# PETROLEUM FUND OF TIMOR-LESTE

## FINANCIAL STATEMENTS
## FOR THE YEAR ENDED
## 31 December 2009

# Petroleum Fund of Timor-Leste
# Annual report - for the year ended 31 December 2009

## Contents

**Petroleum Fund of Timor-Leste**
**Directors' Report**
**31 December 2009**

## BACKGROUND

The Petroleum Fund Law No. 9/2005 was promulgated on 3 August 2005 and it established the Petroleum Fund of Timor-Leste. Banking & Payments Authority (BPA), which functions as the Central Bank of Timor-Leste, is responsible for the operational management of the Fund. In accordance with a Management Agreement dated 12 October 2005 between the Ministry of Finance and the BPA. BPA is also responsible for maintaining the books of account for the Fund on behalf of the Director of Treasury.
A revised management agreement including a new investment mandate between the Ministry of Finance and the BPA was signed on 25 June 2009. In addition, Bank for International Settlements (BIS) was appointed as an external manager of the Fund. BPA Internal Management would manage 80% of global portfolio, while BIS would manage the rest 20% of the global portfolio.

## FINANCIAL STATEMENTS

As per Article 21 of the Petroleum Fund Law, the financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The statements are:

Statement of Comprehensive Income,
Balance Sheet,
Statement of Changes in Capital,
Statement of Cash Flows, and
Notes to the Financial Statements

These financial statements cover the period from 1 January 2009 to 31 December 2009.

The accounts and the financial statements have been externally audited by Deloitte, Touche & Tohmatsu whose audit opinion is attached with the financial statements per pages 5-21.

## PETROLEUM FUND CAPITAL

The Petroleum Fund had capital of US$ 4.197 billion on 1 January 2009. During the period, taxes and other petroleum revenue under Article 6 of the Petroleum Fund were US$ 1.660 billion. The Fund earned an income of US$ 31.465 million during the period. A summary of transactions for the income is given in the "Income Statement".

An amount of US$ 512.00 million was transferred from the Petroleum Fund to the State General Account during the period. The capital of Petroleum Fund as on 31 December 2009 was US$ 5.377 billion. A summary of the transactions is given in the "Statement of Changes in Capital".

## BENCHMARKS AND PERFORMANCE

### *Summary of Benchmarks*

<u>BPA Internal Management (80% of global portfolio)</u>
• US Government 0-5 years 100.0%

<u>Bank for International Settlements (20% of global portfolio)</u>
• US Government 0-5 years 52.0%
• US Government 5-10 years 10.0%
• Governments/Supranationals USD AAA 13.0%
• Governments/Supranationals USD AA 7.0%
• Australian Government 7.0%
• Euro Governments 7.0%
• United Kingdom Gilts 2.0%
• Japan Government 2.0%

### *Performance*

In accordance with the Article 24.1(a) of the Petroleum Fund and the provisions of the Management Agreement, the Petroleum Fund assets were invested in mandated instruments during the year. The list of instruments held as on 31 December 2009 are given at note 9. The credit exposure by credit rating is given in the note 14(c) and the credit rating is higher than the minimum credit rating mandated in the Management Agreement. The interest rate duration (modified duration) of the benchmark and the portfolio at 31 December 2009 and 31 December 2008 was 2.53 years and 2.047 years respectively (note 12 on risk management refers). The performance of the Petroleum Fund during the period has been in accordance with the mandate of the Management Agreement.

During the period, Ministry of Finance together with the Banking & Payments Authority have been able to accomplish the stewardship and fiduciary role for the Petroleum Fund.

(Sara Lobo Brites)

Director of Treasury
Ministry of Finance

**30 June 2010**

Deloitte.

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# Auditor's Report to the Ministry of Finance, Democratic Republic of Timor-Leste in respect of the Annual Financial Statements of the Petroleum Fund of Timor-Leste for the year ended 31 December 2009

We have audited the accompanying financial statements of the Petroleum Fund of Timor-Leste which comprise the balance sheet as at 31 December 2009, and the statement of comprehensive income, statement of changes in capital and statement of cash flows for the year ended, and a summary of significant accounting policies and other explanatory notes.

*The Government's Responsibility for the Financial Statements*

The Government as represented by the Minister of Finance is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditors Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain 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.

We believe that the evidence obtained is sufficient and appropriate to provide a basis for our opinion.

*Opinion*

In our opinion, the financial statements present fairly, in all material respects the financial position of the Petroleum Fund of Timor-Leste as at 31 December 2009 and of its financial performance and its cashflows for the year ended in accordance with the International Financial Reporting Standards.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU
Chartered Accountants
Darwin, 30/06/2010

## Statement of Comprehensive Income

| | *Note* | *Dec-09 USD* | *Dec-08 USD* |
|---|---|---|---|
| **Investment income** | | | |
| Interest on investments | 4 | 177,132,573 | 115,969,341 |
| **Gains and losses on investments** | | | |
| Gains/(losses) on fair value through profit or loss assets | 6 | (143,235,827) | 107,692,562 |
| Net foreign exchange gains/(losses) | | 155,662 | - |
| Other investment income | | 24,806 | - |
| **Total investment income/(loss)** | | **34,077,214** | **223,661,903** |
| **Expenses** | | | |
| Management fee | 9(b) | (2,611,703) | (1,053,088) |
| **Total expenses** | | **(2,611,703)** | **(1,053,088)** |
| **Profit/(loss) for the year** | | **31,465,511** | **222,608,815** |
| Other comprehensive income | | - | - |
| **Total comprehensive income** | | **31,465,511** | **222,608,815** |

The above statement of comprehensive income should be read in conjunction with the policies and notes on pages 9 - 24.

**Petroleum Fund of Timor-Leste**
**Balance Sheet**
**As at 31 December 2009**

| | *Note* | *Dec-09 USD* | *Dec-08 USD* |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 8 | 3,161,653 | 634,535 |
| Interest receivable | 5 | 32,243,875 | 22,405,960 |
| Investments at fair value through profit or loss | 6,10 | 5,341,220,031 | 4,173,931,238 |
| **Total assets** | | **5,376,625,559** | **4,196,971,733** |
| **Net Assets** | | **5,376,625,559** | **4,196,971,733** |
| **Capital** | | | |
| Capital | | 5,376,625,559 | 4,196,971,733 |
| **Total Capital** | | **5,376,625,559** | **4,196,971,733** |

The above balance sheet should be read in conjunction with the policies and notes on pages 9 - 24.

**Petroleum Fund of Timor-Leste**
**Statement of Changes in Capital**
**For the Year Ended 31 December 2009**

| | *Note* | *Dec-09 USD* | *Dec-08 USD* |
|---|---|---|---|
| **Capital at the beginning of the year** | | **4,196,971,733** | **2,086,157,085** |
| Transfers to the Petroleum Fund pursuant to Article 6 of the Petroleum Fund Law | | | |
| Petroleum Fund gross receipts | 7 | 1,660,299,285 | 2,284,231,607 |
| | | **5,857,271,018** | **4,370,388,692** |
| Transfers to the Consolidated Fund *(pursuant to Article 7 of the Petroleum Fund Law)* | 7 | (512,000,000) | (396,000,000) |
| Refunds of taxation *(pursuant to Article 10 of the Petroleum Fund Law)* | | (110,970) | (25,774) |
| Total comprehensive income | | 31,465,511 | 222,608,815 |
| **Capital at the end of the year** | | **5,376,625,559** | **4,196,971,733** |

The above statement of changes to capital should be read in conjunction with the policies and notes on pages 9 - 24.

## Petroleum Fund of Timor-Leste
## Statement of cash flows
## For the Year Ended 31 December 2009

| | Note | Dec-09 USD | Dec-08 USD |
|---|---|---|---|
| **Cash flows from funding activities** | | | |
| Petroleum Fund receipts | 7 | 1,660,299,285 | 2,284,231,607 |
| Transfers to the Consolidated Fund | 7 | (512,000,000) | (396,000,000) |
| Refunds of taxation | | (110,970) | (25,774) |
| **Net cash inflow/(outflow) from funding activities** | | **1,148,188,315** | **1,888,205,833** |
| **Cash flows from investing activities** | | | |
| Proceeds from sale of investments | 6 | 4,266,587,757 | 2,722,472,230 |
| Purchases of investments | 6 | (5,577,112,377) | (4,713,933,757) |
| **Net cash inflow/(outflow) from investing activities** | | **(1,310,524,620)** | **(1,991,461,527)** |
| **Cash flows from operating activities** | | | |
| Interest received | | 167,294,658 | 104,296,681 |
| Operating expenses paid | | (2,611,703) | (1,053,088) |
| Other operating income received | | 24,806 | - |
| **Net cash inflow/(outflow) from operating activities** | 18 | **164,707,761** | **103,243,593** |
| **Net increase/(decrease) in cash and cash equivalents** | | **2,371,456** | **(12,101)** |
| Cash and cash equivalents at the beginning of the year | | 634,535 | 646,636 |
| Effects of foreign currency exchange rate changes on cash and cash equivalents | | 155,662 | - |
| **Cash and cash equivalents at the end of the year** | 8 | **3,161,653** | **634,535** |

The above statement is to be read in conjunction with the policies and notes on pages 9 - 24.

## Contents



## 1. General Information

The Petroleum Fund of Timor-Leste (the "Petroleum Fund") was established under the provisions of the Petroleum Fund Law No. 9/2005 of the Democratic Republic of Timor-Leste enacted on 3 August 2005.

Pursuant to Article 139 of the Constitution of the Republic, petroleum resources are owned by the State and are to be used in a fair and equitable manner in accordance with national interests, with the income derived there from leading to the establishment of mandatory financial reserves. The Petroleum Fund is a means of contributing to the wise management of petroleum resources for the benefit of both current and future generations, and a tool that contributes to sound fiscal policy where appropriate consideration and weight is given to the long-term interests of Timor-Leste's citizens. The Petroleum Fund is integrated into the State budget.

The Banking and Payments Authority of Timor-Leste (BPA), having its office at Avenida Bispo Medeiros, Dili, Timor-Leste, is responsible for the operational management of the Petroleum Fund, and is the registered owner of all the assets of the Petroleum Fund. The management of the Petroleum Fund is undertaken according to a Management Agreement between the Ministry of Finance and the BPA.

The financial results and balances reported in these financial statements are not rounded.

These financial statements were authorized for issue by the Director of Treasury on 30 June 2010.

## 2. Adoption of new and revised International Financial Reporting Standards (IFRSs)

### 2.1 Standards and Interpretations affecting amounts reported in the current period

The following new and revised Standards and Interpretations have been adopted in the current period and have affected the amounts reported in these financial statements. Details of other Standards and Interpretations adopted in these financial statements but that have had no effect on the amounts reported are set out in section 2.2.

**Standards affecting presentation and disclosure**

| | |
|---|---|
| IAS 1 (as revised 2007) Presentation of Financial Statements | IAS 1(2007) has introduced terminology changes (including revised titles for the financial and changes in the format and content of the financial statements). |
| Improving Disclosures about Financial Instruments (Amendments to IFRS 7 Financial Instruments: Disclosures) | The amendments to IFRS 7 expand the disclosures required in respect of fair value measurements and liquidity risk. |

### 2.2 Standards and Interpretations adopted with no effect on the financial statements

The following new and revised Standards and Interpretations have also been adopted in these financial statements. Their adoption has not had any significant impact on the amounts reported in these financial statements but may affect the accounting for future transactions or arrangements.

**Amendments resulting from May 2008 Annual Improvements to IFRSs**

| | |
|---|---|
| Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate | The amendments deal with the measurement of the cost of investments in subsidiaries, jointly controlled entities and associates when adopting IFRSs for the first time and with the recognition of dividend income from subsidiaries in a parent's separate financial statements. |
| Amendments to IFRS 2 Share-based Payment – Vesting Conditions and Cancellations | The amendments clarify the definition of vesting conditions for the purposes of IFRS 2, introduce the concept of 'non-vesting' conditions, and clarify the accounting treatment for cancellations. Amendments to this standard have no material impact to the financial statements. |
| Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations (adopted in advance of effective date of 1 January 2010) | The amendments require disclosures in these financial statements to be modified to reflect the International Accounting Standards Board's clarification (as part of Improvements to IFRSs (2009)) that the disclosure requirements in Standards other than IFRS 5 do not generally apply to non-current assets classified as held for sale and discontinued operations. Amendments to this standard have no material impact to the financial statements. |
| IFRS 8 Operating Segments | IFRS 8 is a disclosure Standard that redesignates the reportable segments. No material impact on the financial statements |
| Amendments to IAS 20 Accounting for Government Grants and Disclosure of Government Assistance | As part of Improvements to IFRSs (2008), IAS 20 requires has been amended to require that the benefit of a government loan at a below-market rate of interest be treated as a government grant. This accounting treatment was not permitted prior to these amendments. Amendments to this standard have no material impact to the financial statements. |
| IAS 23 (as revised in 2007) Borrowing Costs | The principal change to the Standard was to eliminate the option to expense all borrowing costs when incurred. Amendments to this standard have no material impact to the financial statements. |
| Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation | The revisions to IAS 32 amend the criteria for debt/equity classification by permitting certain puttable financial instruments and instruments (or components of instruments) that impose on an entity an obligation to deliver to another party a pro-rata share of the net assets of the entity only on liquidation, to be classified as equity, subject to specified criteria being met. |
| Amendments to IAS 38 Intangible Assets | As part of Improvements to IFRSs (2008), IAS 38 has been amended to state that an entity is permitted to recognise a prepayment asset for advertising or promotional expenditure only up to the point at which the entity has the right to access the goods purchased or up to the point of receipt of services. Amendments to this standard have no material impact to the financial statements. |
| Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items | The amendments provide clarification on two aspects of hedge accounting: identifying inflation as a hedged risk or portion, and hedging with options. The amendments to IAS 39 permit an entity to reclassify non-derivative financial assets out of the 'fair value through profit or loss' (FVTPL) and 'available-for-sale' (AFS) categories in very limited circumstances. Such reclassifications are permitted from 1 July 2008. Reclassifications of financial assets made in periods beginning on or after 1 November 2008 take effect only from the date when the reclassification is made. Amendments to this standard have no material impact to the financial statements<br><br>. |

| | |
|---|---|
| Embedded Derivatives (Amendments to IFRIC 9 and IAS 39) | The amendments clarify the accounting for embedded derivatives in the case of a reclassification of a financial asset out of the 'fair value through profit or loss' category as permitted by the October 2008 amendments to IAS 39 Financial Instruments: Recognition and Measurement (see above) |
| IFRIC 13 Customer Loyalty Programmes | The adoption of IFRIC 13 has no material impact to the financial statements. |
| IFRIC 15 Agreements for the Construction of Real Estate | The Interpretation addresses how entities should determine whether an agreement for the construction of real estate is within the scope of IAS 11 Construction Contracts or IAS 18 Revenue and when revenue from the construction of real estate should be recognised. The requirements have no material impact to the financial statements. |
| IFRIC 16 Hedges of a Net Investment in a Foreign Operation | The Interpretation provides guidance on the detailed requirements for net investment hedging for certain hedge accounting designations. |
| Improvements to IFRSs (2008) | In addition to the changes affecting amounts reported in the financial statements described at 2.1 above, the Improvements have led to a number of changes in the detail of the Group's accounting policies – some of which are changes in terminology only, and some of which are substantive but have had no material effect on amounts reported. The majority of these amendments were effective from 1 January 2009. |

**2.3 Standards and Interpretations in issue not yet adopted**

Management has not yet had an opportunity to consider the potential impact of the adoption of standards and interpretations in issue but not yet effective.

Management of the Fund anticipates that these amendments will be adopted in the Fund's financial statements as outlined below:

| **Standard/Interpretation** | **Effective Date (Periods beginning on or after)** | **Expected to be initially applied in the financial year ending** |
|---|---|---|
| Improvements to IFRS (2008) | 1 July 2009 | 1 January 2010 |
| Improvements to IFRSs (2009) | July 2009, January and July 2010 | I January 2010 and 1 January 2011 |
| IFRS 2: Share based payments— Amendments relating to group cash-settled share-based payment transactions | 1 January 2010 | 1 January 2010 |
| IFRS 3: (as revised in 2008) Business Combinations and consequential adjustments on other standards | 1 July 2009 | 1 January 2010 |
| IFRS 9: Financial Instruments — Classification and Measurement | 1 January 2013 | 1 January 2013 |
| Amendments to IAS 7 Statement of Cash Flows (adopted in advance of effective date of 1 January 2010) | 1 January 2010 | 1 January 2010 |
| IAS 24 Related Party Disclosures – Revised Definition of Related Parties | 1 January 2011 | 1 January 2011 |
| IAS 39 Amendments for embedded derivatives when reclassifying financial instruments and eligible hedged items | 1 July 2009 | 1 January 2010 |
| IAS 32: Amendments relating to classification of rights issues | 1 February 2010 | 1 January 2011 |
| IFRIC 17 Distributions of Non-cash Assets to Owners (adopted in advance of effective date of 1 July 2009) | 1 July 2009 | 1 January 2010 |
| IFRIC 18 Transfers of Assets from Customers (adopted for transfers of assets from customers received on or after 1 July 2009) | 1 July 2009 | 1 January 2010 |
| IFRIC 19 Extinguishing Financial Liabilities with equity Instruments | 1 July 2010 | 1 January 2011 |

## 3. Significant Accounting Policies

**Statement of Compliance**

In accordance with Article 21 of the Petroleum Fund Law, the financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) which comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee (IASC) that remain in effect at the Petroleum Fund's balance date.

**Basis of Preparation**

The financial statements are presented in United States dollars. They are prepared on the historical cost basis, except for the revaluation of certain financial instruments.

The preparation of financial statements in conformity with international accounting standards requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expense. The estimates and associated assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values and assets and liabilities that are not readily apparent from other sources. Actual results may vary from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision, and future periods if the revision affects both current and future periods.

Judgments made by management in the application of international accounting standards that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 11.

The accounting policies have been consistently applied by the Petroleum Fund. The Petroleum Fund has adopted the IFRSs that were effective at balance date.

The Petroleum Fund is not required to report segment information.

The balance sheet presents assets and liabilities in increasing order of liquidity and does not distinguish between current and non current items.

The principal accounting policies are set out below.

**(a) Foreign currency translation**

*(i) Functional and presentation currency*

Items included in the Petroleum Fund's financial statements are measured and presented in United States dollars, being the official currency of the Democratic Republic of Timor-Leste.

*(ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of comprehensive change.

**(b) Financial instruments**

*(i) Classification*

*Investments*

The manner in which the Petroleum Fund is managed is set out in Annex 1 to the Management Agreement between the Banking & Payments Authority and the Minister of Finance, which establishes the performance benchmark for the Fund.

The investment portfolio of the Petroleum Fund, being managed and having its performance measured and reported in accordance with documented risk management and investment strategies, has accordingly been designated at fair value through profit or loss for accounting purposes.

*Interest and other receivables*

Financial assets that are classified as receivables include cash balances due from financial intermediaries from the sale of securities, receivables from reverse repurchase agreements with a maturity of more than one business day, and accounts receivable.

Financial liabilities that are not at fair value through profit and loss include balances payable to financial intermediaries for the purchase of securities, and accounts payable.

*(ii) Recognition and de-recognition*

*Investments*

The Petroleum Fund recognizes financial assets and financial liabilities on its balance sheet from the date the Petroleum Fund becomes a party to the contractual provisions of the instrument. The Petroleum Fund offsets financial assets and financial liabilities if the Petroleum Fund has a legally enforceable right to set off the recognized amounts and interests and intends to settle on a net basis.

Investments are derecognized when the rights to receive cash flows from the investments have expired or the Petroleum Fund has transferred substantially all risks and rewards of the ownership.

Financial liabilities are derecognized when the obligation specified in the contract is discharged or cancelled or expired.

*Interest and other receivables*

Other receivables and payables are recognized on an accruals basis.

*(iii) Measurement*

*Investments*

Financial instruments are measured initially at fair value.

Investments are designated at fair value through profit or loss on initial recognition. As the Petroleum Fund's business is investing in financial assets according to a defined mandate with a view to profiting from their total return in the form of interest or increases in fair value, listed securities and fixed income securities are designated as fair value through profit and loss on initial recognition.

The Petroleum Fund manages and evaluates the performance of these investments on a fair value basis in accordance with its investment mandate, with information about the performance of the investments and their related benchmarks being regularly published.

Financial assets designated as at fair value through profit and loss are measured at subsequent reporting dates at fair value, based on the bid price.

Changes in the fair value of such investments (including impairment losses and foreign exchange gains and losses) are recognized in the Statement of Comprehensive Income until the financial asset is derecognized.

*Interest and other receivables*

Other receivables do not carry interest and are short-term in nature and accordingly are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

*(iv) Impairment*

Financial assets that are stated at cost or amortized cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognized in the Statement of Comprehensive Income as the difference between the asset's carrying amount and the present value estimated future cash flows discounted at the original effective interest rate.

If in a subsequent period the amount of an impairment loss recognized on a financial asset carried at amortized cost decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the Statement of Comprehensive Income.

*(v) Fair value measurement principles*

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs. Financial assets held or a liability to be issued are priced at current bid prices, while financial liabilities held and assets to be acquired are priced at current asking prices.

*(vi) Specific instruments*

*Cash and cash equivalents*

Cash comprises current deposits with banks. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

*Reverse repurchase transactions*

Securities purchased under agreements to resell (reverse repurchase agreements) with a maturity period of greater than one financial day are reported not as purchases of securities, but as receivables and are carried in the balance sheet at amortized cost.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements is recognized as interest income or interest expense over the life of each agreement using the effective interest method.

*(vii) Encumbrances on the assets of the Petroleum Fund*

The Petroleum Fund is not permitted to encumber its assets. In accordance with Article 20 of the Petroleum Fund law any contract, agreement, or arrangement, to the extent that it purports to encumber the assets of the Petroleum Fund, whether by way of guarantee, security, mortgage or any other form of encumbrance, is null and void.

**(c) Recognition of Petroleum Fund Receipts**

The Petroleum Fund Law requires certain parties to deposit taxes and other petroleum related payments payable to the Government of Timor-Leste directly into the Petroleum Fund. The Petroleum Fund recognizes these and other transactions as follows:

- Payments made as Petroleum Fund receipts in accordance with Article 6.1(a) are credited directly to the capital account of the Petroleum Fund.
- Payments made by the Designated Authority in accordance with Article 6.1(b) are credited directly to the capital account of the Petroleum Fund.
- Income earned by the Petroleum Fund from the investment of its assets is recognized in the Statement of Comprehensive Income in accordance with Article 6.1(c).
- Management fees paid from the gross receipts of the Petroleum Fund pursuant to Article 6.2 are recognized in the Statement of Comprehensive Income.
- Refunds of taxation made pursuant to Article 10 are shown as reductions in the capital of the Petroleum Fund.

**(d) Interest income**

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's carrying amount.

**(e) Expenses**

In accordance with the provisions of the Petroleum Fund Law, all expenses of the Petroleum Fund, not relating to the purchase or sale of securities and recognized in the sale or purchase price, are met by the Banking and Payments Authority of Timor-Leste and are covered by a management fee.

In accordance with Article 6.3 of the Petroleum Fund Law, the management fee paid to the Banking and Payments Authority is recognized as a deduction from the gross receipts of the Petroleum Fund, although it is accounted in the Statement of Comprehensive Income of the Petroleum Fund. Management and performance fees payable to external fund managers are met from the management fee payable to the Banking and Payments Authority.

Expenses which are incidental to the acquisition of an investment are included in the cost of that investment.

Expenses that are incidental to the disposal of an investment are deducted from the disposal proceeds of the investment.

**(f) Taxation**

The Petroleum Fund is exempt from paying taxes on income, profits or capital gains under the current system of taxation in the Democratic Republic of Timor-Leste.

Income of the Petroleum Fund earned in foreign jurisdictions is subject to the (withholding) taxes levied in those jurisdictions. Where the income is recoverable, it is recorded as an account receivable. Where the income is not recoverable, the irrecoverable tax is recognized in profit and loss.

## 4. Interest Income

Interest was earned during the year from the following sources:

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | ***USD*** | ***USD*** |
| Fixed interest debt securities | 177,105,772 | 115,607,189 |
| Cash and cash equivalents | 26,801 | 362,152 |
| | **177,132,573** | **115,969,341** |

## 5. Interest Receivable

The amount of interest accrued at balance date was as follows:

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | ***USD*** | ***USD*** |
| Fixed interest debt securities | 32,243,875 | 22,405,960 |
| | **32,243,875** | **22,405,960** |

## 6. Financial Assets

Transactions in financial assets, which arise either from the investment of new funds or the periodic rebalancing of the investment portfolio, are summarised as follows:

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | ***USD*** | ***USD*** |
| **Fair value through profit or loss assets** | | |
| **Opening fair value** | **4,173,931,238** | **2,074,777,149** |
| Purchases at cost | 5,577,112,377 | 4,713,933,757 |
| Proceeds from sales | (4,266,587,757) | (2,722,472,230) |
| Net gain or (loss) | (143,235,827) | 107,692,562 |
| **Fair value of investment assets at the end of the year** | **5,341,220,031** | **4,173,931,238** |

There were no impairment losses at balance date.

The carrying amount of these assets approximates their fair value.

## 7. Capital Receipts and Payments of the Petroleum Fund

As per Article 7 of the Petroleum Fund Law, the only debits permitted to the Petroleum Fund are electronic transfers to the credit of a single State Budget account. The total amount transferred from the Petroleum Fund for a Fiscal Year must not exceed the appropriated amount approved by Parliament for the year.

During the year ended 31 December 2009 a total of US$589,000,000 (31 December 2008 - US$396,100,000) was approved for appropriation by parliament from the Petroleum Fund. A total of US$512,000,000 (31 December 2008 - US$396,000,000) was transferred from the Petroleum Fund to the State Budget account during the year.

During the year ended 31 December 2009 a total of US$661,345,525 (31 December 2008 - US$895,822,882) was received in Article 6.1(a) receipts. A total of US993,712,960 (31 December 2008 - US$1,388,408,724) was received in Article 6.1(b) receipts. A total of US$5,240,800 (31 December 2008 – US$ Nil) was received in Article 6.1(e) receipts.

The following table shows the capital receipts and payments of the Petroleum Fund.

| | | | | *Dec-09* | | |
|---|---|---|---|---|---|---|
| | | | | *USD* | | |
| **Month** | **Article 6.1(a) receipts** | **Article 6.1(b) receipts** | **Article 6.1(e) Other receipts** | **To Consolidated Fund** | **Refunds of taxation** | **TOTAL** |
| January 2009 | 131,553,337 | 84,833,293 | - | - | - | 216,386,630 |
| February | 39,847,973 | 64,685,585 | 5,240,800 | - | - | 109,774,358 |
| March | 56,239,632 | 167,594,780 | - | - | (110,970) | 223,723,442 |
| April | 45,746,229 | 87,667,325 | - | (100,000,000) | - | 33,413,554 |
| May | 22,654,288 | 89,688,208 | - | (50,000,000) | - | 62,342,496 |
| June | 48,508,498 | 89,715,643 | - | (50,000,000) | - | 88,224,141 |
| July | 49,909,949 | 33,902,610 | - | - | - | 83,812,559 |
| August | 39,606,280 | 68,623,221 | - | - | - | 108,229,501 |
| September | 71,979,762 | 68,275,135 | - | - | - | 140,254,897 |
| October | 54,566,108 | 70,400,531 | - | (60,000,000) | - | 64,966,639 |
| November | 52,239,051 | 81,228,790 | - | (100,000,000) | - | 33,467,841 |
| December | 48,494,418 | 87,097,839 | - | (152,000,000) | - | (16,407,743) |
| **Totals** | **661,345,525** | **993,712,960** | **5,240,800** | **(512,000,000)** | **(110,970)** | **1,148,188,315** |

| | | | | *Dec-08* | | |
|---|---|---|---|---|---|---|
| | | | | *USD* | | |
| **Month** | **Article 6.1(a) receipts** | **Article 6.1(b) receipts** | **Article 6.1(e) Other receipts** | **To Consolidated Fund** | **Refunds of taxation** | **TOTAL** |
| January 2008 | 66,268,241 | 9,896,825 | - | - | - | 76,165,066 |
| February | 70,341,211 | 82,793,739 | - | - | - | 153,134,950 |
| March | 85,126,474 | 165,319,180 | - | - | - | 250,445,654 |
| April | 88,942,387 | 109,117,746 | - | - | - | 198,060,133 |
| May | 64,975,502 | 124,809,268 | - | - | - | 189,784,770 |
| June | 79,550,769 | 131,413,035 | - | - | - | 210,963,804 |
| July | 95,598,715 | 86,969,071 | - | (60,000,000) | - | 122,567,786 |
| August | 86,880,451 | 130,544,828 | - | (40,000,000) | - | 177,425,279 |
| September | 74,354,399 | 145,522,331 | - | (40,000,000) | - | 179,876,730 |
| October | 76,617,217 | 167,754,062 | - | (80,000,000) | (25,774) | 164,345,505 |
| November | 54,030,310 | 123,744,891 | - | (80,000,000) | - | 97,775,201 |
| December | 53,137,207 | 110,523,748 | - | (96,000,000) | - | 67,660,955 |
| **Totals** | **895,822,883** | **1,388,408,724** | **-** | **(396,000,000)** | **(25,774)** | **1,888,205,833** |

## 8. Cash and Cash Equivalents

The Petroleum Fund invests surplus cash in overnight markets with banks or through reverse repurchase agreements. For the purposes of the Statement of cash flows, cash and cash equivalents comprise the following balances with original maturity of less than 90 days:

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | *USD* | *USD* |
| Cash at bank | 2,561,653 | 234,535 |
| Overnight reverse repurchase agreements | 600,000 | 400,000 |
| | **3,161,653** | **634,535** |

The cash at bank includes the balance at the Federal Reserve Bank of New York, in the earmarked receipts account held by the BPA in accordance with Article 5.2 of the Petroleum Fund law.

The carrying amounts of cash and cash equivalents approximates their fair value.

## 9. Related Party Transactions

The ultimate controlling party of the Petroleum Fund is the Democratic Republic of Timor-Leste.

The following are related parties:

(a) The government, as stipulated in Article 11.1 of the Petroleum Fund Law, is the overall manager of the Petroleum Fund.

The Petroleum Fund receives receipts on behalf of the government, as disclosed in note 3(c). The government, though the State budget, meets the expenses of the Petroleum Fund, including the audit fee, not otherwise covered by the management fee.

(b) The Banking and Payments Authority of Timor-Leste is the operational manager of the Petroleum Fund, in accordance with Article 11.3 of the Petroleum Fund Law.

The management fee covers the operational management of the Petroleum Fund which is undertaken by the Banking & Payments Authority of Timor-Leste (BPA), in accordance with the provisions of Article 11.3 of the Petroleum Fund Law. The audit fee, expenses of the Investment Advisory Board, and expenses incurred within the Ministry of Finance relating to the overall management of the Petroleum Fund are met directly from the State budget. The management fee paid to the BPA for the period was composed as follows:

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | *USD* | *USD* |
| BPA operating expenses | 1,354,000 | 907,210 |
| Custody and external management services | 1,257,703 | 145,878 |
| **Total** | **2,611,703** | **1,053,088** |

## 10. Financial Assets Valued through Profit & Loss

Fair value of financial assets excludes accrued interest.

| | | | *Dec-09* | |
|---|---|---|---|---|
| | | | *USD* | |
| | **Currency** | **Face Value Units** | **Fair Value** | **% of net assets** |
| US treasury notes | USD | 4,714,388,800 | 4,873,458,634 | 91.2 |
| Australian government bonds | AUD | 83,795,000 | 76,737,157 | 1.4 |
| Japan government bonds | JPY | 1,896,900,000 | 20,708,716 | 0.4 |
| UK government bonds | UK | 9,345,597 | 15,648,269 | 0.3 |
| Other European government bonds | EURO | 51,623,531 | 74,474,638 | 1.4 |
| UK other public sector bonds | UK | 2,939,929 | 5,037,475 | 0.1 |
| Canadian other public sector bonds | USD | 2,950,000 | 3,078,664 | 0.1 |
| US non sovereign bonds | USD | 268,616,000 | 272,076,478 | 5.1 |
| **Total** | | **7,030,558,857** | **5,341,220,031** | **100.0** |

| | | *Dec-08* | |
|---|---|---|---|
| | ***USD*** | ***USD*** | |
| | **Face Value** | **Fair Value** | **% of net assets** |
| US treasury notes | 3,940,200,000 | 4,173,931,238 | 100.0 |
| **Total** | **3,940,200,000** | **4,173,931,238** | **100.0** |

Fair Value Hierarchy of Qualifying Instruments

As at 31 December 2009 and 31 December 2008 all of the Petroleum Fund's financial instruments were classified under the level 1 category - valued using quoted prices in active markets or identical assets**.** The valuation techniques used by the Petroleum Fund are explained in the financial instruments accounting policies note per Note 3**.**

Schedule of Investments held as at 31 December 2009:

| | | ***USD*** |
|---|---|---|
| | **Currency** | **Fair Value** |
| ASIA 1.375% 02MAY12 | USD | 29,931,000 |
| EIB 1.75% 14SEP12 | USD | 49,836,400 |
| EIB 2.625% 16MAY11 | USD | 2,006,515 |
| EIB 4.625% 20OCT15 | USD | 3,216,467 |
| EIB 4.875% 15FEB36 | USD | 1,836,985 |
| EIB 5.125% 30MAY17 | USD | 9,646,069 |
| IBRD 7.625% JAN23 | USD | 2,475,048 |
| KFW 2.00% 17JAN12 | USD | 63,686,424 |
| KFW 3.125% 15NOV10 | USD | 5,825,332 |
| KFW 4.125% 15OCT14 | USD | 22,113,714 |
| NIBCAP 2.80% 02DEC14 | USD | 24,540,000 |
| Q 4.625% 14MAY18 | USD | 1,009,058 |
| SFEFR 1.50% 29OCT10 | USD | 21,801,556 |
| SFEFR 3.375% 05MAY14 | USD | 34,151,910 |
| ACGB 5.25% 15AUG10 | AUD | 3,478,224 |
| ACGB 5.25% 15MAR19 | AUD | 8,565,559 |
| ACGB 5.75% 15APR12 | AUD | 19,870,293 |
| ACGB 5.75% 15MAY21 | AUD | 12,389,696 |
| ACGB 6.00% 15FEB17 | AUD | 12,685,062 |
| ACGB 6.50% 15MAY13 | AUD | 19,748,323 |
| BKO 1.25% 11MAR11 | EUR | 14,130,636 |
| BPTS 4.50% 01MAR19 | EUR | 1,477,539 |
| BTN 2.50% 12JUL10 | EUR | 1,421,970 |
| BTNS 1.50% 12SEP11 | EUR | 2,826,594 |
| BTPS 3.00% 01MAR12 | EUR | 1,440,910 |
| BTPS 4.00% 01FEB17 | EUR | 1,459,696 |
| BTPS 4.50% 01FEB20 | EUR | 5,814,485 |
| DBR 3.50% 04JUL19 | EUR | 4,076,153 |
| FRTR 4.00% 25OCT38 | EUR | 4,062,594 |
| FRTR 4.25% 25OCT23 | EUR | 8,665,557 |
| ITALY 5.25% 01NOV29 | EUR | 1,508,294 |
| ITALY 5.375% 15JUN33 | USD | 2,877,483 |
| JGB 0.40% 15APR11 | JPY | 261,877 |
| JGB 0.40% 15MAR11 | JPY | 5,375,505 |
| JGB 0.70% 20MAR13 | JPY | 2,074,996 |

| | | |
|---|---|---|
| JGB 0.80% 20DEC13 | JPY | 3,730,126 |
| JGB 1.20% 20JUN15 | JPY | 314,287 |
| JGB 1.40% 20MAR18 | JPY | 6,237,260 |
| JGB 2.10% 20MAR29 | JPY | 1,725,890 |
| JGB 2.30% 20JUN35 | JPY | 988,775 |
| NETHER 3.25% 15JUL15 | EUR | 5,764,507 |
| NETHER 4.00% 15JAN37 | EUR | 14,656,286 |
| QUEBEC 7.5% 15SEP29 | USD | 12,203,560 |
| SPGB 2.75% 30APR12 | EUR | 7,169,416 |
| UKT 2.25% 07MAR14 | GBP | 1,556,694 |
| UKT 3.25% 07DEC11 | GBP | 1,642,633 |
| UKT 4.00% 07SEP16 | GBP | 4,137,236 |
| UKT 4.50% 07MAR13 | GBP | 1,695,073 |
| UKT 4.75% 07DEC38 | GBP | 5,004,829 |
| UKT 4.75% 07JUN10 | GBP | 1,611,804 |
| US T-NOTE 15DEC10 | USD | 1,243,922 |
| US T-NOTE 15MAY16 | USD | 17,560,587 |
| US T-NOTE 4.25 NOV14 | USD | 56,444,651 |
| US TN 0.875% 30APR11 | USD | 102,391,796 |
| US TN 1.125% 15JAN12 | USD | 29,971,860 |
| US TN 1.375% 15FEB12 | USD | 2,808,095 |
| US TN 1.75% 15NOV11 | USD | 42,953,188 |
| US TN 1.875% 30APR14 | USD | 380,027,764 |
| US TN 1.875% 30APR14 | USD | 79,145,679 |
| US TN 2.125% 31JAN10 | USD | 39,154,497 |
| US TN 2.375% 31OCT14 | USD | 294,664,806 |
| US TN 2.625% 31JUL14 | USD | 13,567,500 |
| US TN 2.75% 31OCT13 | USD | 320,248,891 |
| US TN 2.75% 31OCT13 | USD | 96,359,174 |
| US TN 2.875% 15FEB19 | USD | 20,253,750 |
| US TN 3.125% 30APR13 | USD | 232,859,063 |
| US TN 3.125% 31OCT16 | USD | 9,874,220 |
| US TN 3.25% 30JUN16 | USD | 2,707,806 |
| US TN 3.875% 15MAY10 | USD | 567,198,861 |
| US TN 3.875% 15MAY18 | USD | 5,027,201 |
| US TN 3.875% 31OCT12 | USD | 462,760,564 |
| US TN 4.50% 15NOV10 | USD | 442,379,138 |
| US TN 4.50% 30APR12 | USD | 473,764,967 |
| US TN 4.625% 31OCT11 | USD | 597,292,875 |
| US TN 4.75% 15AUG17 | USD | 9,765,702 |
| US TN 4.875% 30APR11 | USD | 490,196,977 |
| US TN 7.25% MAY16 | USD | 7,308,508 |
| US TN 1.00% 31OCT11 | USD | 60,445,550 |
| ONT 4.10% 16JUN14 | USD | 3,078,664 |
| UK TREAS 5.0% MAR25 | GBP | 5,037,475 |
| **Total** | | **5,341,220,031** |

## 11. Critical Accounting Estimates and Judgments

The Petroleum Fund makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates are continually evaluated and based on historical experience and other factors, including expectations of the future events that are believed to be reasonable under the circumstances.

Estimates use observable data to the extent practicable. However, areas such as credit risk, volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Judgments have been made as to whether certain transactions should be recognised as capital or revenue. The basis for these judgments is outlined in Note 3(c).

## 12. Risk Management

**Investment Strategy**

The Petroleum Fund's objective is to meet benchmark returns on its capital in accordance with the management agreement and within the limits established in Articles 14 and 15 of the Petroleum Fund Law relating to Investment Rules and Qualifying Instruments.

The Rules provide that not less than 90% of the amounts in the Petroleum Fund shall be invested only in the qualifying instruments and the balance may be invested in other financial instruments that are issued abroad, are liquid & transparent, and are traded in a financial market of the highest regulatory standard.

The Rules further provide that a qualifying instrument is:

(a) an interest bearing debt instrument in US dollars which is rated Aa3 or higher by Moody rating agency or AA- or higher by Standard & Poor's rating agency, or is issued by or guaranteed by World Bank or a sovereign state (other than Timor-Leste) provided the issuer or guarantor is rated as above; or

(b) interest bearing US dollar denominated debt instrument or US dollar deposit issued by Bank for International Settlements, or European Central Bank, or central bank of a sovereign state (other than Timor-Leste) or any other bank with a long term currency ratings as above.

(c) A derivative instrument which is solely based on (a) or (b) above provided its acquisition reduces the financial exposure to the risks associated with the underlying instruments

Furthermore, the average interest rate duration of the qualifying instruments shall be less than 6 years.

Up to 10% of the amounts in the Petroleum Fund may be invested in other financial instruments, provided that they are issued abroad, liquid and transparent, and traded in a market of the highest regulatory standard.

These Articles in the law, together with the mandate in the Operational Management Agreement, define the framework within which risks are to be managed.

The interest rate duration (modified duration) of the benchmark and the portfolio at 31 December 2009 and 31 December 2008 was 2.53 years and 2.047 years respectively.

The Petroleum Fund did not enter into any transactions of a derivative nature during the period covered by these financial statements, whether for hedging purposes or otherwise.

The Petroleum Fund investment portfolio of assets at fair value through profit or loss (excluding cash and cash equivalents) complied with the legislative and contractual requirements outlined above throughout the period.

The financial risks associated with the Petroleum Fund are monitored by the Risk Management Division of the Petroleum Fund Department at the Banking and Payments Authority, which prepares daily reports for senior management. The Petroleum Fund is subject to periodic audit by the Internal Audit Office of the Banking and Payments Authority, which has operational independence from the management of the Petroleum Fund. The Internal Audit Office provides formal monthly reports to the General Manager, and quarterly reports to the Governing Board of the Banking and Payments Authority.

## 13. Operational Risk

Operational risk is the risk of loss in both financial and non-financial terms resulting from human error and the failure of internal processes and systems.

The Banking and Payments Authority, as the operational manager of the Petroleum Fund, manages the operational risks associated with the operations of the Petroleum Fund. Operational risk management includes corporate policies that describe the standard of conduct required of staff, and specific internal control systems designed around the particular characteristics of the Petroleum Fund.

Compliance with corporate policies and departmental internal control systems are managed by an active internal audit function, and specific provision in the daily reports prepared by the Risk Management Division for the reporting of all issues that arise in connection with operational matters. The purpose of this section of the reports is to notify senior management promptly of unexpected operational issues, and provide them with the opportunity to provide advice or take remedial action.

J.P. Morgan was appointed custodian of the Fund on June 2008. As part of the custodial agreement their responsibilities include holding the Funds assets. The Fund relies on the due diligence of the custodian upon appointment. Operational risks arising from this arrangement is managed through the continual monitoring of the custodian against key service level standards including receiving audited internal control reports and existence reports over the assets held.

## 14. Credit Risk

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

**(a) Credit risk management**

As described under Note 12, "Investment Strategy", the framework for managing credit risk is broadly provided for in Articles 14 and 15 of the Petroleum Fund law, which state that 90% of the portfolio must be invested in interest-bearing debt instruments in US dollars which are rated Aa3 or higher by Moody rating agency, or AA- or higher by Standard & Poor's rating agency, or are issued or guaranteed by the World Bank or a sovereign state (other than Timor-Leste) provided the issuer or guarantor is rated as above. Up to 10% of the portfolio may be invested in other financial instruments that are issued abroad, liquid and transparent, and traded in a financial market of the highest regulatory standard.

The mandate in the Operational Management Agreement prescribes that the performance of the Petroleum Fund shall be measured against a benchmark index, restricts the permissible investment universe to highly rated financial instruments, and establishes tracking error limits restricting the permissible deviation of the portfolio investments from the benchmark. The loss that the Petroleum Fund would suffer from the default of a single issuer is the amount disclosed below with respect to investments in Treasury Notes issued by the United States Government.

**(b) Concentration of Credit Exposure**

The Petroleum Fund's significant end-of-year concentrations of credit exposure by the industry of the issuer were as follows:

| | ***Dec-09*** | ***Dec-08*** |
|---|---|---|
| | ***USD*** | ***USD*** |
| **Sovereign Issuers:** | | |
| United States Government | 4,905,943,536 | 4,196,971,733 |
| Australia Government | 78,845,893 | - |
| Japan Government | 20,845,955 | - |
| United Kingdom Government | 21,161,596 | - |
| European Governments | 76,119,563 | - |
| **Non Sovereign Issuers:** | | |
| United States denominated non sovereign bonds | 273,709,016 | - |
| | **5,376,625,559** | **4,196,971,733** |

**c) Credit Exposure by Credit Rating**

The following table presents an analysis of the Petroleum Fund's debt securities classified according to the Standard and Poor, and Fitch's credit rating of the issuer. AAA is the highest rating possible and indicates that 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 to pay interest and principal. BBB is the lowest investment grade rating, indicating a medium capacity to pay interest and principal. Ratings lower than AAA can be modified by + or – signs to indicate relative standing within the major categories.

| | ***Dec-09*** | ***Dec-08*** |
|---|---|---|
| | ***USD*** | ***USD*** |
| **International Fixed Interest Securities** | | |
| AAA | 5,282,472,209 | 4,173,931,238 |
| AA+ | 7,169,417 | - |
| AA | 20,708,716 | - |
| AA- | 3,078,664 | - |
| A+ | 27,791,025 | - |
| **Total** | **5,341,220,031** | **4,173,931,238** |

**(d) Credit Exposure by Counterparty as a percentage of the Petroleum Fund's Capital**

The assets of the Fund exposed to the United States Government amounted to 91.25% (2008: 100%) of the Petroleum Fund's capital.

## 15. Interest Rate Risk

Interest rate risk is the risk of loss arising from a change in interest rates.

The Petroleum Fund manages this risk by investing according to well-defined industry benchmarks with specified duration target. The assets and liabilities of the Petroleum Fund will re-price within the following periods:

| | | | ***Dec-09*** | | | |
|---|---|---|---|---|---|---|
| | | | ***USD*** | | | |
| **FINANCIAL ASSETS** | **Balance Sheet** | **No-interest sensitive** | **6 months or less** | **6 to 12 months** | **1 to 2 years** | **2 to 5 years** |
| Cash and cash equivalents | 3,161,653 | - | 3,161,653 | - | - | - |
| Interest receivable | 32,243,875 | 32,243,875 | - | - | - | - |
| Investments at fair value through profit or loss | 5,341,220,031 | - | 607,965,162 | 476,150,142 | 1,319,524,146 | 2,937,580,581 |
| **Total Assets** | **5,376,625,559** | **32,243,875** | **611,126,815** | **476,150,142** | **1,319,524,146** | **2,937,580,581** |
| **Weighted average interest rate** | | | 3.76% | 4.34% | 4.10% | 3.22% |

| | | | ***Dec-08*** | | | |
|---|---|---|---|---|---|---|
| | | | ***USD*** | | | |
| **FINANCIAL ASSETS** | **Balance Sheet** | **No-interest sensitive** | **6 months or less** | **6 to 12 months** | **1 to 2 years** | **2 to 5 years** |
| Cash and cash equivalents | 634,535 | - | 635,535 | - | - | - |
| Interest receivable | 22,405,960 | 22,405,960 | - | - | - | - |
| Investments at fair value through profit or loss | 4,173,931,238 | - | 653,648,783 | 646,562,305 | 1,114,616,801 | 1,759,103,349 |
| **Total Assets** | **4,196,971,733** | **22,405,960** | **654,284,318** | **646,562,305** | **1,114,616,801** | **1,759,103,349** |
| **Weighted average interest rate** | | | 3.88% | 3.50% | 4.11% | 3.88% |

## 16. Currency Risk

Currency risk is the risk of losses arising from changes in foreign exchange rates.

The Petroleum Fund is required by the Petroleum Fund law to manage this risk by investing at least 90% of the Fund's assets in United States dollar denominated instruments, the United States dollar also being the official currency of Timor-Leste.

The assets of the Petroleum Fund in United States dollars are set out in the following table:

| **31 December 2009** | | | | | | |
|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | **USD** | **EUR** | **AUD** | **GBP** | **JPY** | **Total** |
| Cash and cash equivalents | 1,509,103 | 311,946 | 960,143 | 289,974 | 90,487 | 3,161,653 |
| Interest receivable | 29,529,675 | 1,332,979 | 1,148,592 | 185,878 | 46,751 | 32,243,875 |
| Investments at fair value through profit or loss | 5,148,613,776 | 74,474,638 | 76,737,157 | 20,685,744 | 20,708,716 | 5,341,220,031 |
| **Total Assets** | **5,179,652,554** | **76,119,563** | **78,845,892** | **21,161,596** | **20,845,954** | **5,376,625,559** |

| **31 December 2008** | | | | | | |
|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | **USD** | **EUR** | **AUD** | **GBP** | **JPY** | **Total** |
| Cash and cash equivalents | 634,535 | - | - | - | - | 634,535 |
| Interest receivable | 22,405,960 | - | - | - | - | 22,405,960 |
| Investments at fair value through profit or loss | 4,173,931,238 | - | - | - | - | 4,173,931,238 |
| **Total Assets** | **4,196,971,733** | **-** | **-** | **-** | **-** | **4,196,971,733** |

## 17. Liquidity, Capital and Market Risk

**(a) Liquidity risk**

Liquidity risk is the risk that the Petroleum Fund will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity may result from an inability to sell a financial asset quickly at close to its fair value.

**(b) Capital risk**

The Petroleum Fund is a mandatory financial reserve established with the objective of allocating financial wealth obtained from natural resources fairly and equitably between current and future generations of Timorese. The Fund's capital structure consists solely of paid in capital derived from petroleum receipts and other sources as described in Note 3(c). Each year the Government calculates Estimated Sustainable Income (ESI) which is defined in the Petroleum Fund law as the maximum amount that can be appropriated from the Fund in a fiscal year and leave sufficient resources in the Fund for an amount of equal real value to be appropriated in all later fiscal years. The ESI calculation is submitted with the annual budget to Parliament, which is required to take the ESI into consideration when determining the amount of capital to be appropriated from the Fund.

There has been no change during the year in these objectives and policies for managing capital and the Fund has complied with all legislative requirements relating to the management of the Fund's capital.

**(c) Market risk**

*(i) Interest rate risk*

Market risk is the risk that the Petroleum Fund may encounter high market prices, giving low yields, at the point investments mature and the funds are available for reinvestment.

The Petroleum Fund manages its investment portfolio to a benchmark with the risk limit defined by a maximum tracking error.

The principal tool used to manage and control market risk exposure for the bond portfolio is modified duration. The modified duration is an approximation equal to the percentage change in the value of the underlying bond portfolio for each percentage change in market yield.

The modified duration of the portfolio as at 31 December 2009 was 2.53 years (2008 – 2.047 years). A parallel shift in the yield curve representing a 1% increase/ (decrease) in market interest rates would decrease/ (increase) the fair value of the portfolio by $172 million (2008 – $86 million).

*(ii) Currency risk*

The Petroleum Fund is exposed to the Euro, Australian dollar, Pound sterling and Japanese yen.

The following table details the Petroleum Fund's sensitivity to a 10% increase and decrease in the United States dollar against the relevant foreign currencies. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes cash and cash equivalents, interest receivable and qualifying instruments. A negative number below indicates a decrease in profit where the United States dollar strengthens 10% against the relevant currency. For a 10% weakening of the United States dollar against the relevant currency, there would be a comparable impact on the profit, and the balances below would be a positive.

| | **EUR impact** | | **AUS impact** | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| i. Profit & loss | ($7,611,956) | - | ($7,884,589) | - |

| | **GBP impact** | | **JPY impact** | |
|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** |
| i. Profit & loss | ($2,116,160) | - | ($2,084,595) | - |

i. This is mainly attributable to the exposure outstanding on all relevant foreign currencies relating to cash and cash equivalents, interest receivable and qualifying instruments in the Petroleum Fund at the end of the reporting period.

The Petroleum Fund's sensitivity to foreign currency has increased during the current period because this is the first year that the Petroleum Fund has invested in Qualifying Instruments with currencies other than the United States Dollar.

## 18. Reconciliation of Net Cash Flows with Reported Operating Surplus

| | *Dec-09* | *Dec-08* |
|---|---|---|
| | ***USD*** | ***USD*** |
| **Reported Operating Profit** | **31,465,511** | **222,608,815** |
| **Add/(Subtract) Non-Cash Items** | | |
| Increase in interest receivable | (9,837,915) | (11,672,660) |
| Net unrealised gain/(loss) | 143,080,165 | (107,692,562) |
| **Net Cash Flow from Operating Activities** | **164,707,761** | **103,243,593** |