government securities – Inscribed stock and Treasury bills	Discounted cash flows present value method	Current market yield	7.9% to 16%	7.7% to 15%	Decrease	Increase
Investment property	Income capitalisation	Capitalisation rate	10% to 14%	10% to 12%	Decrease	Increase

(e) Sensitivity analysis

The sensitivity of the Bank's profit and equity to a movement of +/- 10 percent in the value of the kina as at 31 December 2016 is shown below. These figures are generally reflective of the Bank's exposure over the fiscal year.

	2016 K'000	2015 K'000
Changes in profit/equity due to a 10 percent appreciation in the value of the kina	(526,103)	(520,873)
Changes in profit/equity due to a 10 percent depreciation in the value of the kina	654,475	637,184

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.

	2016 K'000	2015 K'000
Changes in profit/equity due to an increase of 1 percentage point	85,411	71,029
Changes in profit/equity due to a decrease of 1 percentage point	(85,411)	(71,029)

Note 24: EVENTS AFTER THE BALANCE DATE

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

Note 25: CONTINGENT LIABILITIES

The Bank had no contingent liabilities at 31 December 2016 (2015: nil) and there are no transactions or events that will have material impact on the financial report during its preparation.

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

Note 26: CAPITAL COMMITMENTS

The Bank has no capital commitments.

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

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank. This group comprises 29 in total (2014: 25), including the Governor, Deputy Governor, 4 Assistant Governors, 8 non-executive Board members and 15 senior staff. The Salaries and Remuneration Committee (SRC) and Salaries, Conditions & Monitoring Committee (SCMC) determine the terms and conditions on which the Governor and Deputy Governor hold office in accordance with the *Central Banking Act 2000*. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

	2016 K'000	2015 K'000
Short term benefits	10,135	8,580
Post employment benefits	2,655	963
Other long term benefits	3,788	3,413
	16,578	12,956

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

As at 31 December 2016 the loans owed by the key management personnel to the Bank were K3,081,922 (2015: K1,956,483).

Note 28: AUDITOR'S REMUNERATION

The total audit fee for the year was K1,698,871 (2015: K1,406,250). 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 CBA 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:

- 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
- Acting as the agent of the Government, or its agencies and institutions, providing guarantees, participating in loans to Government, departments and corporations
- As the agent of the Government managing public debt and foreign reserves.

Declaration by Management

DECLARATION BY MANAGEMENT

In my opinion the foregoing Statement of Profit or Loss and other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows including the Notes to and forming part thereof, have been drawn up so as to give a true and fair view of the matters to which they relate for the year ended 31 December 2016.

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



Loi M Bakani CMG
Governor

26 July 2017

Report of the Auditor-General



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INDEPENDENT AUDITOR'S REPORT ON THE ACCOUNTS OF BANK OF PAPUA NEW GUINEA FOR THE YEAR ENDED 31 DECEMBER 2016

To the Minister for Treasury

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2016** as set out on pages **2 to 26**. The financial statements comprise:

- Statement of Financial Position as at 31 December 2015;
- Statement of Profit or Loss and Other Comprehensive Income;
- Statement of Changes in Equity;
- Statement of Cash Flows for the year ended; and
- Summary of significant accounting policies and other explanatory notes.

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

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

Responsibility of the Auditor-General

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

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

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

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

AUDIT OPINION

In my opinion:

- (a) the financial statements of Bank of Papua New Guinea for the year ended 31 December 2016:
 - (i) give a true and fair view of the financial position of the Bank as at 31 December 2016 and of its financial performance and cash flows for the year then ended; and
 - (ii) comply with the *International Financial Reporting Standards*, *Papua New Guinea Central Banking Act 2000* and other generally accepted accounting practice in Papua New Guinea; and
- (b) proper accounting records have been kept by the Bank as far as it appears from my examination of those records; and
- (c) I have obtained all the information and explanation that were required.


PHILIP NAUGA
Auditor-General

30 June, 2017

Notes

