



AUDITOR-GENERAL'S OFFICE

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WAIGANI
PAPUA NEW GUINEA

The Governor
Bank of Papua New Guinea
PO Box 121
PORT MORESBY
National Capital District

Date : September 20, 2007
Our Reference : 30-13-4
Action Officer :
Designation :
Your Reference :
Date:

Dear Sir,

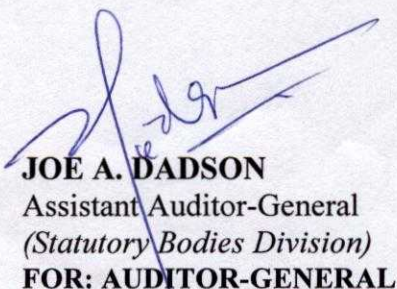
AUDIT REPORT -
BANK OF PAPUA NEW GUINEA
FOR THE YEAR ENDED 31 DECEMBER 2006

I enclose a copy of the Auditor-General's Report together with a copy of the audited financial statements for the year ended **31 December, 2006**.

In accordance with Section 63(2) of the *Public Finances (Management) Act, 1995*, please ensure that the Bank furnishes to the Minister a report of your operations during the year ended 31 December, 2006 together with the financial statements in respect of that year and the Auditor-General's Report thereon for tabling in Parliament as required under Section 63(5) of the *Public Finances (Management) Act, 1995*. A copy of such report when furnished to the Minister, should also be forwarded to this Office.

Kindly take note that Section 63(6) of the aforementioned Act requires that when a report or financial statement of a Public Body is reproduced for publication or for other purposes, the report of the Auditor-General shall be included in the reproduction.

Yours faithfully,


JOE A. DADSON
Assistant Auditor-General
(Statutory Bodies Division)
FOR: AUDITOR-GENERAL

Bank of Papua New Guinea

Statutory Accounts
for the year ended 31 December 2006

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Statement of Financial Performance for the year ended 31 December 2006
Bank of Papua New Guinea

	Note	2006 K'000	2005 K'000
Income from Foreign Currency Operations			
Interest Income	16	163,936	65,450
Securities Trading		3,004	(4,896)
Foreign Exchange Commissions		15,571	9,314
Total Income from Foreign Currency Operations		182,511	69,868
Less; Interest Expense on Liabilities with IMF		1,515	3,128
Net Foreign Currency Income		180,996	66,740
Income from Domestic Operations			
Interest Income	17	37,758	34,539
Other Income	18	2,447	10,319
Total Income from Domestic Operations		40,205	44,858
Expense on Domestic Operations			
Interest Expense	19	58,108	38,858
Total Expenses on Domestic Operations		58,108	38,858
Net Domestic Income/(Loss)		(17,903)	6,000
Total Net Operations Income		163,093	72,740
Less: Operating Expenses			
General and Administration Expenses	20	47,029	47,673
Operating Profit		116,064	25,067
Gold Revaluation Gain/(Loss)		13,679	13,139
Realisation from Gold Valuation Reserve		(23,146)	
Foreign Exchange Revaluation Gain/(Loss)		70,062	(143,713)
Domestic Government Securities Revaluation Gain/Loss)		2,995	-
Net profit/(loss) for the year		179,654	(105,507)

The accounting policies and notes to the financial statements form an integral part of these financial statements.



Statement of Financial Position for the year ended 31 December 2006
Bank of Papua New Guinea

	Note	2006 K'000	2005 K'000
Assets			
Foreign Currency Financial Assets			
Gold	1(d)	81,154	99,240
Foreign Currency	2	208,315	188,594
Investments	3	4,010,430	2,055,433
Assets held with IMF	4	185	81
Other assets – Interest receivable		27,591	11,233
Total Foreign Currency Financial Assets		4,327,675	2,354,581
Local Currency Financial Assets			
Cash & Cash Equivalents	5	2,070	324
Government of Papua New Guinea Securities	6	788,622	743,428
Loans and Advances to Government		211	49
Loans and Advances	7	56,736	56,293
Total Local Currency Financial Assets		847,639	800,094
Total Financial Assets		5,175,314	3,154,675
Other Assets			
Property, Plant & equipment	8	25,706	19,667
Other assets	9	18,047	19,696
Total Other Assets		43,753	39,363
Total Assets		5,219,067	3,194,038
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Liabilities with IMF	4	43,779	41,041
Local Currency Financial Liabilities			
Deposits from Banks & Third Parties	10	451,445	382,232
Deposits from Government and Government Entities		805,620	645,093
Securities Issued	11	2,483,671	925,530
Total Local Currency Financial Liabilities		3,740,736	1,952,855
Total Financial Liabilities		3,784,515	1,993,896
Other Liabilities			
Currency Circulation	12	693,220	606,195
Profit available for Distribution	13	116,064	25,067
Other Liabilities	14	25,560	42,761
Total Other Liabilities		834,844	674,023
Total Liabilities		4,619,359	2,667,919



Statement of Financial Position for the year ended 31 December 2006
Bank of Papua New Guinea

	Note	2006 K'000	2005 K'000
Equity			
Capital	15	74,000	69,000
Asset Revaluation Reserve–Gold		61,458	70,926
Asset Revaluation Reserve–Property, plant & equipment		1,613	1,613
Unrealised Profits Reserve		59,211	-
Currency Movement Reserve		321,431	310,580
Domestic Securities Revaluation Reserve		2,995	-
General Reserve		79,000	74,000
Total Equity		599,708	526,118
Total Liabilities and Equity		5,219,067	3,194,038

Statement of Changes in Equity for the year ended 31 December 2006
Bank of Papua New Guinea

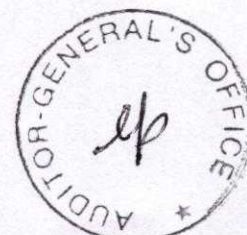
In Kina thousands

	Capita	Gold	Property Plant, & Equip.	Revaluation Reserves Currency Movements	Unrealised Profits	Domestic Settlements	General Reserve	Retained Earnings	Total
Balance at 1 Jan. 2005	74,000	57,786	1,613	454,293	-	-	69,000	-	656,692
Net profit (loss) for the year	-	-	-	-	-	-	-	(105,507)	(105,507)
Revaluation transfers for the year	-	13,139	-	(143,713)	-	-	-	130,574	-
Transfer to General Reserve	-	-	-	-	-	-	-	-	-
Distribution to Government	-	-	-	-	-	-	-	(25,067)	(25,067)
Balance at 31 Dec. 2005	74,000	70,925	1,613	310,580	-	-	69,000	-	526,118
Net profit for the year	-	-	-	-	-	-	-	179,654	179,645
Revaluation transfer for the year	-	13,679	-	10,851	59,211	2,995	-	(86,736)	-
Realised from Gold Revaluation Reserve	-	(23,146)	-	-	-	-	-	23,146	-
Appropriate to other reserves	5,000	-	-	-	-	-	5,000	-	10,000
Distribution to Government	-	-	-	-	-	-	-	(116,064)	(116,064)
Balance at 31 Dec. 2006	79,000	61,458	1,613	321,431	59,211	2,995	74,000	-	599,708



Statement of Cash Flow for the year ended 31 December 2006
Bank of Papua New Guinea

	Note	2006 K'000	2005 K'000
Cash flows from operating activities			
Source;			
Interest Received – Foreign Currency		118,718	59,843
Interest Received – Local Currency		40,934	28,682
Realised Gold Gains		37,215	-
Fees, Commission and Other Miscellaneous Income Received		18,018	22,876
		<u>214,885</u>	<u>111,401</u>
Disbursements;			
Interest paid – Foreign Currency		(1,515)	(3,128)
Interest paid – Local Currency		(55,678)	(41,152)
Payments to Employees		(18,681)	(13,522)
Payments to Suppliers		(22,828)	(30,349)
Securities Trading Gain/(Loss)		14,218	(2,518)
Fees, Commissions Paid		(3,630)	(3,643)
Realised Foreign Exchange gains		70,063	(143,713)
		<u>(18,051)</u>	<u>(238,025)</u>
Net Cash Flow from Operating Activities	21	196,834	(126,624)
Cash Flows from Investing Activities			
Source;			
Net Increase/(Decrease) in Currency Deposits		-	(11)
Net Increase/(Decrease) in Deposits from Banks		69,212	42,451
Net Increase/(Decrease) in Deposits from Government		203,157	539,666
Net Increase/(Decrease) in Other Liabilities		(3,289)	(24,456)
		<u>269,080</u>	<u>557,650</u>
Disbursements;			
Market Movement in Gold Holdings		(23,670)	-
Net Increase/(Decrease) in Gold		(18,086)	-
Net Increase/(Decrease) in Foreign Currency Investments		(1,963,216)	(358,967)
Net Increase/(Decrease) in Assets Held with IMF		(104)	2,284
Net Increase/(Decrease) in Government Securities		(45,194)	(41,400)
Net Increase/(Decrease) in Loans and Advances		(605)	1,329
Purchase of Property, Plant and Equipment		(7,320)	(1,313)
Net Increase/(Decrease) in Other Assets		(1,527)	282
		<u>(2,059,722)</u>	<u>(397,785)</u>
Net Cash Flow from Investing Activities		(1,790,642)	159,865
Cash Flows from Financing Activities			
Source;			
Net Issue of Currency in Circulation		87,026	74,886
Net Increase/(Decrease) in Securities issues		1,558,142	34,039
Net Increase/(Decrease) in Liabilities with IMF		2,738	(204,160)
Profit Paid to Government		(32,630)	(17,563)
		<u>1,615,276</u>	<u>(112,798)</u>
Net Cash Flow from Financing Activities		1,615,276	(112,798)
Net Increase (Decrease) in Cash and Cash Equivalents		21,468	(79,557)
Cash and Cash Equivalent at 1 January		188,917	268,475
Cash and Cash Equivalent at 31 December	22	210,385	188,918



Note 1: SUMMARY OF ACCOUNTING POLICIES

The financial statements have been prepared in accordance with the Central Banking Act 2000 (the "Act") and requirements of International Accounting Standards. In the event of any conflict between the requirements of the Act and the Accounting Standards the Bank (BPNG) is required to comply with the Act.

Unless otherwise stated, the accounting policies and practices followed in these statements are consistent with those followed in the previous year.

All amounts are expressed in kina unless another currency is indicated. Current market values are used for all BPNG's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for premises. In all other cases, a historical cost basis of accounting is used. Revenues and expenses are brought to account on an accrual basis. All revenues, expenses and profits are from ordinary activities of BPNG.

(a) Statement of compliance

The accompanying financial statements have been prepared in compliance with International Financial Reporting Standards (IFRS) approved by the International Accounting Standards Board (IASB).

(b) Basis of preparation

The financial statements are presented in Kina, rounded to the nearest thousand.

The financial statements are prepared on a historical cost basis except that the following assets and liabilities are stated at their fair value: investments held for trading and investments available for sale.

(c) Income Statement

All items of income and expense recognised in a period are included in profit and loss unless a Standard or an Interpretation requires otherwise.

The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and are recorded in the accounting records and reported in the financial statements of the periods to which they relate.

(d) Foreign Currency and Gold

Transactions in foreign currency are translated to Kina at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at a reporting date are translated to Kina at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

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

Gold

Gold is valued at market prices. Gains and losses arising from revaluation are recognised in the Income statement.

(e) Financial assets/instruments

(i) Definition

Trading instruments are those that the Bank principally holds for the purpose of short term profit taking. These include investments, certain purchased loans and derivative contracts that are not designated and effective hedging instruments, and liabilities from short sales of financial instruments. All trading derivatives in a net receivable position (positive fair value), as well as options purchased are reported as trading assets. All trading derivatives in a net payable position (negative fair value) as well as any options written are reported as trading liabilities.

Originated loans and receivables are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term profit taking.



Originated loans and receivables comprise loans and advances to banks and customers other than purchased loans as well as bonds purchased at original issuance.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These include certain purchased loans and advances to banks and customers and certain debt investments.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity. Available-for-sale instruments include money market placements and certain debt and equity investments.

(ii) Recognition

The Bank recognises financial assets held for trading and available-for-sale assets on the date the asset is delivered to the Bank. From this date any gains or losses arising from changes in fair value are recognised.

Held-to-maturity assets and originated loans and receivables are recognised on the day the asset is acquired by the Bank.

(iii) Measurement

Financial instruments are initially measured at cost, including transaction costs.

Subsequent to initial recognition all trading instruments and all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method.

(iv) Fair value measurement principles

The fair value of a financial instrument is based on its quoted market price at the reporting date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using discounted cash flow techniques.

Where discounted cash flow techniques are used, the estimated cash flows are based on management's best estimate and the discount rate used is a market related rate at the reporting date for an instrument with similar terms and conditions.

The fair value of derivatives that are not exchange traded are estimated at the amount the Bank would receive or pay to terminate the contract at the reporting date taking into account current market conditions and the current creditworthiness of the counter parties.

(v) Recognition of gains and losses

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity. When the financial assets are sold, collected or otherwise disposed of the cumulative gain or loss recognised in equity shall be transferred to the income statement.

Gains and losses arising from a change in the fair value of trading instruments and available for sale assets are recognised in the income statement.

(vi) Treatment of specific instruments

Cash and cash equivalents

Cash and cash equivalents comprise notes and coins held by the Bank.

Money market placements

Money market placements are classified as available-for-sale assets.



Investments

Investments that the Bank holds for the purpose of short term profit taking are classified as trading instruments. Debt investments that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity assets. Other assets are classified as available-for-sale assets.

Loans and advances

Loans and advances originated by the Bank are classified as originated loans and receivables.

Loans and advances are reported net of allowances for uncollectibility to reflect the estimated recoverable amounts.

Papua New Guinea Government Securities

Papua New Guinea Government Securities consist of Kina denominated securities issued by the Government of Papua New Guinea and held by the Bank. Interest on these securities is accrued over the term of the security.

Short term borrowings

Short term borrowings are accounted for as other interest bearing borrowings

Other liabilities evidenced by paper

Other liabilities evidenced by paper are classified as non-trading liabilities.

(f) De-recognition

A financial asset is derecognised 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 derecognised when it is extinguished.

Available-for-sale assets and assets held for trading are derecognised when sold and the corresponding receivable from the buyer for the payment is recognised.

Held-to-maturity instruments and originated loans and receivables are derecognised on the day they are repaid in full by the debtor.

(g) Repurchase agreements

Securities purchased and contracted for sale under repurchase agreements are reported in the balance sheet within the relevant investment portfolio and are valued at contract price. The difference between the purchase and sale price is recognised as income over the term of the agreement.

(h) Offsetting

Financial assets and liabilities are only be offset and the net amount reported in the balance sheet when the Bank has a legally enforceable right to offset the recognised amounts and the transactions are intended to be settled on a net basis.

(i) Impairment

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the assets recoverable amount is estimated and a provision is created to cover any shortfall.

(j) Property, plant and equipment

(i) Cost or valuation

Property, plant and equipment is recorded at cost or valuation and reported less accumulated depreciation. Revaluations are made with sufficient regularity to ensure that the carrying amount of an asset does not differ materially from that which would be determined using the fair value at the balance sheet date. Any gains arising on revaluation are credited directly to the asset revaluation reserve account and not taken through the income statement.



Subsequent expenditure is capitalised where it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

(ii) Depreciation

Depreciation is charged to the income statement on a straight line basis with the corresponding credit to the respective accumulated depreciation account.

Depreciation rates are reviewed on an annual basis to ensure they reflect the future economic benefits embodied in the asset.

Current depreciation rates

	Number of Years
Buildings	
Residential Properties	20 & 30
Office Buildings	50
Computer Equipment	5
Vehicles	4
Other Assets	5

(k) Deferred assets/Intangibles

The costs of the production of notes is treated as a deferred asset and amortised over a period of three years.

All other expenditure of a non capital nature is expensed as incurred.

(l) Other receivables

Other receivables are stated at cost less impairment losses.

(m) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at cost, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

**(n) Employee benefits
Pension Fund**

Contributions to the Bank's pension fund are recognised as an expense in the Bank's income statement. The value of the pension fund defined benefit obligations and the fair value of 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 sheet date.

Leave entitlement

Unutilised leave entitlements are recognised on an accruals basis.

(o) Provisions

Provisions are only be recognised in the balance sheet where the Bank has a legal or constructive obligation as the result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(p) Other payables

Other payables are recognised at cost.

(q) Reserves

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



(i) **General reserve**

The General Reserve Fund was established in 1976 as a reserve to protect the bank against contingencies and losses arising from its operations in the financial sector and its involvement in foreign currency.

(ii) **Asset revaluation reserves**

Asset revaluation reserves reflect the impact of changes in the market value of gold and property

(iii) **Unrealised profits reserve**

Unrealised gains on foreign exchange and securities are recognised in profit from ordinary activities. Until such gains are realised, they are retained in the Unrealised Profits Reserve.

(iv) **Currency movements reserve**

Realised gains on foreign currency are recognised in profit from ordinary activities. When they are realised they are transferred to the Currency Movements Reserve and are not available for distribution.

(v) **Domestic Securities Valuation reserve**

Realised gains on domestic securities are recognized in profit from ordinary activities. They are transferred to the Domestic Securities Valuation Reserve and are not available for distribution.

(r) **Determination of distributable profit**

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

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

b) The Board of the Bank is required to determine the net profit of the Bank and then consult with the Minister to determine the amount of profit that is to be placed to the credit of the Bank's Reserve Funds.

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

Note 2: FOREIGN CURRENCY

The amount represents the equivalent accumulated value of different foreign currencies held with overseas central and commercial banks. Included is an amount of K23.6 million recorded as cash in transit.

Note 3: INVESTMENTS – FOREIGN ASSETS

	2006 K'000	2005 K'000
Short term investment in overseas commercial banks	1,000,643	280,400
Foreign Bonds	<u>3,009,787</u>	<u>1,775,033</u>
	<u>4,010,430</u>	<u>2,055,433</u>



Note 4: IMF RELATED ASSETS & LIABILITIES ASSETS

	2006 K'000	2005 K'000
Assets		
SDR Holding	<u>185</u>	<u>81</u>
Liabilities		
IMF Number 1 and 2 accounts	1,558	(19)
SDR allocation	42,369	41,150
Other	<u>(148)</u>	<u>(91)</u>
	<u>43,779</u>	<u>41,040</u>

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 authorized 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 5: CASH & CASH EQUIVALENTS – DOMESTIC ASSETS

Notes and coin held by the Bank at the end of the financial year have been netted against the liability for notes and coin in circulation because it does not represent currency in circulation. Cash equivalents comprise domestic cheques in the course of collection.

Note 6: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

	2006 K'000	2005 K'000
Inscribed Stock	146,937	107,313
Treasury Bills	<u>641,685</u>	<u>636,115</u>
	<u>788,622</u>	<u>743,428</u>

Inscribed Stock in 2005 was stated at cost. In 2006 Inscribed stock has been stated at market value using the effective interest rate methodology. Interest on inscribed stock is accrued.

Treasury bills earn interest at the prevailing market rates. The Treasury bills are stated at market value. i.e. cost plus interest earned up to 31 December 2006.

Note 7: LOANS AND ADVANCES

	2006 K'000	2005 K'000
Domestic Banks – Agricultural Export Commodity Support	23,782	23,782
Loans and Advances to Staff (including housing loans)	6,187	5,744
Loans and Advances – Other (Cocoa Board)	26,220	26,220
Other	<u>547</u>	<u>547</u>
Total Loans & Advances	<u>56,736</u>	<u>56,293</u>



Note 8: PROPERTY, PLANT & EQUIPMENT – DOMESTIC ASSETS*(In Kina thousands)*

	Land and Buildings K'000	Equipment K'000	Vehicles K'000	Computer Equipment K'000	Total K'000
Cost					
As at 31 December 2005	19,539	467	1,336	1,936	23,278
Additions	6,377	347	136	460	7,320
Disposals	-	-	-	-	-
As at 31 December 2006	<u>25,916</u>	<u>814</u>	<u>1,472</u>	<u>2,396</u>	<u>30,598</u>
Accumulated Depreciation					
As at 31 December 2005	1,802	281	575	954	3,612
Charge for the year	474	90	316	400	1,280
Disposals	-	-	-	-	-
As at 31 December 2006	<u>2,276</u>	<u>371</u>	<u>891</u>	<u>1,354</u>	<u>4,892</u>
Net Book Value at 31 December 2006	<u>23,640</u>	<u>443</u>	<u>581</u>	<u>1,042</u>	<u>25,706</u>
Net Book Value at 31 December 2005	<u>17,737</u>	<u>186</u>	<u>761</u>	<u>982</u>	<u>19,667</u>

The items of property, plant & equipment as at 31 December 2005 were revalued in 2003. The next valuation will be in 2007. The net surplus/deficit arising from the valuation has been directly recognized into equity. These amounts are not available for distribution to the Government.

Note 9: OTHER ASSETS – DOMESTIC ASSETS

	2006 K'000	2005 K'000
Accrued Interest Receivable	5,853	9,029
Deferred note production costs	3,111	4,731
Inventories	6,926	4,066
Other Receivables	2,157	1,870
Total Loans & Advances	<u>18,047</u>	<u>19,696</u>

Note 10: LOCAL CURRENCY DEPOSITS FROM BANKS & THIRD PARTIES

Banks		
Exchange Settlement Accounts	246,225	185,253
Other Deposits	196,275	137,907
Amounts outstanding under Repurchase Agreements	-	49,950
Other Deposits	8,945	9,122
	<u>451,445</u>	<u>382,232</u>



Note 11: SECURITIES ISSUED

Treasury and Central Bank bills issued	K2,483,671	K925,530
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Securities issued are debt securities issued by the Bank of Papua New Guinea for terms of 28 days, three, six or twelve months. These bills are used to manage liquidity in the money market through open market operations in the domestic financial markets.

Interest on Securities issued varied between 3.24% and 4.01% during the year.

Note 12: CURRENCY IN CIRCULATION – DOMESTIC LIABILITY

	2006 K'000	2005 K'000
Currency in Circulation	693,220	606,195

Currency in circulation represent currency issued having a claim on the Bank of Papua New Guinea. The liability for Currency in Circulation is recorded at its face valuation in the balance sheet.

Notes and coin held by the Bank as cash on hand at the end of the financial year have been netted of against the liability for notes and coin in circulation because it does not represent currency in circulation.

Note 13: PROFIT AVAILABLE FOR DISTRIBUTION

	2006 K'000	2005 K'000
Opening Balance	42,630	17,563
Payments in the Year	(32,630)	0
Current Years Earnings Available for Distribution	116,064	25,067
Transfer to General Reserve	<u>(10,000)</u>	<u>0</u>
	<u>116,064</u>	<u>42,630</u>

Note 14: OTHER LIABILITIES

Provisions for employee entitlements	5,092	4,481
Accrued interest on deposits and securities issued	3,331	902
Other	<u>17,137</u>	<u>37,378</u>
	<u>25,560</u>	<u>42,761</u>

Note 15: SHARE CAPITAL

At 31 December 2006 the authorized and subscribed capital of the Bank was Kina 79.0 million. The capital is fully subscribed by the Government of Papua New Guinea.

Note 16: INTEREST INCOME – FOREIGN CURRENCY OPERATIONS

	2006 K'000	2005 K'000
Short term deposits	62,515	25,095
Bonds	72,554	40,026
Other	<u>28,867</u>	<u>329</u>
	<u>163,936</u>	<u>65,450</u>

Other income include profit of K28.86 million from partial sale of gold holdings, (K5.71 million from sale proceeds and K23.14 million realised from Gold Revaluation Reserve).



Note 17: INTEREST INCOME – DOMESTIC OPERATIONS

Treasury Bills	23,226	24,654
Inscribed Stock	14,309	9,570
Net Gain/(loss) on Securities	-	2
Other Interest Income	223	313
	<u>37,758</u>	<u>34,539</u>

Note 18: MISCELLANEOUS INCOME – DOMESTIC OPERATIONS

Management & Licensing Fees	693	2,966
Numismatic Currency	41	6
Property Rents	991	825
Others	722	6,522
	<u>2,447</u>	<u>10,319</u>

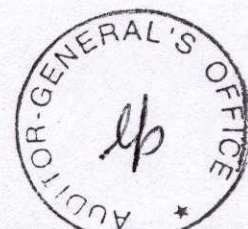
Note 19: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2006 K'000	2005 K'000
Bank Securities	49,973	36,726
Repurchase Agreements	1,763	1,617
Other	6,372	515
	<u>58,108</u>	<u>38,858</u>

Note 20: GENERAL AND ADMINISTRATION EXPENSES

	2006 K'000	2005 K'000
Staff costs	16,132	15,015
Staff Training and Development	1,222	959
Premises and Equipment	8,048	9,431
Depreciation of plant and equipment	1,280	1,150
Currency Distribution Expenses	6,438	7,827
Audit Fee	556	220
Travel	1,938	1,416
Legal & Consultancy Fees	3,074	2,771
Board & Meeting Expenses	320	430
Other Expenses	8,021	8,454
Total	<u>47,029</u>	<u>47,673</u>

Other expenses include Kina 3.38 million (2005, Kina 1.69 million) that was written off in domestic treasury bills transactions.



Note 21: RECONCILIATION OF NET PROFIT TO OPERATING CASH FLOW

	2006 K'000	2005 K'000
Reported Operating Net Profit/(Loss)	179,654	(105,507)
Add (Subtract) Non-Cash Items		
Depreciation	1,280	1,150
Provisions for Staff Entitlements	610	2,452
Net Unrealised Gold (Gain)/Loss	17,822	(13,139)
Add (Subtract) Movements in Other Working Capital Items		
(Increase)/Decrease in Interest Receivable	(13,182)	(11,149)
Increase/(Decrease) in Interest Payable	2,430	(2,809)
Add (Subtract) Investment and Financing Activities		
Net Unrealised Market Value Changes	8,220	2,378
Net Cash Flow from Operating Activities	<u>196,834</u>	<u>(126,624)</u>

Note 22: CLOSING CASH BALANCES

Foreign Currency	<u>208,315</u>	<u>188,594</u>
Cash and Cash Equivalents	<u>2,070</u>	<u>324</u>
Closing Cash Balance	<u>210,385</u>	<u>188,918</u>

Note 23: FINANCIAL INSTRUMENTS

International accounting Standard IAS 32 – Financial Instruments: Disclosure Presentation – requires disclosure of information relating to: both recognized and unrecognized financial instruments their significance and performance accounting policy terms and conditions: net fair values and risk information.

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 enterprise. The identifiable financial instruments for Bank of Papua New Guinea are its domestic government securities, its foreign government securities, loans and advances, bank deposits, currency in circulation and deposit liabilities.

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

Financial risk of financial instruments embodies price risk (currency risk and interest rate risk) credit risk, liquidity risk and cash flow risk. IAS 32 requires disclosure of interest rate risk and credit risk.

The interest rate and credit risk tables are based on Bank of Papua New Guinea's settled portfolio as reported in Bank of Papua New Guinea's balance sheet.

Interest rate risk is the risk that the value of a financial instruments will fluctuate due to changes in market interest rates.



Note 24: CONCENTRATIONS OF FUNDING

The Bank's significant year end concentrations of funding were as follows;

	2006 Total	Papua New Guinea Government	Papua New Guinea Public	Papua New Guinea Commercial Banks	Other
As at 31 December 2006	K'000	K'000	K'000	K'000	K'000
Foreign Curr. Fin. Liabilities					
IMF Related Liabilities	43,779				43,779
Local Currency Financial Liabilities					
Banks and Third Parties	451,445	-	-	451,445	-
Government and Gov't Entities	805,620	805,620			
Securities Issued	2,483,671	0	2,483,671	0	0
Total Local Currency Financial Liabilities	3,740,736	805,620	2,483,671	451,445	0
Total Financial Liabilities	3,784,515	805,620	2,483,671	451,445	43,779
Other Liabilities					
Currency in Circulation	693,220		693,220		
Profit available for Distribution	116,064	116,064			
Miscellaneous Liabilities	25,560	0	25,560	0	0
Total Other Liabilities	834,844	116,064	718,780	0	0
Total Liabilities	4,619,359	921,684	3,202,451	451,445	43,779
	2006 Total	Papua New Guinea Government	Papua New Guinea Public	Papua New Guinea Commercial Banks	Other
As at 31 December 2005	K'000	K'000	K'000	K'000	K'000
Foreign Currency Financial Liabilities					
IMF Related Liabilities	41,041				41,041
Local Currency Financial Liabilities					
Banks and Third Parties	382,232	-	-	382,232	-
Government and Gov't Entities	645,093	645,093			
Securities Issued	925,530	0	925,530	0	0
Total Local Currency Financial Liabilities	1,952,855	645,093	925,530	382,232	0
Total Financial Liabilities	1,993,896	645,093	925,530	382,232	41,041
Other Liabilities					
Currency in Circulation	606,195		606,195		
Profit available for Distribution	25,067	25,067			
Miscellaneous Liabilities	42,761	0	42,761	0	0
Total Other Liabilities	674,023	25,067	648,956	0	0
Total Liabilities	2,667,919	670,160	1,574,486	382,323	41,041



Note 25: CREDIT RISK

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

(a) Credit Risk Management

The Bank manages credit risk by employing the following strategies;

Selection of counterparty based on their respective credit rating Investment asset based on credit rating of particular issuer and the issue size; and Country limits and counterparty limits placed to control exposures.

Foreign currency placements are made in approved currencies in government or government guaranteed or supra-national securities or with approved counterparties. Geographical exposures are controlled by country limits. Limits are updated periodically based on new market information. Credit risk in the Bank's portfolio is monitored, reviewed and analysed.

(b) Concentrate of Credit Exposure

The Banks significant end-of-year concentrations of credit exposure by industry type were are follows

	2006 K'000	2005 K'000
Papua New Guinea Development	788,833	743,477
Foreign Banks and Financial Institutions	4,327,675	2,255,341
Other	<u>58,806</u>	<u>155,533</u>
Total Financial Assets	<u>5,175,314</u>	<u>3,154,351</u>

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

(c) Credit Exposure by Credit Rating

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

	2006 K'000	% 2006 Financial Assets	2005 K'000	% 2005 Financial Assets
Foreign Currency Financial Assets				
Cash Balances	208,315	5	188,594	8
Marketable Securities	4,010,430	93	2,055,433	87
Gold	81,154	2	99,240	4
IMF Related Assets	185	0	81	0
Other Foreign Receivables	27,591	1	11,233	0
Total Foreign Currency Financial Assets	<u>4,327,675</u>	100	<u>2,354,581</u>	100
Local Currency Financial Assets				
Cash & Cash Equivalent	2,070	0	324	0
Papua New Guinea Government Securities	788,622	93	743,428	93
Loans to Government	211	0	49	0
Loans to Other Institutions	<u>56,736</u>	<u>7</u>	<u>56,293</u>	<u>7</u>



Total Local Currency Financial Assets	847,639	100	800,094	100
Total Financial Assets	5,175,314		3,154,675	
Summary of Financial Asset Composition				
Total Foreign Currency Financial Assets	4,327,675	84	2,354,581	75
Total Local Currency Financial Assets	847,639	16	800,094	25
Total Financial Assets	5,175,314	100	3,154,675	100

Note 26: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2006 (2005 Nil).

Note 27: MATURITY ANALYSIS

	Balance Total K'000	Maturity Period			
		0 to 3 months	3 to 12 months	1 to 5 years	Over 5 Years
Foreign Currency Financial Assets					
Gold	81,154	-	-	-	81,154
Foreign Currency	208,315	208,315	-	-	-
Investments	4,010,430	1,001,381	1,449,047	1,148,023	375,979
Assets held with IMF	185	-	-	-	185
Others	27,591	27,591	-	-	-
Sub-total	4,327,675	1,237,287	1,449,047	1,148,023	457,318
Local Currency Financial Assets					
Cash	2,070	2,070	-	-	-
Papua New Guinea Gov't Securities	788,622	641,685	-	64,988	81,949
Land and advances to Government	211	211	-	-	-
Loans and advances	56,736	-	-	56,736	-
Sub-total	847,639	643,966	-	121,724	81,949
Other Assets					
Property, Plant and Equipment	25,706	-	-	-	25,706
Other assets	18,047	-	-	18,047	-
Sub-total	43,753	-	-	18,047	25,706
Total Assets	5,219,067				
Liabilities					
Foreign Currency Fin. Liabilities					
Liabilities with IMF	43,779	-	-	43,779	43,779
Local Currency Fin. Liabilities					
Deposits from Banks and 3 rd parties	451,445	451,445	-	-	-
Deposits from Government	805,620	805,620	-	-	-
Securities Issued	2,483,671	2,306,886	176,785	-	-
Sub-total	3,784,515	3,563,951	176,785	-	43,779
Other Liabilities					
Currency in Circulation	693,220	-	-	693,220	-
Profit available for distribution	116,064	-	116,064	-	-



Other liabilities	25,560	-	25,560	-	-
Sub-total	834,844	-	141,624	693,220	-
Total Liabilities	4,619,359				

Note 28: FOREIGN CURRENCY RISK

Foreign currency risk is the risk of loss arising from changes in exchange rates.

Foreign currency activities results mainly from the Bank's holding of foreign currency assets under its foreign reserves management function. Volatility of the foreign exchange markets may expose the Bank to exchange risk.

As at 31 December Bank of Papua New Guinea's net exposure to major currencies was as follows

As at 31 December 2006	Currency of Denomination							
	US Dollar K'000	Gold K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	Other K'000	Total K'000
Foreign Currency Financial Assets								
Gold		81,154						81,154
Foreign Currency Investments	68,943 1,836,215		45,128 809,816	30,375 1,055,801	24,872 199,150	37,985 129,093	1,012 (19,645)	208,315 4,010,430
Assets held with IMF							185	185
Other assets							27,591	27,591
	<u>1,905,158</u>	<u>81,154</u>	<u>854,944</u>	<u>1,086,176</u>	<u>224,022</u>	<u>167,078</u>	<u>9,143</u>	<u>4,327,675</u>
Foreign Currency Financial Liabilities								
Liabilities with IMF							43,779	43,779
Net Foreign Currency Exposure	<u>1,905,158</u>	<u>81,154</u>	<u>854,944</u>	<u>1,086,176</u>	<u>224,022</u>	<u>167,078</u>	<u>(34,636)</u>	<u>4,283,896</u>
 As at 31 December 2005	 US Dollar K'000	 Gold K'000	 Euro K'000	 AUD K'000	 GBP K'000	 JPY K'000	 Other K'000	 Total K'000
Foreign Currency Financial Assets								
Gold		99,240						99,240
Foreign Currency Investments	76,027 913,883		39,797 461,916	32,968 517,576	8,997 115,935	29,305 91,123	1,500	188,594 2,055,433
Assets held with IMF							81	81
Other assets	5,556		1,472	3,739	347	119		11,233
	<u>995,466</u>	<u>99,240</u>	<u>458,185</u>	<u>554,283</u>	<u>125,279</u>	<u>120,547</u>	<u>1,581</u>	<u>2,354,581</u>
Foreign Currency Financial Liabilities								
Liabilities with IMF							41,041	41,041
Net Foreign Currency Exposure	<u>995,466</u>	<u>99,240</u>	<u>458,185</u>	<u>554,283</u>	<u>125,279</u>	<u>120,547</u>	<u>(39,460)</u>	<u>2,313,540</u>

The functional currency of all operations is kina.



Note 29: EVENTS AFTER THE BALANCE SHEET DATE

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

Note 30: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

Note 31: REMUNERATION OF THE BOARD OF DIRECTORS AND KEY MANAGERIAL PERSONNEL

The Members of the Board of Directors received remuneration totaling Kina 320,000 (2005 Kina 430,000).

Key Managerial personnel received salary and expenses totaling Kina 2,030,000 (2005 Kina 2,270,000).

Loans and Advances to Key Managerial personnel

As at 31 December 2006 an amount of Kina 582,000 (2005 Kina 580,000) was receivable from key managerial personnel as approved advances made by the Bank.



DECLARATION BY MANAGEMENT

In our opinion the foregoing Operating Statement and Statement of Financial Position, including the Notes to and forming part thereof, have been drawn up so as to give a true and fair view of the matters to which they relate for the year ended 31 December 2006.

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



L. Wilson Kamit CBE
Governor



Benny Popoitai MBE
Deputy Governor
Management & Operations



Loi Bakani
Deputy Governor
Policy & Regulation

19 September 2007



AUDITOR – GENERAL OF PAPUA NEW GUINEA

TELEPHONE: 301 2203
FACSIMILE: 325 2872

LEVEL 6, TISA HAUS
P.O. BOX 423
WAIGANI
PAPUA NEW GUINEA

The Honourable Patrick Pruaitch, MP
Minister for Treasury and Finance
Office of the Minister
Vulupindi Haus - 4th Floor
P. O. Box 710
WAIGANI, NCD

Date: 20 September, 2007
Our Reference: 30-13-4
Action Officer:
Designation:
Your Reference:
Date

Dear Sir,

BANK OF PAPUA NEW GUINEA AUDIT REPORT FOR THE YEAR ENDED 31 DECEMBER 2006

In accordance with Section 8(4) of the *Audit Act, 1989 (as amended)*, I have inspected and audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2006** as set out on pages **2 to 20**, submitted by the Bank under Section 63(4) of the *Public Finances Management Act, 1995*. The Bank's Board is responsible for the preparation and presentation of these financial statements and the information contained therein. I have conducted an independent audit of these financial statements in order to express an opinion on them to the Bank's Board.

My audit was conducted in accordance with International Standards on Auditing to provide reasonable assurance as to whether the financial statements are free of material misstatement. My audit procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly and in accordance with generally accepted accounting practice, which requires, amongst other things, compliance with *International Financial Reporting Standards and Statements of Accounting Standards* of the Certified Practising Accountants of Papua New Guinea, and other statutory requirements (including the *Central Banking Act, 2000*), so as to present a view which is consistent with my understanding of the Bank's financial position and the results of its operations and cash flows. I believe that my audit provides a reasonable basis for my opinion.

The audit opinion expressed in this report has been formed on the above basis.

AUDIT OPINION

I now report that in my opinion:

- (a) the financial statements are based on proper accounts and records; and
- (b) the financial statements are in agreement with those accounts and records, and show fairly the state of affairs of the Bank as at 31 December, 2006 and the results of its financial operations and its cash flows for the year then ended.

Yours faithfully,

GEORGE W. SULLIMANN
Auditor-General