AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

PAPUA NEW GUINEA

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

Date: 24 June, 2011
Reference: 30-13-4

BANK OF PNG
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FINANCE & ACCT. DEPT.

Dear Sir,

AUDITOR'S REPORT ON THE
BANK OF PAPUA NEW GUINEA
FOR THE YEAR ENDED 31 DECEMBER 2010

I have audited the accompanying financial statements of the **Bank of Papua New Guinea** for the year ended **31 December, 2010** as set out on pages **2** to **23** which comprise the statement of financial position as at 31 December, 2010, 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 preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

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.* These standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, 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 audit opinion.

AUDIT OPINION

In my opinion:

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

(b) the financial statements are in agreement with those accounts and records and show fairly the state of affairs of the Bank as at 31 December, 2010 and the results of 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 2010

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Statement of Comprehensive Income for the year ended 31 December 2010
Bank of Papua New Guinea

	Note	2010 *K'000*	2009 *K'000*
Income from foreign currency investments			
Interest income	**2**	222,815	179,118
Net realised gain/(loss) on financial instruments classified as held for trading		1,670	10,158
Foreign exchange commissions		3,006	6,608
Total income from foreign currency operations		**227,491**	**195,884**
Expenses on foreign currency investments			
Interest expense on liabilities with IMF		1,544	345
Custodian and investment management fees		4,494	3,650
Total expenses from foreign currency operations		**6,038**	**3,995**
Net Foreign Currency Income		**221,453**	**191,889**
Income from domestic operations			
Interest income	**3**	35,929	33,182
Other income	**4**	3,646	7,865
Total income from domestic operations		**39,575**	**41,047**
Expense on domestic investments			
Interest expense	**5**	164,710	222,312
Total expenses on domestic operations		**164,710**	**222,312**
Net Domestic Income/(Expense)		**(125,135)**	**(181,265)**
Total net operations income		**96,318**	**10,624**
Less: Operating Expenses			
General and administration expenses	**6**	74,420	73,260
Operating Profit/(Loss) for the year		**21,899**	**(62,636)**
Other unrealised income and expense			
Fair value and foreign exchange revaluation gain/(loss) on foreign currency		9,860	247,737
Fair value revaluation gain/(loss) on domestic investments		72,807	(14,611)
Profit for the year		**104,565**	**170,490**
Other comprehensive income			
Gain/(loss) on property revaluation		58,747	(303)
Gains/(loss) on gold asset revaluation		31,817	26,085
Other comprehensive income/(loss) for the year		90,564	25,782
Total Comprehensive Income for the year		**195,129**	**196,272**

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

Statement of Financial Positionas at 31 December 2010
Bank of Papua New Guinea

	Note	2010 *K'000*	2009 *K'000*
Assets			
Foreign Currency Financial Assets			
Gold		157,288	125,390
Cash and cash equivalents	**8**	2,045,663	329,790
Financial assets held for trading	**9**	5,834,933	5,973,094
Assets held with IMF	**7**	43,639	490,566
Other assets	**12**	50,421	68,824
Total Foreign Currency Financial Assets		**8,131,944**	**6,987,664**
Local Currency Financial Assets			
Government of Papua New Guineasecurities	**10**	409,470	303,408
Loans and advances	**11**	11,299	11,150
Total Local Currency Financial Assets		**420,769**	**314,558**
Total Financial Assets		**8,552,713**	**7,302,222**
Other Assets			
Property, plant & equipment	**13**	124,279	62,742
Capitalised currency production cost		56,011	53,342
Other assets	**12**	10,805	7,105
Total Other Assets		**191,095**	**123,189**
Total Assets		**8,743,808**	**7,425,411**
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Liabilities with IMF	**7**	511,992	530,536
Financial liabilities	**17**	30,655	3,659
Total Foreign Liabilities		**542,647**	**534,195**
Local Currency Financial Liabilities			
Deposits from banks & third parties	**14**	817,701	816,059
Deposits from Government and Government entities		1,035,128	592,726
Debt securities issued	**15**	4,576,182	4,109,111
Currency in circulation	**16**	1,192,711	997,093
Total Local Currency Financial Liabilities		**7,621,722**	**6,514,989**
Total Financial Liabilities		**8,164,369**	**7,049,184**
Other Liabilities			
Other liabilities	**17**	61,087	53,003
Total Other Liabilities		**61,087**	**53,003**
Total Liabilities		**8,225,456**	**7,102,187**
Equity			
Capital	**18**	145,540	145,540
Gold reserve		137,511	105,694
Property revaluation reserve		83,074	24,327
Currency movement reserve		0	47,665
Unrealised profit/(loss) reserve		63,549	0
Retained profit/(loss)		88,678	0
Total Equity		**518,352**	**323,226**
Total Liabilities and Equity		**8,743,808**	**7,425,411**

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 2010
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. 2009	145,540	79,609	24,630	-	-	-	142,629	(265,454)	**126,952**
Total Comprehensive Income for the year	-	26,085	(303)	47,662	-	-	-	122,825	**196,271**
Prior Year Proposed Dividend	-	-	-	-	-	-	(142,629)	142,629	**-**
Share Capital Issued	-	-	-	-	-	-	-	-	**-**
Balance at 31 Dec. 2009	**145,540**	**105,694**	**24,327**	**47,662**	**-**	**-**	**-**	**-**	**323,223**
Total Comprehensive Income for the year	-	31,817	58,747	-	82,666	-	-	21,899	**195,129**
Reclassification of reserves (Note 1 (n) (d).	-	-	-	(47,662)	(19,117)	-	-	66,779	**-**
Balance at 31 Dec. 2010	**145,540**	**137,511**	**83,074**	**-**	**63,549**	**-**	**-**	**88,678**	**518,352**

Statement of Distribution for the year ended 31 December 2010
Bank of Papua New Guinea

	2010 *K'000*	2009 *K'000*
Total Comprehensive Income for the year:	**195,129**	196,272
Unrealised (profit)/ loss	(173,230)	(148,607)
Transfer to/from currency movement reserve	-	(47,662)
Distributable profit/(loss)	**21,899**	**-**

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 2010
Bank of Papua New Guinea

	Note	2010 *K'000*	2009 *K'000*
Cash flows from operating activities			
Interest received – foreign currency		222,308	188,504
Interest received – local currency		35,213	40,082
Fees, commissions and other income received		2,158	14,552
Interest paid – foreign currency		(1,544)	(345)
Interest paid – local currency		(154,643)	(223,305)
Payments to employees		(27,214)	(30,409)
Payments to suppliers		(44,722)	(55,824)
Fees and commissions paid		(4,015)	(4,031)
Net proceeds from/(payments for) foreign investments		188,715	(925,366)
Net Cash Flow from Operating Activities	**19**	**216,256**	**(996,142)**
Cash Flows from Investing Activities			
Net increase/(decrease) in foreigndeposits including IMF		(18,544)	490,555
Net increase/(decrease) in deposits from Banks		1,642	41,364
Net deposit from/(payment to) Government		442,253	(1,298,454)
Net increase/(decrease) in assets held with IMF		446,630	(490,268)
Net payment for/(proceeds from) investment in Government Securities		(33,255)	(134,998)
Purchase of property, plant and equipment		(9,566)	(15,966)
Proceeds from sale of institutional housing/motor vehicle		3,489	252
Net increase/(decrease) in other assets and liabilities		4,279	-
Net Cash Flow from Investing Activities		**836,928**	**(1,407,515)**
Cash Flows from Financing Activities			
Net issue of currency in circulation		195,618	146,154
Net increase/(decrease) in debt securities issued		467,071	1,894,169
Net Cash Flow from Financing Activities		**662,689**	**2,040,323**
Net Increase/(Decrease) in Cash and Cash Equivalents		**1,715,873**	**(363,334)**
Cash and cash equivalent at 1 January		329,790	693,124
Cash and Cash Equivalent at 31 December	**8**	**2,045,663**	**329,790**

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

Note 1: SUMMARY OF SIGNIFICANT 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 the ordinary activities of BPNG.

(i). The following new and amendments to standards are mandatory for the first time for financial year beginning 1 January 2010:

- IFRIC 9 'Reassessment of embedded derivative and IAS 39, Financial Instruments'
- IAS 36 (amendment) 'Impairment of assets'
- IAS 1 (amendment) 'Presentation of Financial Statements'

These new and amended accounting standards have not had a significant impact on the reported financial position or financial performance of the Bank.

(ii). The following new and amendments to standards are issued but not yet effective for the financial year ending 31 December 2010 and not early adopted by the Bank:

- IAS 24 (revised) 'Related Party Disclosures'
- IRFIC 19 'Extinguishing financial liabilities with equity instruments'
- 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 reporting 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 ofone entity and a financial liability or equity instrument of another entity. The Bank's financial instrumentsare its domestic government securities, foreign government securities, gold holdings, Central Bank Bills issued, bank deposits, cash and cash equivalents, deposit liabilities and currency in circulation.

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

(i) Domestic Government securities

The Bank holds inscribed stocks 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 securityand included as revenue in the statement of comprehensive income. Interest isreceived 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 internationalbanks, Central banks and international agencies). These instruments are classified as 'financial assets held for trading" in accordance with IAS 39. Accordingly, these assets are measured at their fair value. External fund managers engaged by the Bank also enter into forward exchange contracts to hedge the returns of portfolios under their management to the US Dollar. No Kina forward contracts are entered into.

Assets and liabilities denominated in foreign currencyare 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 heldunder repurchase agreements. Coupon securities have biannual or annual interest paymentsdepending on the currency and type of security; the principal of these securities is received atmaturity. Interest earned on discount securities is the difference between the actual purchasecost and the face value of the security; this is amortised over the term of the securities. Theface value is received at maturity. Foreign securities, except those contracted for sale underrepurchase agreements, are classified under IAS 39 as 'at fair value through statement of comprehensive income', asthey are held for trading. In accordance with this standard, the securities are valued at marketbid prices on balance date; realised and unrealised gains or losses are taken to profit. Onlyrealised 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 internationalbanks; it also maintains working accounts in foreign currencies. Deposits are classified as 'loansand receivables' under IAS 39 and recorded at their face value, which is equivalent to theiramortised cost using the effective interest method. Interest is accrued over the term of depositsand is received periodically or at maturity. Interest accrued but not received is included ininterest receivable in the statement of financial position.

(v) Foreign currency forward contracts

External fund managers engaged to manage part of the Bank's investment portfolioenter into forward foreign exchange contracts to hedge the return of portfolios under their management to the US Dollar. Gains/(losses)on this portfolio are treated as unrealised by the Bank as they remain as part of the overall portfolio under the management of external fund managers. These contractsforeign exchange areaccounted for on a fair value basis, with all changes in fair value being reflectedin the statement of comprehensive income in accordance with IAS 39. The fair values are determined with reference to prevailing exchange ratesat balance date.

(vi) Repurchase agreements

(a). Buy repurchase agreements

In the course of its financial market operations, the BPNG engages in repurchase agreements involving foreign and domestic marketable securities. Securities purchased and contracted for sale under buy repurchase agreements are classified under IAS39 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.

(b). Sell repurchase agreements

Securities sold and contracted for purchase under sell repurchase agreements are classified under IAS 139 as ‘at fair value through profit and loss’, as they are held for trading, and reported on the Balance Sheet within the relevant investment portfolio. The counterpart obligation to repurchase the securities is reported in Other Liabilities at amortised cost; the difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense.

(vii) Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilitiesunder IAS 39. Deposit balances are shown at their amortised cost, which is equivalent totheir face value. Details ofdeposits are included in Note 17 and on the face of the statement of financial position.

(viii) Central Bank Bills on issue

Since 2006, the Bankhas issued Central Bank Bills as part of its money market operations. These are classified as financial liabilities. The Bills issued have maturities ranging from 28 days to 181 days and are recorded at 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 ofthe prevailing exchange rate at balance date. Unrealised gains and losses on gold are recognised in the gold revaluation reserve until such time as they are realised whereby they are recognised in profit and loss from ordinary activities. The Bank lends gold to financial institutions participating in the gold market. Goldholdings are a financial instrument and the Bank accounts for these 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 costs and measured subsequently at amortised cost using the 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. The IMF assets and liabilities are denominated in SDR which are based on the weighted average of four main trading currencies. These are translated to PGK using the SDR market rate at balance date. These assets and liabilities are accounted for on a fair value basis, with changes to the fair value being taken to the statement of comprehensive income in accordance with IAS39.

(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) Propertyand equipment

Formal valuations of all the Banks properties are conducted on atriennial basis. The properties are valued by localindependent valuers. The mostrecent independent valuation of the properties was at 31December 2010. In accordance withIAS 16 – Property, Plant and Equipment, properties are valued at market value, whichreflects observable prices and are based on the assumption that assets would be exchangedbetween knowledgeable, willing parties at arm's length. Valuation gains and losses are transferred to theProperty Revaluation Reserve. Annualdepreciation is based on fair values and assessments of the useful remaining life of the relevantasset. Management has assessed the fair value of all property and equipment as at 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
Computer Software	13

(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.

(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) Capitalised currency production cost

From1 January 2010, the cost of the printing of notes and minting of coins areinitially capitalised until such time as they are issued into circulation at which point the related cost is expensed. All other expenditures of a non capital nature are expensedwhen incurred.

The change in accounting estimateduring the period required an adjustment for the restatement of opening balances of capitalised production costs as at 1 January 2010. This resulted in a gain of K5.5 million for the prior year which has been recognised in profit & loss, in accordance with IAS 8.

(i) Cash and cash equivalents

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

(j) Other receivables

Other receivables are stated at amortised cost.

(k) Employee benefits

(i) Pension Fund

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

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

(ii) Provision For Leave Entitlement

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

(l) Other payables

Other payables are initially recognised at their fair value and subsequently recognised at amortised 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 Fund
The Bank of Papua New Guinea Reserve Fund was created under the Central Banking Act 2000Section 42, and represents reserves set aside as determined are required to meet contingencies which arise in the course of the Central Bank's operations in carrying out its functions.

(ii) Asset Revaluation Reserve
The asset revaluation reserve reflects the impact of changes in the market value of property.

(iii) Unrealised Profits Reserve
Unrealised gains and losses on foreign exchange balances and securities are recognised in the unrealised profits reserve until such gains and losses are realised whereby they are recognised in profit and loss from ordinary activities.

(iv) Currency Movement Reserve
Realised gains and losses are recognised in profit and loss from ordinary activities and are transferred to the Currency Movement Reserve at the discretion of the Bank.

(v) Distributable Profit Reserve
The distributable profit reserve reflects closing distributable profit which may be distributed to the Government of Papua New Guinea after ensuring that thecurrent financial position of the Bank meets the requirements under the Central Banking Act 2000 Section 49(3).

(vi) Gold Revaluation Reserve
Gold is valued at current quoted market prices. Unrealised gains and losses arising from revaluation are recognised in the Gold Revaluation Reserve at end of the accounting period. Realised gains and losses are recognised in profit and loss from ordinary activities.

(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 bedistributed to the Government or paid into the Consolidated Revenue Fund. Accordingly such 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 of Papua New GuineaReserve Fund.

(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.

(d) The unrealised profit reserve of the bank represents gains or loss arising from the revaluation of gold, properties and other financial assets of the Bank. These gains and losses are separately classified under the respective reserves in the statement of changes in equity. The Bank performed an exercise to determine the unrealised profit reserve in relation to the Bank's financial assets at year end. This resulted in the reclassification of unrealised profit reserve, currency movement reserve and the retained profit/(loss) during the year.

(o) Critical accounting estimates

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

	2010 K'000	***2009 K'000***
Foreign bank deposits	39,702	21,039
Foreign securities	182,357	157,857
Assets with the IMF	756	222
	222,815	**179,118**

Interest income on foreign securities includes income of K63.7 million (2009: K71.9 million) in relation to investments managed by external fund managers

Note 3: INTEREST INCOME – DOMESTIC OPERATIONS

	2010	*2009*
	K'000	***K'000***
Inscribed stock	35,873	32,750
Other interest income	56	432
	35,929	**33,182**

Note 4: OTHER INCOME – DOMESTIC OPERATIONS

	2010	*2009*
	K'000	***K'000***
Management and Agency fees	-	(421)
Licensing fees	2,104	191
Numismatic currency	154	77
Property rents	1,197	1,101
Withdrawal of old K1 coins	-	5,248
Others	191	1,669
	3,646	**7,865**

Old K1 coins were withdrawn from circulation during the year 2009, However some of these coins were not returned to the Bank and remained in circulation. The total value of these coins was recognised as income in2009as they are no longer legal tender and no longer represent a liability to the Bank.

Note 5: INTEREST EXPENSE – DOMESTIC OPERATIONS

	2010	*2009*
	K'000	***K'000***
Central Bank bills issued	163,886	217,582
Other	824	4,730
	164,710	**222,312**

Note 6: GENERAL AND ADMINISTRATION EXPENSES

	2010	*2009*
	K'000	***K'000***
Staff costs	24,270	27,892
Staff training and development	1,892	1,437
Premises and equipment	12,119	9,625
Depreciation of property, plant and equipment	2,659	2,672
Amortisation of computer software cost	498	-
Amortisation of coins production expenses	531	6,352
Amortisation of notes production expenses	8,841	12,759
Currency distribution expenses	8,131	447
Audit fee	1,275	1,228
Travel	2,740	2,421
Legal &consultancy fees	2,230	2,849
Board &meeting expenses	522	788
Other expenses	8,712	4,790
	74,420	**73,260**

Note 7: IMF RELATED ASSETS & LIABILITIES

	2010 *K'000*	*2009* *K'000*
Assets		
SDR holding	43,639	490,566
Liabilities		
IMF number 1 and 2 accounts	1,557	1,558
SDR allocation	510,435	528,979
	511,992	**530,536**

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

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

Note 8: CASH & CASH EQUIVALENTS

	2010 *K'000*	*2009* *K'000*
Foreign currency holdings – Nostro accounts	2,045,663	329,790
	2,045,663	**329,790**

The foreign currency holdings represent the Bank's foreign Nostro holding with corresponding foreign banks.

Note 9: FINANCIAL ASSETS HELD FOR TRADING

	2010 *K'000*	*2009* *K'000*
Bank for International Settlement	-	410,560
Other short term investments	2,173,789	652,568
Bonds	3,660,083	4,876,910
Derivative assets	1,061	33,056
	5,834,933	**5,973,094**

Other short term investments and bonds include K2.27 billion of investments managed by the external fund managers.

Note 10: GOVERNMENT OF PAPUA NEW GUINEA SECURITIES

	2010 *K'000*	*2009* *K'000*
Inscribed stock	409,470	303,408
	409,470	**303,408**

Note 11: LOANS AND ADVANCES

	2010 *K'000*	*2009* *K'000*
Loan &advances to Government	1,238	1,927
Agricultural export commodity support loans	1,386	1,386
Loans and advances to staff (including housing loans)	8,675	7,837
	11,299	**11,150**

Note 12: OTHER ASSETS

(a) Foreign Currency Other Assets

	2010 K'000	***2009 K'000***
Interest receivable	50,421	49,995
Prepayment	-	18,829
	50,421	**68,824**

(b) Domestic Other Assets - receivables

	2010 K'000	***2009 K'000***
Interest receivable	7,821	7,105
Other receivables	2,984	-
	10,805	**7,105**

Note 13: PROPERTY PLANT & EQUIPMENT

	Land and Buildings	**Equipment**	**Motor Vehicles**	**Computer Equipment**	**Computer Software**	**Total**
	K'000	K'000	K'000	K'000	K'000	K'000
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**
Year end December 2010						
Opening net book amount	51,109	9,392	977	1,265	-	62,742
Additions	5,629	3,882	-	156	-	9,667
Disposals	(3,862)	-	-	-	-	(3,862)
Transfer	-	(9,707)	-	-	9,707	-
Revaluation	58,747	-	-	-	-	58,747
Depreciation charges	(1,206)	(519)	(371)	(422)	(498)	(3,016)
Closing Book Amount	**110,417**	**3,048**	**606**	**999**	**9,209**	**124,279**
At 31 December 2010						
Cost	110,417	4,908	1,806	4,172	9,707	131,010
Accumulated Depreciation	-	(1,861)	(1,200)	(3,173)	(498)	(6,731)
Net Book Amount	**110,417**	**3,048**	**606**	**999**	**9,209**	**124,279**

The properties of the Bank were externally re-valued in December 2010.

The deferred cost on computer software is the net cost of the Opics system since going live upon completion in May 2010. This cost will be amortised over a period of 13 years, which is in line with the life of the licence.

Note 14: DEPOSITS FROM BANKS & THIRD PARTIES

	2010 K'000	2009 K'000
Banks		
Exchange settlement accounts	280,153	439,714
Cash reserve requirement ratio	530,073	368,777
Other Deposits	7,475	7,569
	817,701	816,060

Note 15: SECURITIES ISSUED

	2010 K'000	2009 K'000
Central Bank bills issued	4,576,182	4,109,111

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 open market operations in the domestic financial markets.

Interest on securities issued varied between 2.3% and 5.3% during the year (2009: 4.8%, 8.45%). Accrued interest is included in other liabilities in Note 17(b).

Note 16: CURRENCY IN CIRCULATION – DOMESTIC LIABILITY

	2010 K'000	2009 K'000
Currency in circulation	1,192,711	997,093

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

Note 17: FINANCIAL LIABILITIES

(a) Foreign Currency Liabilities

	2010 K'000	2009 K'000
Derivative liabilities	26,748	3,659
Foreign currency vostro accounts	3,907	-
	30,655	3,659

(b)Domestic Other Liabilities

	2010 K'000	2009 K'000
Provisions for employee entitlements	8,055	6,367
Accrued interest on deposits and securities issued	18,351	8,284
Accrued currency warehouse &production costs	4,832	21,885
Outstanding warrants	22,934	9,092
Other	6,915	7,375
	61,087	53,003

Accrued interest on deposit and securities issued represents the discount incurred on central bank bills issued. Outstanding warrants include cheques or warrant issued by the bank but not yet presented for clearance and subsequent encashment by government departments, investors and suppliers.

Note 18: SHARE CAPITAL

At 31 December 2010 the authorised and subscribed capital of the Bank was Kina 145.54 million (2009: Kina 145.54 million). The capital is fully subscribed by the Government of Papua New Guinea.

	2010 K'000	***2009 K'000***
At the beginning of the year	145,540	145,540
At the end of the year	**145,540**	**145,540**

Note 19: RECONCILIATION OF NET PROFIT TO OPERATING CASH FLOW

	2010 K'000	***2009 K'000***
Reported operating net profit/(loss)	195,129	196,272
Add /(Subtract) Non-Cash Items		
Depreciation	3,016	2,672
Provisions for staff entitlements	1,688	1,343
Net unrealised gold (gain)/loss	(31,898)	(26,085)
Net unrealised (gain)/loss on property valuation	(58,747)	-
Net unrealised market value changes	(72,807)	14,611
Add /(Subtract) Movements in Other Working Capital Items		
(Increase)/decrease in interest receivable	(1,142)	16,286
Increase/(decrease) in interest payable	10,067	(1,020)
(Increase)/decrease in foreign investment including derivatives	161,250	(1,164,244)
(Increase)/decrease in other receivable	13,371	(40,984)
Increase/(decrease) in other payables	(3,671)	5,007
Net Cash Flow from Operating Activities	**216256**	**996,142**

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.

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 conduct the Bank's local currency, foreign currency reserves management, and foreign exchange dealing operations in accordance with a clearly defined risk management framework, including delegated authority limits as set by the Governor.

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

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

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

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

(b) Concentration of Credit Exposure

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

	2010 K'000	***2009 K'000***
Papua New Guinea Government	409,470	303,408
Other Government Institutions	2,624	3,313
Foreign Banks and Financial Institutions	8,131,944	6,987,664
Other	8,675	7,837
Total Financial Assets	**8,552,713**	**7,302,222**

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 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.

95% of the total exposure is derived from loans and advances to banks and other financial institutions, of which 64% 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. Other indicates the entity has not been rated by Standard and Poor's and Moody's.

Investment in Financial Assets	**2010 K'000**	**% 2010 Financial Assets**	**2009 K'000**	**% 2009 Financial Asset**
AAA	2,931,524	50	4,380,928	73
AA	611,869	10	1,477,936	25
A	498,231	9	70,687	1
A 1	1,792,248	31	69,884	1
Total Financial Assets	**5,833,872**	**100**	**5,969,435**	**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 endeavor to comply with this benchmark through rebalancing the investment portfolio following benchmarking daily / weekly as approved by the Investment Committee.

As at 31 December 2010 Bank of Papua New Guinea's net exposure to major currencies was as follows.

Currency of Denomination

As at 31 December 2010	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	864,460	-	236,580	588,274	148,048	206,391	-	1,910	2,045,663
Investments	3,133,386	-	865,767	1,432,340	230,496	197,905	-	-	5,859,894
Assets held with IMF		-	-	-	-	-	43,639	-	43,639
Derivative asset	1,061	-	-	-	-	-	-	-	1,061
Other assets	-	157,288	-	-	-	-	-	24,399	181,687
	3,998,907	**157,288**	**1,102,347**	**2,020,614**	**378,544**	**404,296**	**43,639**	**26,309**	**8,131,944**
Foreign currency financial liabilities									
Liabilities with IMF	-	-	-	-	-	-	511,992	-	511,992
Foreign currency liabilities	30,649	-	-	6	-	-	-	-	30,655
	30,649	**-**	**-**	**6**	**-**	**-**	**511,992**	**-**	**542,647**
Net Foreign Currency Exposure	**3,968,258**	**157,288**	**1,102,347**	**2,020,608**	**378,544**	**404,296**	**(468,353)**	**26,090**	**7,589,297**

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 assets	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
Foreign currency liabilities	3,659	-	-	-	-	-	-	-	3,659
	3,659	**-**	**-**	**-**	**-**	**-**	**530,536**	**-**	**534,195**
Net Foreign Currency Exposure	**3,655,515**	**125,390**	**268,662**	**1,151,256**	**275,449**	**307,429**	**(39,970)**	**709,736**	**6,453,469**

The functional currency of all operations is PNG Kina.

(b) INTEREST RATE RISK

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

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

(c) LIQUIDITY RISK

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

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

The table below 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.

As at 31 December 2010:

	Balance Total K'000	Maturity Period				
		0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity
Liabilities in 2010						
Foreign Currency Financial Liabilities						
Liabilities with IMF	511,992	511,992	-	-	-	-
Foreign currency liabilities	30,864	30,864	-	-	-	-
	542,856	**542,856**	**-**	**-**	**-**	**-**
Local currency financial liabilities						
Deposits from banks and third parties	817,701	817,701	-	-	-	-
Deposits from Government	1,035,128	1,035,128	-	-	-	-
Securities issued	4,613,100	3,981,100	632,000	-	-	-
Currency in Circulation	1,192,711	-	-	-	-	1,192,711
	7,658,640	**5,833,929**	**632,000**	**-**	**-**	**1,192,711**
Other Liabilities						
Other liabilities	61,087	61,087	-	-	-	-
	61,087	**61,087**	**-**	**-**	-	-
Total Liabilities	**8,262,829**	**6,438,118**	**632,000**	**-**	**-**	**1,192,711**

As at 31 December 2009:

	Balance Total K'000	Maturity Period				
		0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity
Liabilities						
Foreign Currency Financial Liabilities						
Liabilities with IMF	530,536	530,536	-	-	-	-
Foreign currency liabilities	3,659	3,659	-	-	-	-
	534,194	**534,194**	**-**	**-**	**-**	**-**
Local currency financial liabilities						
Deposits from banks and third parties	816,059	816,059	-	-	-	-
Deposits from Government	592,726	592,726	-	-	-	-
Securities issued	4,109,111	4,109,111	-	-	-	-
Currency in Circulation	997,093	-	-	-	-	997,093
	6,514,989	**5,517,896**	**-**	**-**	**-**	**997,093**
Other Liabilities						
Other liabilities	53,003	53,003	-	-	-	-
	53,003	**53,003**	**-**	**-**	-	-
Total Liabilities	**7,102,186**	**6,105,093**	**-**	**-**	**-**	**997,093**

Note 21(iv): SENSITIVITY ANALYSIS

At 31December 2010, 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 K13.9million lower (2009:K9.7million), arising mainly as a result of lower interest income on financial assets. Conversely if interest rates had been 100 basis points higher with all other variables held constant profit for the year and the net assets at year end would have been K13.9million higher (2009: K9.7million) arising mainly as a result of higher interest income on financial assets.

At 31 December 2010, 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 K758.9 million higher, (2009: K 698.8 million). Conversely if the Kina had strengthened 10 per cent against the same currencies with all other variables held constant the bank would have experienced a reduction of profit for the year of K758.9million, (2009: K698.8 million).

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	***2010***	***2009***
	K'000	***K'000***
At fair value through profit/(loss)	6,445,330	6,892,458
Loans and receivables	2,107,383	409,764
	8,552,713	**7,302,222**
Financial Liabilities		
At fair value through profit/(loss)	542,647	534,195
At amortised cost	7,683,809	6,567,992
	8,225,456	**7,102,187**

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 over the counter derivative contracts. The sources of input parameters are Bloomberg or Reuters.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

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 2010	*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 – inscribed stock	-	409,470	-	409,470
- Foreign Government and semi-Government bonds	2,205,818	-	-	2,205,818
- Money market instruments	288,507	1,069,932	-	1,358,439
- Derivatives managed by external fund managers	-	1,061	-	1,061
- Investments in bonds and other instruments managed by external fund managers	2,269,615	-	-	2,269,615
- Gold	157,288	-	-	157,288
- Assets held with IMF	43,639	-	-	43,639
Total assets	**4,964,867**	**1,480,463**	**-**	**6,445,330**
Financial liabilities held at fair value through profit and loss				
- Derivatives	-	26,748	-	26,748
- Foreign currency vostro accounts	3,907	-	-	3,907
- Liabilities with IMF	511,992	-	-	511,992
Total liabilities	**515,899**	**26,748**	**-**	**542,647**

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

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 – inscribed stock	-	303,408	-	303,408
- Foreign Government and semi-Government bonds	3,150,020	-	-	3,150,020
- Money market instruments	-	570,367	-	570,367
- 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
- Assets held with IMF	490,566	-	-	490,566
Total assets	**5,985,627**	**906,831**	**-**	**6,892,458**
Financial liabilities held at fair value through profit and loss				
- Derivatives	-	3,659	-	3,659
- Liabilities with IMF	530,536	-	-	530,536
Total liabilities	**530,536**	**3,659**	**-**	**534,195**

Note 22: EVENTS AFTER THE BALANCE DATE

The board of the bank resolved to transfer K22 million of operating profit to the capital reserves of the bank at the board meeting held on 16 June 2011. The transfer from reserves to the capital will be effected once the approval of the minister is obtained in accordance with section 42 (2) of the Central Banking Act.

No other events have occurred subsequent to the balance date, which require adjustments to/or disclosures in the financial statements.

Note 23: CONTINGENT LIABILITIES

The Bank had no material contingent liabilities at 31 December 2010 (2009 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 members of the Board and senior staff who have responsibility for planning, directing and controlling the activities of the Bank: this group comprises 26 in total (2009: 27), including the Governor, 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

	2010 *K'000*	2009 *K'000*
Short term benefits	2,884	3,376
Post employment benefits	444	343
Other long term benefits	1,493	889
	4,820	4,608

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 includelong service leave. The components of benefits are reported on an accruals basis.

As at 31 December 2010, the loans owed by the key management personnel to the Bank wereK1,433,671(2009: K1,223,325)

Note 26: Auditors Remuneration

The total audit fee for the year was K1,275,313 (2009: K1,182,500). This represents the total statutory audit fee paid to the Auditor General's Office.

Note 27: TRANSACTIONS WITH GOVERNMENT AND GOVERNMENT CONTROLLED ENTERPRISES

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

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

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

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

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 2010.

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

Loi M Bakani
Governor

Benny Popoitai MBE
Deputy Governor
Regulation

17 June 2011