Papua New Guinea

AUDITOR-GENERAL'S OFFICE

TELEPHONE : 301 2200
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P. O. BOX 423
WAIGANI
PAPUA NEW GUINEA

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

BANK OF PNG
RECEIVED
09 JUL 2010
#4456
FINANCE & ACCT. DEPT.

Date : 18 June, 2010
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 2009

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, 2009**.

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, 2009* 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,

S. Prathaban

SINGER PRATHABAN
Assistant Auditor-General
(Statutory Bodies Branch)
FOR: AUDITOR-GENERAL

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

PAPUA NEW GUINEA

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The Grand Chief, Rt. Hon. Sir Michael Somare, GCL, GCMG,CH, CF, KstJ, MP
Prime Minister for Papua New Guinea
Office of the Prime Minister
P. O. Box 639
WAIGANI, NCD

Date: *18 June, 2010*
Reference: *30-13-4*

Dear Sir,

BANK OF PAPUA NEW GUINEA
AUDIT REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

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, 2009** as set out on pages **2** to **21**, which comprise the statement of financial position as at 31 December, 2009, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Bank Board's Responsibility for the financial statements

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

Responsibility of the Auditor-General

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Audit Act and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

AUDIT OPINION

In my opinion:

(a) the financial statements are based on proper accounts and records;

(b) the financial statements are in agreement with those accounts and records, and show fairly the state of affairs of the Bank as at 31 December, 2009 and the results of its financial operations, changes in equity and its cash flows for the year then ended; and

(c) I have obtained all the information and explanation that were required.

Yours faithfully,

GEORGE W. SULLIMANN
Auditor-General

Bank of Papua New Guinea

Statutory Accounts
For the year ended 31 December 2009

TABLE OF CONTENTS

Statement of Comprehensive Income for the year ended 31 December 2009
Bank of Papua New Guinea

	Note	2009 K'000	2008 K'000
Income from foreign currency investments			
Interest income	2	179,118	262,749
Net realised gain/(loss) on financial instruments classified as held for trading		10,158	40,486
Foreign Exchange Commissions		6,608	15,663
Total income from foreign currency operations		**195,884**	**318,898**
Expenses on foreign currency investments			
Interest expense on Liabilities with IMF		345	1,022
Custodian and Investment Management Fees		3,650	2,287
Total expenses from foreign currency operations		**3,995**	**3,309**
Net Foreign Currency Income		**191,889**	**315,589**
Income from domestic operations			
Interest income	3	33,182	15,586
Other income	4	7,865	18,643
Total income from domestic operations		**41,047**	**34,229**
Expense on domestic investments			
Interest expense	5	222,312	189,721
Total expenses on domestic operations		**222,312**	**189,721**
Net Domestic Income/(Expense)		**(181,265)**	**(155,492)**
Total net operations income		**10,624**	**160,097**
Less: Operating Expenses			
General and administration expenses	6	73,260	57,211
Operating Profit/(Loss) for the year		**(62,636)**	**102,886**
Other Unrealised Income and Expense			
Fair value and foreign exchange revaluation gain/(loss) on foreign currency		247,737	(774,796)
Fair value revaluation gain/(loss) on domestic investments		(14,611)	(12,689)
Profit/(Loss) for the year		**170,490**	**(684,599)**
Other Comprehensive Income			
Loss on property revaluation		(303)	(115)
Gains/(loss) on gold asset revaluation		26,085	(1,043)
Other Comprehensive Income/(Loss) for the year		25,782	(1,158)
Total Comprehensive Income/(Loss) for the year		**196,272**	**(685,757)**

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

AUDITOR-GENERAL'S OFFICE

Statement of Financial Position as at 31 December 2009
Bank of Papua New Guinea

	Note	2009 K'000	2008 K'000
Assets			
Foreign Currency Financial Assets			
Gold		125,390	99,305
Cash and cash equivalents	8	329,790	692,594
Financial assets held for trading	9	5,973,094	4,876,475
Assets held with IMF	7	490,566	298
Other Assets	13	68,824	59,380
Total Foreign Currency Financial Assets		**6,987,664**	**5,728,052**
Local Currency Financial Assets			
Cash & cash equivalents	8	-	529
Government of Papua New Guinea Securities	10	303,408	183,021
Loans and Advances	11	11,150	56,753
Total Local Currency Financial Assets		**314,558**	**240,303**
Total Financial Assets		**7,302,222**	**5,968,355**
Other Assets			
Property, Plant & equipment	12	62,742	49,826
Other assets	13	60,447	45,298
Total Other Assets		**123,189**	**95,124**
Total Assets		**7,425,411**	**6,063,479**
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Liabilities with IMF	7	530,536	39,981
Financial liabilities held for trading	17	3,659	71,284
Total Foreign Liabilities		**534,195**	**111,265**
Local Currency Financial Liabilities			
Deposits from banks & third parties	14	816,059	774,695
Deposits from Government and Government Entities		592,726	1,937,014
Debt securities issued	15	4,109,111	2,214,942
Total Local Currency Financial Liabilities		**5,517,896**	**4,962,651**
Total Financial Liabilities		**6,052,091**	**5,037,916**
Other Liabilities			
Currency in Circulation	16	997,093	850,939
Other liabilities	17	53,003	47,672
Total Other Liabilities		**1,050,096**	**898,611**
Total Liabilities		**7,102,187**	**5,936,527**
Equity			
Capital	18	145,540	145,540
Gold Reserve		105,694	79,609
Property Revaluation Reserve		24,327	24,630
Currency Movement Reserve		47,665	-
Distributable Profit Reserve		-	142,629
Retained Profit/(Loss)		-	(265,454)
Total Equity		**323,224**	**126,952**
Total Liabilities and Equity		**7,425,411**	**6,063,479**

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

AUDITOR-GENERAL'S OFFICE

Statement of Changes in Equity for the year ended 31 December 2009
Bank of Papua New Guinea

In Kina thousands (K'000)

	Capital	Gold Reserve	Property Revaluation Reserve	Currency Movement Reserve	Unrealised Profit Reserve	Bank of PNG Reserve Fund	Distributable Profit Reserve	Retained Profit/ (Loss)	Total
Balance at 1 Jan. 2008	131,000	80,652	24,745	-	328,625	90,520	-	-	655,542
Total Comprehensive Income for the year	-	(1,043)	(115)	-	(328,625)	(90,520)	-	(265,454)	(685,757)
Prior Year Proposed Dividend	-	-	-	-	-	-	142,629	-	142,629
Share Capital Issued	14,540	-	-	-	-	-	-	-	14,540
Balance at 31 Dec. 2008	**145,540**	**79,609**	**24,630**	**-**	**-**	**-**	**142,629**	**(265,454)**	**126,952**
Total Comprehensive Income for the year	-	26,085	(303)	47,665	-	-	-	122,825	196,272
Appropriate to other reserves	-	-	-	-	-	-	(142,629)	142,629	-
Balance at 31 Dec. 2009	**145,540**	**105,694**	**24,327**	**47,665**	**-**	**-**	**-**	**-**	**323,224**

Currency movement reserve includes unrealised losses of K135.2million as at 31 December 2009 (2008: 368.3million).

Statement of Distribution for the year ended 31 December 2009
Bank of Papua New Guinea

	2009 *K'000*	2008 *K'000*
Net profit/ (loss)	**196,272**	**(685,757)**
Unrealised (profit)/ loss	(148,607)	685,757
Transfer (to)/from currency movement reserve	(47,665)	-
Distributable profit/(loss)	-	-
Distributed as follows:		
Bank of PNG Reserve Fund	-	-
Payable to the PNG Government	-	-
	-	-

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

Statement of Cash Flows for the year ended 31 December 2009
Bank of Papua New Guinea

	Note	2009 *K'000*	2008 *K'000*
Cash flows from operating activities			
Interest received – Foreign Currency		188,504	238,719
Interest received – Local Currency		40,082	8,382
Fees, Commissions and Other Income received		14,552	34,306
Interest paid – Foreign Currency		(345)	(1,022)
Interest paid – Local Currency		(223,305)	(184,651)
Payments to employees		(30,409)	(21,460)
Payments to suppliers		(55,824)	(31,167)
Fees and commissions paid		(4,031)	(3,662)
Net payments for and proceeds from foreign investments		(925,366)	(415,932)
Net Cash Flow from Operating Activities	**20**	**(996,142)**	**(376,487)**
Cash Flows from Investing Activities			
Net Increase/(Decrease) in IMF Deposits		490,555	(3,085)
Net Increase/(Decrease) in Deposits from Banks		41,364	(251,460)
Net Deposit from/(payment to) Government		(1,298,454)	593,111
Net Increase/(Decrease) in Assets Held with IMF		(490,268)	(36)
Net Payment for/(proceeds from) investment in Government Securities		(134,998)	10,117
Purchase of Property, Plant and Equipment		(15,966)	(5,225)
Proceeds from sale of motor vehicle		252	-
Net Cash Flow from Investing Activities		**(1,407,515)**	**343,422**
Cash Flows from Financing Activities			
Net Issue of Currency in Circulation		146,154	32,016
Net Increase/(Decrease) in debt securities issued		1,894,169	21,241
Net Cash Flow from Financing Activities		**2,040,323**	**53,257**
Net Increase (Decrease) in Cash and Cash Equivalents		**(363,334)**	**20,193**
Cash and Cash Equivalent at 1 January		693,124	672,931
Cash and Cash Equivalent at 31 December	**8**	**329,790**	**693,124**

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

Note 1: SUMMARY OF ACCOUNTING POLICIES

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

(a) Basis of preparation

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

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.

Standards, amendments and interpretations effective on or after 1 January 2009

- **Amendments to IFRS 7, 'Financial instruments: Disclosures'**
  The IASB published amendments to IFRS 7 in March 2009. The amendment requires enhanced disclosures about fair value measurements by level of a fair value measurement hierarchy. The adoption of the amendment results in additional disclosures but does not have an impact on the financial position or the comprehensive income of the Bank.

- **IAS 1 (revised), 'Presentation of financial statements'**
  A revised version of IAS 1 was issued in September 2007. It prohibits the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity in a statement of comprehensive income. As a result, the Bank presents in the statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the statement of comprehensive income. Comparative information has been re-presented so that it also conforms with the revised standard. According to the amendment of IAS 1 in January 2008, each component of equity, including each item of other comprehensive income, should be reconciled between carrying amount at the beginning and the end of the period. Since the change in accounting policy only impacts presentation aspects, there is no impact on retained earnings.

Standards and interpretations issued but not yet effective

- **IFRS 9, 'Financial instruments part 1: Classification and measurement'**
  IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. Key features are as follows:
  - Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
  - An instrument is subsequently measured at amortised cost only if it is a debt instrument and both the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and the asset's contractual cash flows represent only payments of principal and interest (that is, it has only 'basic loan features'). All other debt instruments are to be measured at fair value through profit or loss.
  - All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
  - While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted.

  The Bank is considering the implications of the standard, the impact on the Bank and timing of its adoption.

(b) Foreign Currency

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

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

(c) Financial assets and liabilities

Definition of financial instruments

A financial instrument is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The Bank's financial instruments are its domestic government securities, foreign government securities, gold holdings, Central Bank Bills issued, bank deposits, cash and cash equivalents 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 prices determined using valuation models, with valuations occurring on a monthly basis with all changes in fair value taken to the statement of comprehensive income in accordance with IAS 39. Interest earned on the securities is accrued over the term of the security and included as revenue in the statement of comprehensive income. Interest is received biannually at the coupon rate and the principal is received at maturity.

(ii) Foreign exchange

Foreign exchange holdings are invested mainly in securities (issued by the governments of Australia, the United Kingdom, United States of America, Germany, France and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). These instruments are classified as 'Financial assets held for trading" in accordance with IAS 39. Accordingly, these assets are measured at their fair value. External fund managers 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 unrealised gains or losses on foreign currency are taken to profit or loss, 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 statement of comprehensive income, 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 statement of comprehensive income.

(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 statement of financial position.

(v) Foreign Currency Forward Contracts

External Fund Managers employed by the Bank 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 statement of comprehensive income in accordance with IAS 39. The fair values are determined with reference to prevailing exchange rates of balance date.

(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. The counterpart obligations to repurchase the securities is reported under liabilities at amortised cost. 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. Details of deposits are included in Note 17 and on the face of the statement of financial position.

(viii) Central Bank Bills on issue

Since 2006, the Bank has issued Central Bank Bills as part of its money market operations. These are classified as financial liabilities. The Bills issued has maturities ranging from 28 days to 91 days and are recorded at face value, which is equivalent to their amortised cost using the effective interest method. Interest is paid at maturity.

(ix) 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 recognised on the statement of comprehensive income and transferred to the gold revaluation reserve. Only realised gains are available for distribution. 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.

(x) Loans and Advances

Loans and advances are non derivative financial assets with fixed or determinable repayment terms that are not quoted in an active market. Loans are receivables and initially recognised at fair value which is the cash consideration to originate or purchase the loan including any transaction cost and measured subsequently at amortised cost using effective interest rate method.

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

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

(d) Determination of fair value

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

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

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

The Bank uses widely recognised valuation models for determining fair values of non-standardised financial instruments of lower complexity.

For more complex instruments, the Bank uses internally developed models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value unlisted debt securities and other debt instruments for which markets were or have become illiquid. Some of the inputs to these models may not be market observable and are therefore estimated based on assumptions. The impact on net profit of financial instrument valuations reflecting non-market observable inputs (level 3 valuations) is disclosed in Note 21.

(e) Property 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. Annual depreciation is based on fair values and assessments of the useful remaining life of the relevant asset. Management has assessed the fair value of all property and equipment as of year end and consider them to be appropriate.

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

	Years
Residential Properties	20 & 30
Office Buildings	50
Computer Equipment	5
Vehicles	4
Equipment	5

(f) Derecognition

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.

(g) Offsetting financial instruments

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

(h) 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 expensed as incurred.

(i) Cash and cash equivalents

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

AUDITOR-GENERAL'S OFFICE

(j) Other receivables

Other receivables are stated at amortised cost.

(k) 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. Interest is paid on accumulated balance half yearly based on the average rate of Nasfund and Nambawan Superannuation Fund.

Contributions to the Bank's pension fund and external superannuation fund are recognised as an expense in the Bank's statement of comprehensive income. The value of the 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 date.

(ii) Provision For Leave Entitlement

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

(l) Other payables

Other payables are recognised at cost.

(m) 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 property.

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

(iv) Currency Movement Reserve
Realised and unrealised gains on foreign currency are recognised in profit from ordinary activities and transferred to the Currency Movement Reserve and are not available for distribution.

(v) Distributable Profit Reserve
Distributable profit which can not be distributed due to the 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.

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

AUDITOR-GENERAL'S OFFICE

(n) 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.

(o) Critical Accounting Estimates

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

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

(p) Tax Exemption

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

(q) Comparatives

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

(r) Rounding

Financial information has been rounded to the nearest thousand kina.

Note 2: INTEREST INCOME – FOREIGN CURRENCY OPERATIONS

	2009 K'000	*2008 K'000*
Foreign bank deposits	21,039	89,127
Foreign securities	85,960	113,032
Assets with the IMF	222	7
Income from outsourced investment	71,897	60,583
	179,118	**262,749**

Interest income includes income of K71.9 million (2008: K60.6 million) in relation to investments managed by external fund managers.

Note 3: INTEREST INCOME – DOMESTIC OPERATIONS

	2009 K'000	*2008 K'000*
Inscribed Stock	32,750	15,199
Other Interest Income	432	387
	33,182	**15,586**

AUDITOR-GENERAL'S OFFICE

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

	2009 K'000	2008 K'000
Management and Agency Fees	(421)	6,458
Licensing Fees	191	3,326
Numismatic Currency	77	26
Property Rents	1,101	991
Withdrawal of old K1 coins	5,248	-
Others	1,669	7,842
	7,865	**18,643**

Old K1 coins were withdrawn from circulation during the year, however some of these coins were not returned to the Bank and remained in the circulation. Total value of these coins were recognised as income as they are no longer legal tender and do not represent a liability to the Bank.

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2009 K'000	2008 K'000
Central Bank Securities	217,582	176,218
Repurchase Agreements	-	1,371
Other	4,730	12,132
	222,312	**189,721**

Note 6: GENERAL AND ADMINISTRATION EXPENSES

	2009 K'000	2008 K'000
Staff costs	27,892	19,078
Staff Training and Development	1,437	1,304
Premises and Equipment	9,625	9,577
Depreciation of property, plant and equipment	2,672	2,127
Amortisation of coins production expenses	6,352	2,472
Amortisation of notes production expenses	12,759	7,644
Currency distribution expenses	447	534
Audit Fee	1,228	1,454
Travel	2,421	3,221
Legal & Consultancy Fees	2,849	2,208
Board & Meeting Expenses	788	786
Other Expenses	4,790	6,806
Total	**73,260**	**57,211**

Note 7: IMF RELATED ASSETS & LIABILITIES

	2009 K'000	2008 K'000
Assets		
SDR Holding	490,566	298
Liabilities		
IMF Number 1 and 2 accounts	1,558	1,558
SDR allocation	528,979	38,423
	530,536	**39,981**

AUDITOR-GENERAL'S OFFICE

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

Special Drawing Rights (SDR) are allocated by the IMF to members on the basis of members' quota at the time of the SDR allocation. The Bank of Papua New Guinea pays interest on its SDR allocations and earns interest on its holdings of SDR. During the year, PNG received an SDR allocation of SDR116 million (K491 million).

Note 8: CASH & CASH EQUIVALENTS

	2009 K'000	*2008 K'000*
Foreign currency holdings – Nostro accounts	329,790	692,594
Cash and cash equivalents – Local currency held overnight	-	529
	329,790	**693,123**

Note 9: FINANCIAL ASSETS HELD FOR TRADING

	2009 K'000	*2008 K'000*
Bank for International Settlement	410,560	205,027
Other Short Term Investments	652,568	704,867
Bonds	4,876,910	3,959,751
Derivative Assets	33,056	6,830
	5,973,094	**4,876,475**

Composition of Bonds & Other Short Term Investments:

	2009 K'000	*2008 K'000*
Bonds		
In-house managed investments	3,150,021	2,312,747
Investments managed by External Fund Managers	1,726,889	1,647,004
	4,876,910	3,959,751
Other short term investments		
In-house managed investment	159,806	124,082
Investments managed by External Fund Managers	492,762	580,785
	652,568	704,867

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

	2009 K'000	*2008 K'000*
Inscribed Stock	303,408	183,021
	303,408	**183,021**

Note 11: LOANS AND ADVANCES

	2009 K'000	*2008 K'000*
Loan & Advances to Government	1,927	231
Agricultural Export Commodity Support Loans	1,386	23,782
Loans to Cocoa Board and other institutions	-	26,220
Loans and Advances to Staff (including housing loans)	7,837	6,520
Total Loans & Advances	**11,150**	**56,753**

AUDITOR-GENERAL'S OFFICE

Note 12: PROPERTY & EQUIPMENT

	Land and Buildings	Equipment	Motor Vehicles	Computer Equipment	Total
	K'000	K'000	K'000	K'000	K'000
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**
Year end December 2009					
Opening Net Book Amount	45,067	2,177	1,512	1,070	49,826
Additions	7,447	7,827	-	693	15,966
Disposals	(107)	-	(267)	(4)	(378)
Revaluation	-	-	-	-	-
Depreciation Charges	(1,298)	(612)	(268)	(494)	(2,672)
Closing Book Amount	**51,109**	**9,392**	**977**	**1,265**	**62,742**
At 31 December 2009					
Cost	53,670	10,734	1,806	4,016	70,225
Accumulated Depreciation	(2,561)	(1,342)	(829)	(2,751)	(7,483)
Net Book Amount	**51,109**	**9,392**	**977**	**1,265**	**62,742**

Properties of the Bank were externally revalued in December 2007

Note 13: OTHER ASSETS

(a) Foreign Currency Other Assets

	2009 *K'000*	*2008* *K'000*
Interest Receivable	49,995	59,380
Prepayment	18,829	-
	68,824	59,380

(b) Domestic Other Assets

	2009 *K'000*	*2008* *K'000*
Interest Receivable	7,105	14,005
Deferred currency production costs	53,342	30,343
Other Receivables	-	950
	60,447	45,298

Note 14: DEPOSITS FROM BANKS & THIRD PARTIES

	2009 *K'000*	*2008* *K'000*
Banks		
Exchange Settlement Accounts	439,714	463,874
Cash Reserve Requirement Ratio	368,777	303,094
Other Deposits	7,569	7,727
	816,060	774,695

Note 15: SECURITIES ISSUED

	2009 *K'000*	*2008* *K'000*
Central Bank Bills issued	4,109,111	2,214,942

AUDITOR-GENERAL'S OFFICE

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 4.87% and 8.45% during the year. Accrued interest is included in Other Liabilities in Note 17(b).

Note 16: CURRENCY IN CIRCULATION – DOMESTIC LIABILITY

	2009 K'000	*2008 K'000*
Currency in Circulation	997,093	850,939

Currency in circulation represents currency issued having a claim on the Bank of Papua New Guinea. The liability for Currency in Circulation is recorded at its face value in the statement of financial position.

Note 17: FINANCIAL LIABILITIES HELD FOR TRADING AND OTHER LIABILITIES

(a) Foreign Currency Liabilities Held for Trading

	2009 K'000	*2008 K'000*
Derivative Liabilities	3,659	71,284
	3,659	71,284

(b) Domestic Other Liabilities

	2009 K'000	*2008 K'000*
Provisions for employee entitlements	6,367	5,024
Accrued interest on deposits and securities issued	8,284	9,303
Accrued currency production costs	21,885	-
Other	16,467	33,345
	53,003	47,672

Note 18: SHARE CAPITAL

At 31 December 2009 the authorised and subscribed capital of the Bank was Kina 145.54 million (2008: Kina 145.54 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2009 K'000	*2008 K'000*
At the beginning of the year	145,540	131,000
Capitalisation of distributable profit	-	14,540
At the end of the year	145,540	145,540

Note 19: RECONCILIATION OF NET PROFIT TO OPERATING CASH FLOW

	2009 K'000	*2008 K'000*
Reported Operating Net Profit/(Loss)	196,272	(685,645)
Add (Subtract) Non-Cash Items		
Depreciation	2,672	2,127
Provisions for Staff Entitlements	1,343	(1,078)
Net Unrealised Gold (Gain)/Loss	(26,085)	1,043
Add (Subtract) Movements in Other Working Capital Items		
(Increase)/Decrease in Interest Receivable	16,286	(31,234)
Increase/(Decrease) in Interest Payable	(1,020)	5,070
(Increase)/Decrease in foreign investment including derivatives	(1,164,244)	318,380
(Increase)/Decrease in other receivable	(40,984)	(16,292)
Increase/(Decrease) in other payables	5,007	18,452

AUDITOR-GENERAL'S OFFICE

Add (Subtract) Investment and Financing Activities		
Net Unrealised Market Value Changes	14,611	12,689
Net Cash Flow from Operating Activities	**996,142**	**(376,487)**

Note 20: 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 21: RISK MANAGEMENT

Note 21(i): Financial Risk Management

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

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

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

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

Bank management seeks to ensure that strong and effective risk management and control systems are in place for assessing, monitoring and managing risk exposure. Experienced staff 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 statement of financial position.

Note 21(ii): 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) Concentration of Credit Exposure

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

	2009 *K'000*	*2008* *K'000*
Papua New Guinea Government	303,408	183,021
Other Government Institutions	3,313	50,002
Foreign Banks and Financial Institutions	6,987,664	5,728,052
Other	7,837	7,280
Total Financial Assets	**7,302,222**	**5,968,355**

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

Credit exposures arising 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.

96% of the total exposure is derived from loans and advances to banks and other financial institutions, of which 97% of the total assets have a credit rating of AA or above.

(c) Credit Exposure by Credit Rating

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

Investment in Financial Assets	**2009 K'000**	**% 2009 Financial Assets**	**2008 K'000**	**% 2008 Financial Asset**
AAA	4,380,928	73	3,415,395	70
AA	1,447,936	25	477,450	10
A	70,687	1	9,049	-
AA+	-	-	298,604	6
A+	-	-	26,587	1
A-1+	-	-	446,302	9
A-1	69,884	1	107,469	2
A-	-	-	37,189	1
AA-	-	-	29,919	1
Total Assets	**5,969,435**	**100**	**4,847,963**	**100**

Note 21(iii): MARKET RISK

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

Market risks arising from the outsourced investment portfolio are managed by external fund managers through the use of forward exchange derivative contracts.

(a) FOREIGN EXCHANGE RISK

Currency risk (foreign exchange rate risk) is a form of risk that arises from the change in price of one currency against another, which directly affects the value of foreign exchange reserves as well as investments. 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 2009 Bank of Papua New Guinea's net exposure to major currencies was as follows.

Currency of Denomination

As at 31 December 2009	US Dollar K'000	Gold K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	Total K'000
Foreign Currency Financial Assets									
Foreign Currency	97,115	-	58,992	(17,181)	46,330	143,422		1,112	329,790
Investments	3,529,003	-	209,671	1,168,437	229,119	164,007		639,800	5,940,038
Assets held with IMF		-	-	-	-	-	490,566	-	490,566
Derivative Asset	33,056	-	-	-	-	-		-	33,056
Other assets	-	125,390	-	-	-	-		68,824	194,214
	3,659,173	**125,390**	**268,662**	**1,151,256**	**275,449**	**307,429**	**490,566**	**709,736**	**6,987,664**
Foreign Currency Financial Liabilities									
Liabilities with IMF	-	-	-	-	-	-	-	530,536	530,536
Derivative liabilities	3,659	-	-	-	-	-	-	-	3,659
Total Financial Liabilities	**3,659**							**530,536**	**534,194**
Net Foreign Currency Exposure	**3,655,515**	**125,390**	**268,662**	**1,151,256**	**275,449**	**307,429**	**490,566**	**179,202**	**6,454,123**

As at 31 December 2008	US Dollar K'000	Gold K'000	Euro K'000	AUD K'000	GBP K'000	JPY K'000	SDR K'000	Other K'000	Tot K'0
Foreign Currency Financial Assets									
Foreign Currency	108,403	-	167,110	174,549	80,917	160,321		1,294	692,5
Investments	2,415,389	-	924,601	-1,200,162	174,658	102,456		52,379	4,869,9
Assets held with IMF	-	-	-	-	-	-	-	298	2
Derivative Assets	6,830	-	-	-	-	-	-	-	6,8
Other Assets	-	99,305	-	-	-	-	-	59,380	158,6
	2,530,622	**99,305**	**1,091,711**	**1,374,711**	**255,575**	**262,777**	**-**	**113,351**	**5,728,0**
Foreign Currency Financial Liabilities									
Liabilities with IMF	-	-	-	-	-	-	39,981	-	39,9
Derivative Liabilities	71,284	-	-	-	-	-		-	71,2
Total Financial Liabilities	**71,284**		**-**	**-**	**-**	**-**		**-**	**111,2**
Net Foreign Currency Exposure	**2,459,338**	**99,305**	**1,091,711**	**1,374,712**	**255,575**	**262,777**	**39,981**	**-**	**5,616,7**

The functional currency of all operations is PNG Kina.

(b) INTEREST RATE RISK

AUDITOR-GENERAL'S OFFICE

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

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

(c) LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities in its operations. The ultimate source of liquidity is Kina and the Bank has the authority to create liquidity by 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 Bank's assets held for managing liquidity risk comprise cash and bank balances with other central banks and Government bonds and other securities that are readily acceptable in repurchase agreements with other central banks.

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

	Balance	Maturity Period			
	Total K'000	0 to 3 months	3 to 12 months	1 to 5 years	Over 5 Years
Liabilities					
Foreign Currency Financial Liabilities					
Liabilities with IMF	530,536	530,536			-
Derivative Liabilities	3,659	3,659			-
Total Foreign Liabilities	**534,195**	**534,195**	-	-	-
Local Currency Financial Liabilities					
Deposits from Banks and Third parties	816,059	816,060			-
Deposits from Government	592,726	592,726			-
Securities Issued	4,109,111	4,109,111			-
Sub-total	**5,517,896**	**5,517,896**	-	-	-
Other Liabilities					
Currency in Circulation	997,093	997,093			-
Profit available for distribution	-	-			-
Other liabilities	53,003	53,003			-
Sub-total	**1,050,096**	**1,050,096**	-	-	-
Total Liabilities	**7,102,187**	**7,102,187**		-	-

Note 21(iv): SENSITIVITY ANALYSIS

At 31st December 2009, 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 K 9.7 million lower (2008:K 11.3 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 K 9.7 million higher (2008: K 11.3 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 2009, 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 K 698.8 million higher, (2008: K572.8 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 K 698.8 million, (2008: K 572.8 million). Profit is very sensitive to changes in exchange rates movements. The Bank by necessity holds substantial foreign currency assets.

Note 21(v): FAIR VALUE

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

Financial Assets	*2009*	*2008*
	K'000	*K'000*
At fair value through profit/(loss)	6,892,458	5,158,801
Loans and Receivables	409,764	809,554
	7,302,222	5,968,355
Financial Liabilities		
At fair value through profit/(loss)	534,195	71,284
At amortised cost	6,567,992	5,865,243
Total	7,102,187	5,936,527

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

FAIR VALUE HIERARCHY

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

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

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

31 December 2009	*Level 1*	*Level 2*	*Level 3*	*Total*
	K'000	**K'000**	**K'000**	**K'000**
Financial assets held at fair value through profit and loss				
Financial assets held for trading				
- Domestic Government Securities	-	303,408	-	303,408
- Foreign Government and Semi-Government Bonds	3,150,021	-	-	3,150,021
- Money Market instruments	-	570,366	-	570,366
- Derivatives managed by external fund managers	-	33,056	-	33,056
- Investments in bonds and other instruments managed by external fund managers*	2,219,651	-	-	2,219,651
- Gold	125,390	-	-	125,390
Total assets	**5,495,062**	**906,830**	-	**6,401,892**
Financial liabilities held at fair value through profit and loss				
- Derivatives	-	3,659	-	3,659
Total liabilities	-	**3,659**	-	**3,659**

AUDITOR-GENERAL'S OFFICE

Investments managed by external fund managers include foreign Government Bonds and other debt instruments for which quoted prices are available as well as derivatives which are value with reference to observable market data. Accordingly, these are classified under level 1 and 2 respectively.

Note 22: EVENTS AFTER THE BALANCE DATE

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

Note 23: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2009 (2008 Nil) and there is no transactions or events that will have material impact on the financial report during the preparation of this report.

Note 24: CAPITAL COMMITMENTS

The Bank has no material capital commitments.

Note 25: REMUNERATION OF MEMBERS OF THE BOARD AND KEY MANAGEMENT PERSONNEL

IAS 24 – Related party disclosures requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the Bank are member of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank: this group comprises 27 in total (2008: 24), including the Governor, Deputy Governor Policy and Deputy Governor Regulation, Assistant Governor, 8 non-executive Board members and 15 senior staff. The Salaries and Remuneration Committee (SRC) and Salaries, Conditions & Monitoring Committee (SCMC) determine the terms and conditions on which the Governor and Deputy Governor hold office in accordance with the Central Banking Act 2000. The Governor, in consultation with the Salaries, Conditions & Monitoring Committee (SCMC), determines the remuneration of other key executives.

Key Management Personnel Remuneration

	2009 *K'000*	2008 *K'000*
Short term benefits	3,376	2,482
Post employment benefits	343	507
Other long term benefits	889	651
Total	4,608	3,640

Short term benefits include cash salary and in the case of staff, annual leave and motor vehicle and housing benefits. Post employment benefits include superannuation benefit payments. Other long term benefits include long service leave. The components of benefits are reported on accrual basis.

As at 31 December 2009, the loans owed by the key management personnel to the Bank was K1,223,325 (2008: K1,166,032)

Note 26: Auditors Remuneration

The total audit fee for the year was K1.228 million. This includes K0.046 million paid to KPMG for an agreed upon procedures report on the bank's external fund managers. Total statutory audit fee paid to Auditor General Office, inclusive of contracted auditors fee is K1.182 million.

Note 27: 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.

BANK OF PAPUA NEW GUINEA

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DECLARATION BY MANAGEMENT

In our opinion the foregoing Statement of Financial Performance and Statement of Financial Position, including the Notes to and forming part thereof, have been drawn up so as to give a true and fair view of the matters to which they relate for the year ended 31 December 2009.

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

Loi M Bakani
Governor

Benny Popoitai MBE
Deputy Governor
Regulation

17 June 2010