AUDITOR - GENERAL OF PAPUA NEW GUINEA

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PAPUA NEW GUINEA

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

Date: *29 June, 2009*
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 2008

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, 2008** 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, the results of its operations, changes in equity and its cash flows. I believe that my audit provides a reasonable basis for my opinion. During the course of my audit, I obtained all information and explanation that were required.

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, 2008 and the results of its financial operations, changes in equity and its cash flows for the year then ended.

Yours faithfully,

GEORGE W. SULLIMANN
Auditor-General

Bank of Papua New Guinea

Statutory Accounts
For the year ended 31 December 2008

TABLE OF CONTENTS

Statement of Financial Performance for the year ended 31 December 2008
Bank of Papua New Guinea

	Note	2008 *K'000*	2007 *K'000*
Income from foreign currency investments			
Interest income	2	262,749	220,867
Net gain/(loss) on securities trading		40,486	30,233
Foreign Exchange Commissions		15,663	19,216
Total income from foreign currency operations		**318,898**	**270,316**
Less: Interest expense on Liabilities with IMF		1,022	1,672
Net Foreign Currency Income		**317,876**	**268,644**
Income from domestic operations			
Interest income	3	15,586	23,868
Other income	4	18,643	13,582
Total income from domestic operations		**34,229**	**37,450**
Expense on domestic investments			
Interest expense	5	189,721	114,692
Total expenses on domestic operations		**189,721**	**114,692**
Net Domestic Income/(Loss)		**(155,492)**	**(77,242)**
Total net operations income		162,384	191,402
Less: Operating Expenses			
General and administration expenses	6	59,498	48,776
Operating Profit		**102,886**	**142,626**
Asset revaluation gain/(loss)		(1,043)	42,326
Fair Value and Foreign exchange revaluation gain/(loss)		(710,346)	(56,149)
Net gain/(loss) on derivatives		(64,452)	-
Domestic Government Securities revaluation gain/(loss)		(12,689)	1,137
Net profit/(loss) for the year		**(685,643)**	**129,940**

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

AUDITOR-GENERAL'S OFFICE
E.K

Statement of Financial Position as at 31 December 2008

Bank of Papua New Guinea

	Note	2008 *K'000*	2007 *K'000*
Assets			
Foreign Currency Financial Assets			
Gold		99,305	100,348
Foreign Currency Accounts		692,594	672,558
Investments	9	4,869,645	5,123,571
Assets held with IMF	7	298	262
Other Assets	13	66,210	35,351
Total Foreign Currency Financial Assets		**5,728,052**	**5,932,090**
Local Currency Financial Assets			
Cash & cash equivalents	8	529	373
Government of Papua New Guinea Securities	10	183,021	205,827
Loans and Advances	11	56,753	56,717
Total Local Currency Financial Assets		**240,303**	**262,917**
Total Financial Assets		**5,968,355**	**6,195,007**
Other Assets			
Property, Plant & equipment	12	49,826	48,802
Other assets	13	45,298	21,152
Total Other Assets		**95,124**	**69,954**
Total Assets		**6,063,479**	**6,264,961**
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Liabilities with IMF	7	39,981	43,066
Other Liabilities	18	71,284	-
Total Foreign Liabilities		**111,265**	**43,066**
Local Currency Financial Liabilities			
Deposits from banks & third parties	14	774,695	1,026,155
Deposits from Government and Government Entities		1,937,014	1,343,867
Securities issued	15	2,214,942	2,193,700
Total Local Currency Financial Liabilities		**4,926,651**	**4,563,722**
Total Financial Liabilities		**5,037,916**	**4,606,788**
Other Liabilities			
Currency Circulation	16	850,939	818,923
Profit available for distribution	17	-	157,170
Other liabilities	18	47,672	26,538
Total Other Liabilities		**898,611**	**1,002,631**
Total Liabilities		**5,936,527**	**5,609,419**
Equity			
Capital	19	145,540	131,000
Gold Reserve		79,609	80,652
Property Revaluation Reserve		24,630	24,745
Unrealised Profits Reserve		-	328,625
Bank of Papua New Guinea Reserve Fund		-	90,520
Distributable Profit Reserve		142,629	-
Retained Losses		(265,455)	-
Total Equity		**126,952**	**655,542**
Total Liabilities and Equity		**6,063,479**	**6,264,961**

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

Statement of Changes in Equity for the year ended 31 December 2008
Bank of Papua New Guinea

In Kina thousands (K'000)

	Capital	Gold Reserve	Property Revaluation Reserve	Unrealised Profit Reserve	Bank of PNG Reserve Fund	Distributable Profit Reserve	Retained Profit/ (Loss)	Total
Balance at 1 Jan. 2007	79,000	61,458	1,613	383,637	74,000	-	-	599,708
Net profit (loss) for the year	-	-	-	-	-	-	129,940	129,940
Revaluation transfers for the year	-	19,194	23,132	(55,012)	-	-	12,682	-
Transfer to General Reserve	52,000	-	-	-	16,520	-	-	(68,520)
Distribution to Government	-	-	-	-	-	-	(142,629)	(142,629)
Balance at 31 Dec. 2007	**131,000**	**80,652**	**24,745**	**328,625**	**90,520**	**-**	**-**	**655,542**
Net loss for the year	-	-	-	-	-	-	(685,643)	(685,643)
Transferred to General Reserve	14,540	-	-	-		-	-	14,540
Revaluation transfer for the year	-	(1,043)	-	(328,625)	(90,520)	-	420,188	-
Appropriate to other reserves	-	-	-	-	-	142,629	-	142,629
Realised gain on property	-	-	(115)	-	-	-	-	(115)
Balance at 31 Dec. 2008	**145,540**	**79,609**	**24,630**	**-**	**-**	**142,629**	**(265,455)**	**126,952**

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

AUDITOR-GENERAL'S OFFICE
E.K

Statement of Cash Flow for the year ended 31 December 2008
Bank of Papua New Guinea

	Note	2008 *K'000*	2007 *K'000*
Cash flows from operating activities			
Source;			
Interest received – Foreign Currency		238,719	213,107
Interest received – Local Currency		7,432	24,817
Fees, Commission and Other Miscellaneous Income Received		34,306	32,798
		280,457	270,722
Disbursements;			
Interest paid – Foreign Currency		(1,022)	(1,672)
Interest paid – Local Currency		(184,660)	(113,780)
Payments to employees		(24,680)	(20,612)
Payments to suppliers		(20,487)	(22,631)
Securities trading Gain/(Loss)		40,370	22,313
Fees and commissions paid		(2,561)	(2,989)
Realised Foreign Exchange gains ((loss)		(768,601)	(36,955)
		(961,640)	(176,326)
Net Cash Flow from Operating Activities	**20**	**(681,183)**	**94,396**
Cash Flows from Investing Activities			
Source;			
Net Increase/(Decrease) in IMF Deposits		(3,085)	(713)
Net Increase/(Decrease) in Gold		1,043	(19,194)
Net Increase/(Decrease) in Deposits from Banks		(251,459)	574,710
Net Increase/(Decrease) in Deposits from Government		593,147	495,616
Net Increase/(Decrease) in Other Liabilities		92,042	18,288
		431,688	1,068,707
Disbursements;			
Net Increase/(Decrease) in Foreign Currency Investments		253,926	(1,086,711)
Net Increase/(Decrease) in Assets Held with IMF		(36)	(77)
Net Increase/(Decrease) in Government Securities		22,806	583,707
Net Increase/(Decrease) in Loans and Advances		(35)	230
Purchase of Property, Plant and Equipment		(5,225)	1,720
Net Increase/(Decrease) in Other Assets		(55,005)	(2,157)
		216,430	(503,288)
Net Cash Flow from Investing Activities		**648,118**	**565,420**
Cash Flows from Financing Activities			
Source;			
Net Issue of Currency in Circulation		32,016	125,702
Net Increase/(Decrease) in Securities issues		21,241	(289,971)
Profit Paid to Government		-	(33,000)
Net Cash Flow from Financing Activities		**53,257**	**(197,269)**
Net Increase (Decrease) in Cash and Cash Equivalents		**20,193**	**462,546**
Cash and Cash Equivalent at 1 January		672,931	210,385
Cash and Cash Equivalent at 31 December	**21**	**693,124**	**672,931**

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

AUDITOR-GENERAL'S OFFICE
E. K

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 rounded to the nearest thousand unless another currency is indicated. Current market values are used for all BPNG 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) Foreign Currency

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 the 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.

(c) Financial assets/instruments

Definition

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

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

(i) Domestic Government securities

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

(ii) Foreign exchange

Foreign exchange holdings are invested mainly in securities (issued by the governments of the Australia, United Kingdom, United States, Germany, France and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). External fund managers employed 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.

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 unrealized gains or losses on foreign currency are taken to profit, but only realised gains are available for distribution.

(iii) Foreign government securities

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

(iv) Foreign bank deposits

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

(v) Foreign Currency Forward Contracts

External Fund Managers employed by the bank also enter into forward foreign exchange contracts to hedge the return of portfolios under their management to the US Dollar. These contracts are accounted for on a fair value basis, with all changes in fair value being taken to the income statement in accordance with IAS 39. The fair values are determined with reference with relevant exchange rates.

(vi) Repurchase agreements

In the course of its financial market operations, the bank periodically engages in repurchase agreements with domestic banks. Securities sold and contracted for purchase under repurchase agreements are classified under IAS 39 as 'at fair value through profit or loss', as they are held for trading, and reported on the Balance Sheet within the relevant investment portfolio. In accordance with this standard, the securities are valued at market bid prices on balance date and realised and unrealised gains or losses on securities are taken to profit.

Only realised gains are available for distribution in accordance with the Central Banking Act 2000. The difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense. Securities purchased and contracted for sale under repurchase agreements are classified under IAS 39 as 'loans and receivables' and valued at amortised cost. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue.

(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 deposits and is paid periodically or at maturity. Interest accrued but not paid is included in Other Liabilities (Note 18). Details of deposits are included in Note 14 and on the face of the balance sheet.

(viii) Central Bank Bills on issue

Since 2006, the Bank has issued Central Bank Bills as part of its money market operations. The Bills issued has maturity period ranging from 28 days to 364 days and are recorded at face value, which is equivalent to their amortised cost using the effective interest method. Interest is paid at maturity.

(d) Gold

Gold holdings which are on loan to other institutions are valued at the Kina equivalent on the prevailing exchange rate on balance date. Revaluation gains and losses on gold are recognized on the income statement and transferred to the gold revaluation reserve. Only realized gains are available for distribution. Interest earned on securities are accrued over the term of the security as revenue in the income statement. The Bank lends gold to financial institutions participating in the gold market. Gold holdings are a financial instrument and the Bank accounts for these loans in accordance with IAS 39 and reports these loans under IFRS 7.

(e) Property, plant and equipment

Formal valuations of all the Banks properties are conducted on a triennial basis. The properties are valued by local independent valuers. The most recent independent valuation of the properties was at 31 December 2007. In accordance with IAS 16 – Property, Plant and Equipment, properties are valued at market 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. These valuations have been incorporated in the accounts. Annual depreciation is based on fair values and assessments of the useful remaining life of the relevant asset.

Plant and equipment is recognised on a fair value basis; valuation gains and losses are treated in accordance with IAS 16.

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
Plants & Equipment	5

(f) 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.

Financial assets and liabilities are only to be off-set 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.

(g) Deferred Costs

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 expenses as incurred.

(h) Other receivables

Other receivables are stated at cost less impairment losses.

(i) Employee benefits

(i) Pension Fund

The Governor and Deputy Governors contribute to the Bank's pension fund and all other employees contribute to an approved external superannuation fund.

Contributions to the Bank's pension fund and external superannuation 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.

(ii) Leave entitlement

Unutilised leave entitlements are recognised on an accruals basis.

(iii) Provisions

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.

(j) Other payables

Other payables are recognised at cost.

(k) Reserves

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

(i) Bank of Papua New Guinea Reserve Funds
The Bank of Papua New Guinea Reserve Funds was created under the Central Banking Act 2000 Section 42, and represents reserves set aside as determined are required to meet contingencies which arises in the course of the Central Bank's operations in carrying out its functions.

(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) Distributable Profit Reserve
Distributable profit which cannot be distributed at a particular time due to financial position of the Bank under the Central Banking Act 2000 Section 49(3). Such profits will become payable when the Bank is in a position to distribute under the Act.

(v) Gold Revaluation Reserve
Gold is valued at market prices. Gains and losses arising from revaluation are recognized in the income statement and transferred to the Gold Revaluation Reserve at end of the accounting period.

(l) 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.

(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.

(m) Critical Accounting Estimates

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 revenues and expenses recognition criteria are clearly defined.

(n) Tax Exemption

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

Note 2: INTEREST INCOME – FOREIGN CURRENCY OPERATIONS

	2008	*2007*
	K'000	*K'000*
Short term deposits	89,127	114,786
Bonds	113,039	106,071
Income from outsourced investment	60,583	-
Other	-	10
	262,749	220,867

AUDITOR-GENERAL'S OFFICE
B.K

Note 3: INTEREST INCOME – DOMESTIC OPERATIONS

	2008	*2007*
	K'000	*K'000*
Treasury Bills	-	10,512
Inscribed Stock	15,199	13,151
Other Interest Income	387	205
	15,586	**23,868**

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

	2008	*2007*
	K'000	*K'000*
Management & Licensing Fees	9,784	7,909
Numismatic Currency	26	39
Property Rents	991	1,126
Others	7,842	4,508
	18,643	**13,582**

Other income includes K4 million realized from the sale of Bank properties and K3.26 million transferred from trust accounts. (2007 K4 million for 2 toea and 1 toea coins withdrawn from circulation)

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2008	*2007*
	K'000	*K'000*
Central Bank Securities	176,218	109,083
Repurchase Agreements	1,371	-
Other	12,132	5,609
	189,721	**114,692**

Note 6: GENERAL AND ADMINISTRATION EXPENSES

	2008	*2007*
	K'000	*K'000*
Outsourced Investments fees and charges	2,287	-
Staff costs	19,078	17,534
Staff Training and Development	1,304	1,371
Premises and Equipment	9,577	7,833
Depreciation of plant and equipment	2,127	1,536
Currency Distribution Expenses	10,650	7,310
Audit Fee	1,454	769
Travel	3,221	2,716
Legal & Consultancy Fees	2,208	2,220
Board & Meeting Expenses	786	455
Other Expenses	6,806	7,032
Total	**59,498**	**48,776**

Note 7: IMF RELATED ASSETS & LIABILITIES

	2008	*2007*
	K'000	*K'000*
Assets		
SDR Holding	298	262
Liabilities		
IMF Number 1 and 2 accounts	1,558	1,558
SDR allocation	38,541	41,648
Other	(118)	(140)
	39,981	**43,066**

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 8: CASH & CASH EQUIVALENTS – DOMESTIC ASSETS

Cash and cash equivalents are cheques held overnight for collection.

Note 9: INVESTMENTS

	2008 *K'000*	*2007* *K'000*
Bank for International Settlement	205,027	110,408
Other Short term Investments	124,082	131,246
Outsourced Investments	2,227,789	-
Bonds	2,312,747	4,881,917
	4,869,645	5,123,571

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

	2008 *K'000*	*2007* *K'000*
Inscribed Stock	183,021	205,827
	183,021	205,827

Inscribed stock is stated at market value using the effective interest rate methodology. Accrued interest on inscribed stock is included under interest receivable in note 13 (b).

Note 11: LOANS AND ADVANCES

	2008 *K'000*	*2007* *K'000*
Loan & Advances to Government	231	175
Agricultural Export Commodity Support Loans	23,782	23,782
Loans to Cocoa Board and other institutions	26,220	26,220
Loans and Advances to Staff (including housing loans)	6,520	6,540
Total Loans & Advances	56,753	56,717

Note 12: PROPERTY, PLANT & EQUIPMENT

	Land and Buildings	Plant & Equipment	Motor Vehicles	Computer Equipment	Total
	K'000	K'000	K'000	K'000	K'000
At 31 December 2007					
Cost	47,142	951	1,553	2,704	52,349
Accumulated Depreciation	(287)	(501)	(995)	(1,765)	(3,548)
Net Book Amount	**46,855**	**450**	**558**	**939**	**48,802**
Year end December 2008					
Opening Net Book Amount	46,855	450	558	939	48,802
Additions	1,440	1,956	1,299	625	5,225
Disposals	(1,999)	-	(49)	-	(2,048)
Revaluation	-	-	-	-	-
Depreciation Charges	(1,134)	(229)	(296)	(446)	(2,153)
Closing Book Amount	**45,067**	**2,177**	**1,512**	**1,070**	**49,826**
At 31 December 2008					
Cost	46,330	2,907	2,073	3,327	54,637
Accumulated Depreciation	(1,263)	(730)	(561)	(2,257)	(4,811)
Net Book Amount	**45,067**	**2,177**	**1,512**	**1,070**	**49,826**

AUDITOR-GENERAL'S OFFICE
E.K

Properties of the Bank were revalued in December 2007.

Note 13: OTHER ASSETS

(a) Foreign Currency Other Assets

	2008 *K'000*	*2007* *K'000*
Interest Receivable	59,380	35,351
Derivative Assets- Outsourced Investments	6,830	-
	66,210	**35,351**

(b) Domestic Other Assets

	2008 *K'000*	*2007* *K'000*
Interest Receivable	14,005	6,801
Deferred currency production costs	30,343	14,168
Other Receivables	950	183
	45,298	**21,152**

Note 14: DEPOSITS FROM BANKS & THIRD PARTIES

	2008 *K'000*	*2007* *K'000*
Banks		
Exchange Settlement Accounts	463,874	754,249
Other Deposits	303,094	262,150
Other Deposits	7,727	9,756
	774,695	1,026,155

Note 15: SECURITIES ISSUED

	2008 *K'000*	*2007* *K'000*
Central Bank bills issued	**2,214,942**	**2,193,700**

Securities issued are debt securities issued by the Bank of Papua new Guinea for terms of twenty eight 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 5.5% and 7.5% during the year.

Note 16: CURRENCY IN CIRCULATION – DOMESTIC LIABILITY

	2008 *K'000*	*2007* *K'000*
Currency in Circulation	**850,939**	**818,923**

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 value in the balance sheet.

Note 17: PROFIT AVAILABLE FOR DISTRIBUTION

	2008 *K'000*	*2007* *K'000*
Opening Balance	157,170	116,064
Payments in the Year	-	(33,000)
Capitalization of profit	(14,540)	-
Profit Available for Distribution	-	142,626
Transfer to Capital and Reserves	(142,630)	(68,520)
	-	**157,170**

AUDITOR-GENERAL'S OFFICE
B.K

Note 18: OTHER LIABILITIES

(a) Foreign Currency Other Liabilities

	2008 K'000	2007 K'000
Derivative Liabilities- Outsourced Investments	71,284	-
	71,284	-

(b) Domestic Other Liabilities

	2008 K'000	2007 K'000
Provisions for employee entitlements	5,024	6,102
Accrued interest on deposits and securities issued	9,303	4,243
Other	33,345	16,193
	47,672	26,538

Note 19: SHARE CAPITAL

At 31 December 2008 the authorized and subscribed capital of the Bank was Kina 145.54 million (2007: Kina 131 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2008 K'000	2007 K'000
At the beginning of the year	131,000	79,000
Capitalization of distributable profit	14,540	52,000
At the end of the year	145,540	131,000

Note 20: RECONCILIATION OF NET PROFIT TO OPERATING CASH FLOW

	2008 K'000	2007 K'000
Reported Operating Net Profit/(Loss)	(685,642)	129,940
Add (Subtract) Non-Cash Items		
Depreciation	2,127	1,536
Provisions for Staff Entitlements	(1,078)	1,010
Net Unrealised Gold (Gain)/Loss	1,043	(19,194)
Add (Subtract) Movements in Other Working Capital Items		
(Increase)/Decrease in Interest Receivable	(31,233)	(8,708)
Increase/(Decrease) in Interest Payable	5,060	912
Add (Subtract) Investment and Financing Activities		
Property Revaluation	-	(23,132)
Net Unrealised Market Value Changes	29,583	12,032
	(681,183)	94,396
Net Cash Flow from Operating Activities		

Note 21: CLOSING CASH BALANCES

	2008	2007
Foreign Currency	692,594	672,558
Cash and Cash Equivalents	529	373
Closing Cash Balance	693,123	672, 931

AUDITOR-GENERAL'S OFFICE
S.K

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. Over ninety five percent of the Bank's assets and revenues are managed for that purpose by the Bank.

Note 23: RISK MANAGEMENT

Note 23(i): Financial Risk Management

International Financial Reporting Standard (IFRS) 7 – Financial Instruments: Disclosure Presentation – 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 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.

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 recognized instruments are carried at amortised cost or current market value, which approximates fair value.

The Bank is involved in policy-oriented activities. Therefore, the Bank's risk management framework, differs form the risk management framework for most other financial institutions. The main financial risks to which the Bank is exposed include credit risk, foreign exchange risk and interest rate risk. In the management of foreign reserves, minimizing 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 conducts the Bank's local currency, foreign currency reserves management, and foreign exchange dealing operations in accordance with a clearly defined risk management framework, including limits and delegated authorities set by the Governor.

The Bank is subject to an annual audit by an external auditor. Auditing arrangements are overseen by an audit Committee of the Board to monitor the financial reporting and audit functions within the Bank and the committee reviews the internal audit functions as well. The committee reports to the Board of Director 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 portfolio as reported in its balance sheet.

Note 23(ii): Operational Risk

Operational risk is the risk of loss in both financial and non-financial terms resulting form human error and the failure of internal processes and systems. Managing operational risk is seen as an integral part of the day to day operations and management, which includes explicit consideration of both the opportunities and the risk of all business activities. Operational risk management includes bank-wide corporate policies that describe the standard required of staff and specific internal control systems designed around the particular characteristics of various Bank activities. Compliance with corporate polices and departmental internal controls systems are managed by departmental management and an active internal audit function.

AUDITOR-GENERAL'S OFFICE
E.K

Note 23(iii): CONCENTRATIONS OF FUNDING

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

As at 31 December 2008	2008 Total K'000	Papua New Guinea Government K'000	Papua New Guinea Public K'000	Papua New Guinea Commercial Banks K'000	Other K'000
Foreign Currency Financial Liabilities					
IMF Related Liabilities	39,981	-	-	-	39,981
Derivative Liabilities	71,284	-	-	-	71,284
Total Foreign Liabilities	**111,265**	**-**	**-**	**-**	**111,265**
Local Currency Financial Liabilities					
Banks and third parties	774,695	-	-	774,695	-
Government and Government Entities	1,937,014	1,937,014	-	-	-
Securities Issued	2,214,942	-	-	2,214,942	-
Total Local Currency Financial Liabilities	**4,926,651**	**1,937,014**	**-**	**2,989,637**	**-**
Total Financial Liabilities	**5,037,916**	**1,937,014**	**-**	**2,989,637**	**111,265**
Other Liabilities					
Currency in Circulation	850,939	-	850,939	-	-
Profit available for distribution	-	-	-	-	-
Other Liabilities	47,672	-	47,672	-	-
Total Other Liabilities	**898,611**	**-**	**898,611**	**-**	**-**
Total Liabilities	**5,936,527**	**1,937,014**	**898,611**	**2,989,637**	**111,265**

As at 31 December 2007	2007 Total K'000	Papua New Guinea Government K'000	Papua New Guinea Public K'000	Papua New Guinea Commercial Banks K'000	Other K'000
Foreign Currency Financial Liabilities					
IMF Related Liabilities	**43,066**	**-**	**-**	**-**	**43,066**
Local Currency Financial Liabilities					
Banks and third parties	1,026,155	-	-	1,026,155	-
Government and Gov't Entities	1,343,867	1,343,867	-	-	-
Securities Issued	2,193,700	-	2,193,700	-	-
Total Local Currency Financial Liabilities	**4,563,722**	**1,343,867**	**2,193,700**	**1,026,155**	**-**
Total Financial Liabilities	**4,606,788**	**1,343,867**	**2,193,700**	**1,026,155**	**43,066**
Other Liabilities					
Currency in Circulation	818,923	-	818,923	-	-
Profit available for distribution	157,170	157,170	-	-	-
Other Liabilities	26,538	-	26,538	-	-
Total Other Liabilities	**1,002,631**	**157,170**	**845,461**	**-**	**-**
Total Liabilities	**5,609,419**	**1,501,037**	**3,039,161**	**1,026,155**	**43,066**

Note 23(iv): 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 balance sheet 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.

Note 23(v): CREDIT RISK

Credit risk is the risk of loss arising from a counter party 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 is made based on their respective credit rating. Investment decisions are based on credit rating of particular issuer and the issue size, Country limits and counterparty limits placed to control exposures.

Foreign currency placements are made in approved currencies in government or government guaranteed 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 regularly.

(b) Concentrate of Credit Exposure

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

	2008 K'000	*2007 K'000*
Papua New Guinea Government	183,021	205,827
Other Government Institutions	50,002	50,002
Foreign Banks and Financial Institutions	5,728,052	5,932,090
Other	7,280	7,088
Total Financial Assets	5,968,355	6,195,007

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

AUDITOR-GENERAL'S OFFICE
E.K

(c) Credit Exposure by Credit Rating

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

	2008 K'000	% 2008 Financial Assets	2007 K'000	% 2007 Financial Asset
Investment in Financial Assets				
AAA	3,415,395	70	3,982,972	78
AA	477,450	10	433,893	8
A	9,049	-	316,170	6
Aa	-	-	283,673	6
AA+	298,,604	6	-	-
A+	26,587	1	-	-
A-1+	446,302	9	-	-
A-1	107,469	2	-	-
A-	37,189	1	-	-
AA-	29,919	1	97,173	2
Total Assets	**4,847,963**	**100**	**5,113,882**	**100**

AUDITOR-GENERAL'S OFFICE

Note 23(vi): 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 producing unlimited amount 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 table below summarizes the maturity profile of the Bank's assets and liabilities based on the contractual repayment date determined on the basis of the remaining period at the balance sheet data to the contractual maturity date.

	Balance	Maturity Period			
	Total K'000	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 Years
Foreign Currency Financial Assets					
Gold	99,305	-	-	-	99,305
Foreign Currency	692,594	692,594	-	-	-
Investments	4,869,645	2,989,768	410,759	1,212,093	257,025
Assets held with IMF	298	-	-	-	298
Derivative Assets	6,830	6,830	-	-	-
Others	59,380	59,380	-	-	-
Sub-total	**5,728,052**	**3,748,572**	**410,759**	**1,212,093**	**356,628**
Local Currency Financial Assets					
Cash	529	529	-	-	-
Papua New Guinea Government Securities	190,965	17,200	30,000	42,400	101,365
Loans and advances to Government	231	231	-	-	-
Loans and advances	56,522	-	-	6,520	50,002
Sub-total	**248,247**	**17,960**	**30,000**	**48,920**	**151,367**
Other Assets					
Property, Plant and Equipment	49,826	-	-	-	49,826
Other assets	45,298	-	-	45,298	-
Sub-total	**95,124**	-	-	**45,298**	**49,826**
Total Assets	**6,071,423**	**3,766,532**	**440,759**	**1,306,311**	**557,821**
Liabilities					
Foreign Currency Financial Liabilities					
Liabilities with IMF	39,981	-	-	39,981	-
Derivative Liabilities	71,284	71,274	-	-	-
Total Foreign Liabilities	**111,265**	**71,274**		**39,981**	
Local Currency Financial Liabilities					
Deposits from Banks and Third parties	774,696	774,696	-	-	-
Deposits from Government	1,937,014	1,937,014	-	-	-
Securities Issued	2,228,216	2,228,216	-	-	-
Sub-total	**4,939,926**	**4,939,926**	-	**39,981**	-
Other Liabilities					
Currency in Circulation	850,939	850,939	-	-	-
Profit available for distribution	-	-	-	-	-
Other liabilities	47,672	47,672		-	-
Sub-total	**898,611**	**898,611**	-	-	-
Total Liabilities	**5,949,802**	**5,909,811**	-	**39,981**	-

AUDITOR-GENERAL'S OFFICE

Note 23 (vii): CURRENCY RISK

Currency risk (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. In Bank of Papua New Guinea, foreign exchange reserve management and investment functions are guided by an Investment Committee. The decision of the Investment Committee and dealing practices approved by the Investment Committee serve as operational guidelines for the Bank's reserve management and investments. The guidelines are directed towards managing different types of risks, while earning a reasonable return. There is an approved benchmark for investment in terms of currency composition, portfolio duration and proportion of different assets within a bank. Dealers/portfolio managers afford best to comply with this benchmark and keep on rebalancing the investment portfolio following benchmark daily / weekly as approved by the Investment Committee.

As at 31 December 2008 Bank of Papua New Guinea's net exposure to major currencies was as follows.

Currency of Denomination As at 31 December 2008	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								
Foreign Currency	108,403	-	167,110	174,549	80,917	160,321	1,294	692,594
Investments	2,415,389	-	924,601	1,200,162	174,658	102,456	52,379	4,869,645
Assets held with IMF	-	-	-	-	-	-	298	298
Other assets	6,830	99,305	-	-	-	-	59,380	165,515
	2,530,622	**99,305**	**1.091,711**	**1,374,711**	**255,575**	**262,777**	**113,351**	**5,728,052**
Foreign Currency Financial Liabilities								
Liabilities with IMF	-	-	-	-	-	-	39,981	39,981
Derivative liabilities	71,284	-	-	-	-	-	-	71,284
Total Financial Liabilities	**71,284**	-	-	-	-	-	**39,981**	**111,265**
Net Foreign Currency Exposure	**2,459,338**	**99,305**	**1,091,711**	**1,374,712**	**255,575**	**262,777**	**73,370**	**5,616,787**

As at 31 December 2007	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								
Foreign Currency	299,879	-	180,004	110,212	72,103	8,919	1,441	672,558
Investments	2,230,559	-	991,308	1,408,121	232,732	254,067	6,784	5,123,571
Assets held with IMF	-	-	-	-	-	-	262	262
Other Assets	-	100,348	-	-	-	-	35,351	135,699
	2,530,438	100,348	1,171,312	1,518,333	304,835	262,986	43,838	5,932,090
Foreign Currency Financial Liabilities	-	-	-	-	-	-	-	-
Liabilities with IMF	-	-	-	-	-	-	43,066	43,066
Total Financial Liabilities	-	-	-	-	-	-	43,066	43,066
Net Foreign Currency Exposure	**2,530,438**	**100,348**	**1,171,312**	**1,518,333**	**304,835**	**262,986**	**772**	**5,889,024**

The functional currency of all operations is kina.

Note 23(viii): SENSITIVITY ANALYSIS

At 31st December 2008, if interest rates had been 100 basis points lower with all other variables constant, profit for the year and the net assets at year end would have been K11.3 million lower (2007:K13.5 million), arising mainly as a result of lower interest income on financial assets. Conversely if interest rates had been 100 basis point higher with all other variables held constant profit for the year and the net assets at year end would have been K11.3 million higher (2007: K13.5 million) arising mainly as a result of higher interest income on financial assets. Profit is very sensitive to changes in interest rates as interest is the principal source of income of the bank.

At 31st December 2008, if the Kina had weakened 10 per cent against the principal currencies in its foreign reserves portfolio with all other variables held constant profit for the year would have been K572.8 million higher, (2007: K593 million). Conversely if the Kina had strengthened 10 per cent against the same currencies with all other all other variables held constant the bank would have experienced a reduction of profit for the year of K572.8 million, (K2007: K593 million). Profit is very sensitive to changes in exchange rates movements. The Bank by necessity holds substantial foreign currency assets.

Note 23(ix): FAIR VALUE

Fair value represents the amount at which an asset could be replaced or a liability settled on an arm length basis. 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 summarizes the fair values of those financial assets and liabilities.

Financial Assets	*2008*	*2007*
	K'000	*K'000*
At fair value through profit/(loss)	4,830,519	5,188,465
Loans and Receivables	1,152,791	1,013,526
	5,983,310	**6,201,991**
Financial Liabilities		
At fair value through profit/(loss)	71,204	-
At amortised cost	5,859,845	5,446,157
Total	**5,931,129**	**5,446,157**

Fair values of the above financial instruments are the same as their carrying values in the balance sheet.

Note 24: 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 25: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2008 (2007 Nil) and there is no transactions or events that will have material impact on the financial report during the preparation of this report.

Note 26: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

RELATED PARTIES

Note 27: REMUNERATION OF MEMBERS OF THE BOARD AND SENIOR MANAGEMENT AND RELATED PARTIES NOTE

The Members of the Board of Directors received remuneration totaling K665,000 (2007 K455,000). Senior management personnel received salaries and expenses totaling K3,087,000 (2007 K2,030,000). In addition K0.5 million (2007 K0.15 million) was paid to retirement benefit plans for the benefit of Statutory Appointees. Interest is paid on accumulated balance half yearly based on the average rate of Nashfund and Nambawan Superannuation Fund. Loan and advances receivable from senior management total K1,229,782.00 (2007 K1,191,000).

Note 28: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Government of Papua New Guinea; as ultimate owner of the Bank's various government departments, and government controlled enterprises/entities. All transactions are carried out with reference to market rates.
Transactions entered into include:

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

(b) Acting as the agent of the government or its agencies and institutions, provides guarantees, participates in loans to government departments and corporations.

(c) As the agent of the government manages public debt and foreign reserves.

AUDITOR-GENERAL'S OFFICE
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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 2008.

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

L. Wilson Kamit CBE Governor	Benny Popoitai MBE Deputy Governor Regulation	Loi Bakani Deputy Governor Policy

30 June 2009