Bank of South Pacific Limited

Financial Statements

31 December 2020

Contents of Financial Statements

Directors' Report

for the Year Ended 31 December 2020

The Directors take pleasure in presenting the Financial Statements of the Bank of South Pacific Limited and its subsidiaries (Bank and the Group) for the year ended 31 December 2020. In order to comply with the provisions of the Companies Act 1997, the Directors report as follows:

Principal activities

The principal activity of the Bank of South Pacific Limited (BSP) is the provision of commercial banking and finance services throughout Papua New Guinea and the Asia Pacific region. The Group's activities also include fund management and life insurance business services. BSP is a company listed on the PNG Exchange Markets (PNGX), incorporated under the Companies Act of Papua New Guinea, and is an authorised Bank under the Banks and Financial Institutions Act of Papua New Guinea. The Group is also licensed to operate in the Solomon Islands, Fiji, Cook Islands, Samoa, Tonga, Vanuatu, Cambodia and Laos. The registered office is at Section 34, Allotment 6 & 7, Klinki Street, Waigani Drive, Port Moresby.

Review of operations

For the year ended 31 December 2020, the Group's profit after tax was K806.218 million (2019: K890.363 million). The Bank's profit after tax was K759.452 million (2019: K845.828 million).

The Directors are of the view that there are reasonable grounds to believe that the Bank and the Group will be able to pay their debts as and when they become due and payable; and the attached financial statements and notes thereto are in accordance with the PNG Companies Act 1997, including compliance with accounting standards and give a true and fair view of the financial position and performance of the Bank and the Group.

The results of the Bank and the Group operations during the financial year have, in the opinion of the Directors, not been materially affected by items of an abnormal nature, other than those disclosed in the financial statements.
In the opinion of the Directors, no circumstances have arisen, that make adherence to the existing method of valuation of assets or liabilities of the Bank and the Group misleading or inappropriate.

At the date of this report the Directors are not aware of any circumstances that would render the values attributed to current assets in the financial statements misleading.

No contingent liability other than that disclosed in the notes to the attached financial statements has become enforceable, or is likely to become enforceable, within a period of twelve months from the date of this report, that will materially affect the Bank and the Group in its ability to meet obligations as and when they fall due.

Dividends

Dividends totalling K569.355 million were paid in 2020 (2019: K653.940 million). A detailed breakup of this is provided in Note 28.

Directors and officers

The following were directors of the Bank of South Pacific Limited at 31 December 2020:

Sir K Constantinou, OBE	Mr. R Fleming, CSM	Mr. S Davis	Ms. P Kevin
Mr. E B Gangloff	Mr. F Bouraga	Mr. R Bradshaw	Mr. A Sam
Mr. G Robb, OAM	Dr. F Lua'iufi		

Details of directors' tenure and directors and executives' remuneration during the year are provided in Note 36 of the Notes to the Financial Statements. The Group CEO Robin Fleming is the only executive director.

The company secretary is Mary Johns.

Directors' Report

Independent auditor's report

The financial statements have been audited and should be read in conjunction with the independent auditor's report on page 62. Details of amounts paid to the auditors for audit and other services are shown in Note 37 of the Notes to the Financial Statements.

Donations and sponsorships

Donations and sponsorship by the Group during the year amounted to K4.582 million (2019: K5.581 million).

Change in accounting policies

Changes to accounting policies that impacted the Group's result during the year are included in Note 1(A) of the Notes to the Financial Statements.

For, and on behalf of, the Directors.

Dated and signed in accordance with a resolution of the Directors in Port Moresby this 24th day of February 2021.

Sir Kostas Constantinou, OBE	**Robin Fleming, CSM**
Chairman	Group Chief Executive Officer/ Managing Director

Statements of Comprehensive Income

for the Year Ended 31 December 2020

All amounts are expressed in K'000	Note	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Interest income	3	1,591,992	1,585,773	1,477,343	1,477,235
Interest expense	3	(144,980)	(193,989)	(126,059)	(180,464)
Net interest income		**1,447,012**	**1,391,784**	**1,351,284**	**1,296,771**
Net fee and commission income	4	345,179	384,761	311,619	346,951
Other income	4	323,934	364,130	330,214	373,366
Net insurance operating income	31	29,525	30,675	-	-
Net operating income before impairment and operating expenses		**2,145,650**	**2,171,350**	**1,993,117**	**2,017,088**
Impairment on financial assets	6	(201,273)	(99,183)	(189,011)	(88,092)
Operating expenses	5	(802,542)	(819,248)	(730,885)	(740,729)
Profit before income tax		**1,141,835**	**1,252,919**	**1,073,221**	**1,188,267**
Income tax expense	7	(335,617)	(362,556)	(313,769)	(342,439)
Net profit for the year		**806,218**	**890,363**	**759,452**	**845,828**
Other comprehensive income					
Items that may be subsequently reclassified to profit or loss:					
Translation of financial information of foreign operations to presentation currency	29	97,995	10,620	53,381	5,493
Items that will not be reclassified to profit or loss:					
Recognition of deferred tax on asset revaluation reserve movement	29	6,190	3,642	6,190	3,664
Fair value gain / (loss) on re-measurement of investment securities	29	72	(14)	72	(14)
Net movement in asset revaluation	29	(18,914)	(5,719)	(20,055)	(5,714)
Other comprehensive income, net of tax		**85,343**	**8,529**	**39,588**	**3,429**
Total comprehensive income for the year		**891,561**	**898,892**	**799,040**	**849,257**
Earnings per share - basic and diluted (toea)	8	**172.6**	**190.6**	**162.5**	**181.0**

The attached notes form an integral part of these financial statements

Statements of Financial Position

As at 31 December 2020

All amounts are expressed in K'000	Note	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
ASSETS					
Cash and operating balances with Central Banks	10	2,897,195	1,816,564	2,379,542	1,510,406
Amounts due from other banks	11	1,187,461	1,022,469	1,130,805	997,816
Treasury and Central Bank bills	12	2,841,006	2,459,497	2,801,339	2,420,088
Cash reserve requirement with Central Banks	13	1,559,284	1,766,601	1,475,103	1,693,300
Other financial assets	14	3,242,225	2,121,071	2,653,577	1,572,755
Loans and receivables from customers	15	13,506,660	13,200,807	12,058,241	11,819,970
Property, plant and equipment		895,476	879,942	691,634	698,755
Asset subject to operating lease		36,434	48,133	36,434	48,133
Investment in subsidiaries		-	-	385,078	378,263
Deferred tax assets	7	290,484	250,846	284,605	246,086
Other assets	16	1,067,212	961,188	537,186	505,281
Total assets		**27,523,437**	**24,527,118**	**24,433,544**	**21,890,853**
LIABILITIES					
Amounts due to other banks	17	126,270	83,931	229,098	162,145
Customer deposits	18	21,654,024	19,339,056	20,104,351	17,981,756
Insurance policy liabilities	31	1,043,990	890,147	-	-
Other liabilities	19	1,230,172	1,065,409	1,066,198	946,329
Deferred tax liabilities	7	35,376	31,542	-	-
Total liabilities		**24,089,832**	**21,410,085**	**21,399,647**	**19,090,230**
SHAREHOLDERS' EQUITY					
Ordinary shares	28	372,189	372,310	372,189	372,310
Retained earnings	29	2,622,249	2,394,382	2,360,983	2,173,836
Other reserves	29	438,516	346,513	300,725	254,477
Equity attributable to the members of the company		3,432,954	3,113,205	3,033,897	2,800,623
Minority interests		651	3,828	-	-
Total shareholders' equity		**3,433,605**	**3,117,033**	**3,033,897**	**2,800,623**
Total equity and liabilities		**27,523,437**	**24,527,118**	**24,433,544**	**21,890,853**

The attached notes form an integral part of these financial statements.

Sir Kostas Constantinou, OBE

Chairman

Robin Fleming, CSM

Group Chief Executive Officer/

Managing Director

Statements of Changes in Shareholders' Equity

for the Year Ended 31 December 2020

All amounts are expressed in K'000	Note	Share capital	Reserves	Retained earnings	Minority Interests	Total
Bank						
Balance as at 1 January 2019		**372,364**	**252,384**	**1,976,138**	**-**	**2,600,886**
Net profit		-	-	845,828	-	845,828
Other comprehensive income		-	3,429	-	-	3,429
Total comprehensive income		-	3,429	845,828	-	849,257
Dividends paid during the year	28	-	-	(649,466)	-	(649,466)
Share buyback	28	(54)	-	-	-	(54)
Total transactions with owners		(54)	-	(649,466)	-	(649,520)
Transfer from asset revaluation reserve	29	-	(4,933)	4,933	-	-
BSP Life policy reserve	29	-	3,597	(3,597)	-	-
Balance at 31 December 2019		**372,310**	**254,477**	**2,173,836**	**-**	**2,800,623**
Net profit		-	-	759,452	-	759,452
Other comprehensive income		-	39,588	-	-	39,588
Total comprehensive income		-	39,588	759,452	-	799,040
Dividends paid during the year	28	-	-	(565,354)	-	(565,354)
Share buyback	28	(121)	-	-	-	(121)
Total transactions with owners		(121)	-	(565,354)	-	(565,475)
Transfer from asset revaluation reserve	29	-	(1,032)	741	-	(291)
BSP Life policy reserve	29	-	7,692	(7,692)	-	-
Balance at 31 December 2020		**372,189**	**300,725**	**2,360,983**	**-**	**3,033,897**
Group						
Balance as at 1 January 2019		**372,364**	**339,320**	**2,156,873**	**3,578**	**2,872,135**
Net profit		-	-	890,363	-	890,363
Other comprehensive income		-	8,529	-	-	8,529
Total comprehensive income		-	8,529	890,363	-	898,892
Dividends paid during the year	28	-	-	(653,940)	-	(653,940)
Share buyback	28	(54)	-	-	-	(54)
Gain attributable to minority interests		-	-	(250)	250	-
Total transactions with owners		(54)	-	(654,190)	250	(653,994)
Transfer from asset revaluation reserve	29	-	(4,933)	4,933	-	-
BSP Life policy reserve	29	-	3,597	(3,597)	-	-
Balance at 31 December 2019		**372,310**	**346,513**	**2,394,382**	**3,828**	**3,117,033**
Net profit		-	-	806,218	-	806,218
Other comprehensive income		-	85,343	-	-	85,343
Total comprehensive income		-	85,343	806,218	-	891,561
Dividends paid during the year	28	-	-	(569,191)	(164)	(569,355)
Share buyback	28	(121)	-	-	-	(121)
Gain attributable to minority interests				(2,209)	2,209	-
Acquisition of minority interest		-	-	-	(5,222)	(5,222)
Total transactions with owners		(121)	-	(571,400)	(3,177)	(574,698)
Transfer from asset revaluation reserve	29	-	(1,032)	741	-	(291)
BSP Life policy reserve	29	-	7,692	(7,692)	-	-
Balance at 31 December 2020		**372,189**	**438,516**	**2,622,249**	**651**	**3,433,605**

The attached notes form an integral part of these Financial Statements.

Statements of Cash Flows

for the Year Ended 31 December 2020

All amounts are expressed in K'000	Note	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
CASH FLOW FROM OPERATING ACTIVITIES					
Interest received		1,556,496	1,605,387	1,443,885	1,480,232
Fees and other income		697,930	779,565	641,246	719,567
Interest paid		(89,307)	(167,913)	(71,615)	(153,354)
Amounts paid to suppliers and employees		(886,940)	(776,812)	(756,232)	(646,339)
Operating cash flow before changes in operating assets & liabilities	9	**1,278,179**	**1,440,227**	**1,257,284**	**1,400,106**
Net (increase)/ decrease in:					
Loans and receivables from customers		(448,960)	(737,195)	(371,177)	(644,594)
Cash reserve requirements with the Central Banks		207,317	(81,058)	218,197	(71,265)
Bills receivable and other assets		(39,982)	(201,387)	33,310	(98,089)
Net increase/ (decrease) in:					
Customer deposits		2,314,968	1,106,290	2,122,595	1,022,586
Bills payable and other liabilities		218,669	(184)	(36,312)	(207,231)
Net cash flow from operations before income tax		**3,530,191**	**1,526,693**	**3,223,897**	**1,401,513**
Income taxes paid	7	(372,872)	(383,287)	(346,003)	(363,837)
Net cash flow from operating activities		**3,157,319**	**1,143,406**	**2,877,894**	**1,037,676**
CASH FLOW FROM INVESTING ACTIVITIES					
Sale/(purchase) of government securities		(1,502,663)	429,961	(1,462,073)	561,386
Expenditure on property, plant and equipment		(63,945)	(82,780)	(45,994)	(79,249)
Expenditure on software development costs		(46,530)	(52,108)	(46,330)	(49,979)
Proceeds from disposal of property, plant and equipment		1,787	7,076	1,787	7,076
Additional funding of subsidiaries	32	-	-	(6,815)	(30,666)
Net cash flow from/ (used in) investing activities		**(1,611,351)**	**302,149**	**(1,559,425)**	**408,568**
CASH FLOW FROM FINANCING ACTIVITIES					
Share buyback	28	(121)	(54)	(121)	(54)
Dividends paid	28	(569,355)	(653,940)	(565,354)	(649,466)
Principal repayments of borrowings		(113,418)	(61,153)	(113,418)	(61,153)
Proceeds from borrowings	19	242,215	33,670	242,215	33,670
Subordinated debt securities matured		-	(75,525)	-	(75,525)
Net cash flow used in financing activities		**(440,679)**	**(757,002)**	**(436,678)**	**(752,528)**
Net (decrease)/increase in cash and cash equivalents		**1,105,289**	**688,553**	**881,791**	**693,716**
Exchange rate movements on cash and cash equivalents		97,995	10,620	53,381	5,493
Cash and cash equivalents at the beginning of the year	9	2,755,102	2,055,929	2,346,077	1,646,868
Cash and Cash Equivalents at the end of the year	9	**3,958,386**	**2,755,102**	**3,281,249**	**2,346,077**

The attached notes form an integral part of these Financial Statements.

1. Financial Statements Preparation

The principal accounting policies adopted in the preparation of these Financial Statements are set out below. These policies have been consistently applied to all the periods presented unless otherwise stated. The assets and liabilities are presented in order of liquidity on the Statements of Financial Position.

A. Basis of Presentation and General Accounting Policies

The Financial Statements of the Bank of South Pacific Limited and the Group are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and interpretations of these standards issued by the International Financial Reporting Interpretations Committee. They are prepared on the basis of the historical cost convention, as modified by the revaluation of certain non-current assets, financial instruments and liabilities.

Estimates and assumptions have been used to achieve conformity with generally accepted accounting principles in the preparation of these financial statements. These assumptions and estimates affect balances of assets and liabilities, contingent liabilities and commitments at the end of the reporting period, and amounts of revenues and expenses during the reporting period. Whilst the estimates are based on management's best knowledge of current events and conditions, actual results may ultimately differ from those estimates.

The financial statements are presented in Papua New Guinea Kina, expressed in thousands of Kina, as permitted by International Financial Reporting Standards.

Standards, amendments and interpretations effective in the year ended 31 December 2020

The following standards, amendments and interpretations to existing standards became applicable for the first time during the accounting period beginning 1 January 2020.

- Amendments to IFRS 3 – definition of a business. This amendment revises the definition of a business. According to feedback received by the IASB, application of the current guidance is commonly thought to be too complex, and it results in too many transactions qualifying as business combinations.
- Amendments to IAS 1 and IAS 8 on the definition of 'material'. These amendments to IAS 1, 'Presentation of financial statements', and IAS 8, 'Accounting policies, changes in accounting estimates and errors', and consequential amendments to other IFRSs:
  - use a consistent definition of materiality throughout IFRSs and the Conceptual Framework for Financial Reporting
  - clarify the explanation of the definition of material; and
  - incorporate some of the guidance in IAS 1 about immaterial information
- Amendments to IFRS 9, IAS 39 and IFRS 7 – interest rate benchmark reform. These Phase 1 amendments provide relief in relation to hedge accounting and interest rate benchmark reform and have the effect that IBOR reform should not generally cause hedge accounting to terminate. Any hedge ineffectiveness should continue to be recorded in the income statement. Given the pervasive nature of hedges involving IBOR based contracts, the relief will affect companies in all industries who do hedge accounting.
- Amendment to IFRS 16, 'Leases' – Covid-19 related rent concessions. As a result of the coronavirus (COVID-19) pandemic, rent concessions have been granted to lessees. Such concessions might take a variety of forms, including payment holidays and deferral of lease payments. This amendment provides an optional practical expedient for lessees from assessing whether a rent concession related to COVID-19 is a lease modification. Lessees can elect to account for such rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concession as variable lease payments in the period(s) in which the event or condition that triggers the reduced payment occurs.

Standards, amendments and interpretations issued but not yet effective for the year ended 31 December 2020 or adopted early

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the entity's accounting periods beginning on or after 1 January 2021 or later periods, but the entity has not early adopted them:

- Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 Interest Rate Benchmark Reform – Phase 2 (effective1 January, 2021) - The Phase 2 amendments address issues that arise from the implementation of the reforms, including the replacement of one benchmark with an alternative one.
- A number of narrow-scope amendments to IFRS 3, IAS 16, IAS 37 and some annual improvements on IFRS 1, IFRS 9, IAS 41 and IFRS 16 (effective 1 January, 2022).
  - Amendments to IFRS 3, 'Business combinations' update a reference in IFRS 3 to the Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations.
  - Amendments to IAS 16, 'Property, plant and equipment' prohibit a company from deducting from the cost of property, plant and equipment amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognise such sales proceeds and related cost in the income statement.
  - Amendments to IAS 37, 'Provisions, contingent liabilities and contingent assets' specify which costs a company includes when assessing whether a contract will be loss-making.
- IFRS 17 'Insurance contracts" (effective 1 January 2023) replaces IFRS 4. IFRS 17 will fundamentally change the accounting by all entities that issue insurance contracts and investment contracts with discretionary participation features.

B. Consolidation

The Financial Statements incorporate the assets and liabilities of all controlled entities of the Group as at 31 December 2020, and their results for the year then ended.

Controlled entities are those over which the Group has the power to govern financial and operating policies, generally accompanied by a shareholding that commands the majority of voting rights, and are commonly referred to as subsidiaries.

Subsidiaries are accounted for at acquisition under the acquisition method of accounting, where:

- consideration transferred is measured at fair value of assets transferred, equity issued and liabilities assumed;
- identifiable net assets are recorded initially at acquisition, at their fair values;
- any excess of the acquisition cost over the relevant share of identifiable net assets acquired is treated as goodwill, and any deficiency is recognised directly in the Statement of Comprehensive Income.

All intercompany transactions and balances are eliminated.

C. Foreign currency

The Financial Statements of the Group are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of these Financial Statements, the results and financial position of the Bank are expressed in Papua New Guinea kina, which is the Bank's functional and presentation currency.

In preparing the Financial Statements, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Foreign operations

On consolidation, the assets and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit or loss on disposal of the foreign operation.

D. Critical accounting estimates and judgments

The application of the Group's accounting policies requires the use of estimates and assumptions. If different assumptions or estimates were applied, the resulting values would change, impacting the net assets and income of the Group.

This note provides an overview of the areas that involve a higher degree of judgement or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgements is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

The areas involving significant estimates and judgments are:

- Estimation of current tax liability in the multiple tax jurisdictions - note 7
- Estimated impairment of financial or non-financial assets – note 12, 14 and 15
- Estimated insurance liability – note 31
- Estimation of fair value of financial and non-financial assets and liabilities – note 27

Measurement of expected credit loss allowance for financial assets measured at amortised cost in line with IFRS 9 is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring Expected Credit Losses (ECL) is further detailed in note 15, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Group in the above areas are set out in note 15.

Impact of COVID-19

The COVID-19 pandemic and the measures put in place domestically and globally to control the spread of the virus have had a significant impact on global economies and financial markets. As a result, this has increased the uncertainty and judgement required in relation to our critical accounting assumptions and estimates, primarily relating to expected credit losses as there is a higher than usual degree of uncertainty associated with these assumptions and estimates, the actual economic conditions are likely to be different from those forecast which may significantly impact accounting estimates included in these financial statements. The impact of COVID-19 is discussed further in each of the related notes.

Financial Performance

2. Segment Reporting

Accounting Policy

Segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker. This reflects the way the Group's businesses are managed, rather than the legal structure of the Group.

For management purposes, segment information determination is based on the risks involved with the provision of core banking services and products and the Bank and Group's management reporting system. The main business lines/segments for management purposes are banking services, split into PNG Bank and Offshore Banks and non-banking services which comprise insurance operations, fund management and asset financing activities. The Bank and Group's business segments operate in Papua New Guinea, Fiji, Solomon Islands, Cook Islands, Tonga, Samoa, Vanuatu, Laos and Cambodia. Inter segment adjustments reflect elimination entries in respect of inter segment income and expense allocations including funds transfer pricing.

Consolidated

All amounts are expressed in K'000	PNG Bank	Offshore Banks	Non-Bank Entities	Adjust Inter Segments	Total
Analysis by segments					
Year ended 31 December 2020					
Net interest income	1,148,684	263,807	32,289	2,232	1,447,012
Other income	496,137	196,194	24,344	(47,562)	669,113
Net insurance income	-	-	32,246	(2,721)	29,525
Total operating income	**1,644,821**	**460,001**	**88,879**	**(48,051)**	**2,145,650**
Operating expenses	(581,448)	(207,639)	(18,755)	5,300	(802,542)
Impairment expenses	(146,472)	(48,845)	(5,956)	-	(201,273)
Profit before income tax	**916,901**	**203,517**	**64,168**	**(42,751)**	**1,141,835**
Income tax	(274,985)	(50,191)	(10,441)	-	(335,617)
Net profit after income tax	**641,916**	**153,326**	**53,727**	**(42,751)**	**806,218**
Assets	18,579,915	8,566,675	1,921,829	(1,544,982)	27,523,437
Liabilities	(16,104,050)	(7,463,833)	(1,418,414)	896,465	(24,089,832)
Net assets	**2,475,865**	**1,102,842**	**503,415**	**(648,517)**	**3,433,605**
Year ended 31 December 2019					
Net interest income	1,115,454	241,808	30,772	3,750	1,391,784
Other income	542,027	243,347	18,496	(54,979)	748,891
Net insurance income	-	-	34,999	(4,324)	30,675
Total operating income	**1,657,481**	**485,155**	**84,267**	**(55,553)**	**2,171,350**
Operating expenses	(582,740)	(220,439)	(20,393)	4,324	(819,248)
Impairment expenses	(58,555)	(36,244)	(4,384)	-	(99,183)
Profit before income tax	**1,016,186**	**228,472**	**59,490**	**(51,229)**	**1,252,919**
Income tax	(297,480)	(58,085)	(6,991)	-	(362,556)
Net profit after income tax	**718,706**	**170,387**	**52,499**	**(51,229)**	**890,363**
Assets	16,841,489	7,527,333	1,728,459	(1,570,163)	24,527,118
Liabilities	(14,495,105)	(6,565,047)	(1,274,339)	924,406	(21,410,085)
Net assets	**2,346,384**	**962,286**	**454,120**	**(645,757)**	**3,117,033**

3. Net Interest Income

Accounting Policy

Interest income and expense are recognised in the Statement of Comprehensive Income on an accrual basis using the effective interest rate ("EIR") method. The EIR method calculates the amortised cost of a financial instrument by discounting the financial instrument's estimated future cash receipts or payments to their present value and allocates the interest income or interest expense, including any fees, costs, premiums or discounts integral to the instrument, over its expected life.

Interest income includes coupons earned on Government inscribed stock, accrued discount and premium on Treasury and Central Bank bills.

Interest income is recognised for Stage 1 and Stage 2 financial assets measured at amortised cost by applying the EIR to gross carrying amounts of the financial instruments. For Stage 3 financial instruments, interest income is recognised by applying EIR on the net carrying value of the financial instrument.

Expenses associated with the borrowing of funds are charged to the Statement of Comprehensive Income in the period in which they are incurred.

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Interest income				
Loans and receivables from customers[1]	1,199,823	1,238,453	1,084,444	1,125,395
Other financial assets - inscribed stock	220,328	198,484	219,956	198,164
Treasury and Central Bank bills	163,332	141,573	162,287	140,086
Cash and balances with Central Banks	6,138	6,189	8,005	9,714
Other	2,371	1,074	2,651	3,876
	1,591,992	**1,585,773**	**1,477,343**	**1,477,235**
Less: **Interest expense**				
Customer deposits	136,688	178,053	116,387	162,912
Other banks	8,292	12,396	9,672	14,012
Subordinated debt securities	-	3,540	-	3,540
	144,980	**193,989**	**126,059**	**180,464**
	1,447,012	**1,391,784**	**1,351,284**	**1,296,771**

[1]Group interest income includes K20.511m (Bank K18.915m) recognized on impaired loans (Stage 3) to customers, 2019: K13.079m (Bank K12.957m). The Group takes up required provisions on such interest income as detailed in the accounting policy in note 15.

4. Non-Interest Income

Accounting policy

Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the performance obligation is satisfied (i.e. service has been provided). Other non-risk fee income which includes facility fees include certain line fees and fees for providing customer bank accounts. They are recognised over the term of the facility/period of service on a straight-line basis.

4. Non-Interest Income (continued)

Accounting policy (continued)

Fee and commission income (continued)

All other risk related fees that constitute cost recovery are taken to income when levied. Income which forms an integral part of the effective interest rate of a financial instrument is recognised using the effective interest method and recorded in interest income (for example, loan origination fees).

Foreign exchange income or losses

Realised and unrealised gains or losses from foreign currency trading, or from changes in the fair value of the trading assets and liabilities are recognised as income in the Statement of Comprehensive Income in the period in which they arise.

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Net Fee and commission income				
Product related	178,512	182,220	163,186	169,131
Trade and international related	19,320	21,259	18,185	20,366
Electronic banking related	116,514	143,801	112,572	132,861
Other	30,833	37,481	17,676	24,593
	345,179	**384,761**	**311,619**	**346,951**
Other income				
Foreign exchange related[1]	288,203	327,705	260,181	291,308
Operating lease rentals	7,503	7,503	7,503	7,503
Other	28,228	28,922	62,530	74,555
	323,934	**364,130**	**330,214**	**373,366**

[1]Foreign exchange related income includes gains and losses from spot and forward contracts and translated foreign currency assets and liabilities.

5. Operating Expenses

Accounting Policy

Salaries and related on-costs include annual leave, long service leave, employee incentives and relevant taxes. Staff expenses are recognised over the period the employee renders the service. Long service leave is discounted to present value using assumptions relating to staff departure, leave utilisation and future salary.

Superannuation expense includes expenses relating to defined contribution plans. Defined contribution expense is recognized in the period the service is provided.

Premises and equipment expenses include depreciation, which is calculated using the straight-line method over the asset's estimated useful life. The right-of-use assets are recognized under IFRS 16. Leases are depreciated over the shorter of the lease term or the useful life of the underlying asset, with the depreciation presented within depreciation of Property, Plant and Equipment.

5. Operating Expenses (continued)

Accounting Policy (continued)

Computing expenses are recognised as incurred, unless they qualify for capitalization as computer software due to the expenditure generating probable future economic benefits. If capitalised, computer software is subsequently amortised over its estimated useful life. The Group assesses, at each balance sheet date, useful lives and residual values and whether there is any objective evidence of impairment. If an asset's carrying value is greater than its recoverable amount, the carrying amount is written down immediately to its recoverable amount.

Other expenses are recognised as the relevant service is rendered. Operating expenses related to provisions are recognised for present obligations arising from past events where a payment to settle the obligation is probable and can be reliably estimated.

Operating expenses

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Administration	109,703	95,246	99,115	90,694
Computing	109,719	125,412	93,899	111,245
Depreciation	75,202	80,959	68,257	63,405
Amortisation of computer development costs	25,597	28,173	25,375	22,577
Non-executive directors costs	4,234	3,639	3,538	3,044
Non-lending losses	10,775	2,318	10,349	1,654
Fixed asset impairment expenses	640	1,975	640	1,975
Premises and equipment	86,179	87,940	80,424	83,442
	422,049	**425,662**	**381,597**	**378,036**
Staff costs				
Wages and salaries	301,887	312,239	275,676	286,004
Defined contribution plans	14,787	15,531	13,358	14,133
Statutory benefit contributions	10,890	10,929	10,061	10,320
Other staff benefits	52,929	54,887	50,193	52,236
	380,493	**393,586**	**349,288**	**362,693**
	802,542	**819,248**	**730,885**	**740,729**

6. Impairment of Financial Assets

Accounting Policy

Impairment

All Loans and receivables from customers are subject to continuous management review. If there is an expectation that the Group will not be able to collect amounts due under the terms of the loan, provision is recognised equivalent to lifetime ECL. All bad debts are written off against available specific provision for loan impairment in the period in which they are classified as irrecoverable. Subsequent recoveries are credited to the provision for loan losses in the Statement of Comprehensive Income.

6. Impairment of Financial Assets (continued)

Accounting Policy (continued)

Impairment *(continued)*

General provisions for impairment are maintained to cover expected losses unidentified at balance date in the overall portfolio of Loans and receivables from customers. The provisions are determined having regard to the level of risk weighted assets, economic conditions, the general risk profile of the credit portfolio, past loss experience and a range of other criteria. The amount necessary to bring the provisions to their assessed levels, after write-offs, is charged to the Statement of Comprehensive Income.

The Group assesses on a forward-looking basis the ECL associated with its debt instrument assets carried at amortised cost and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 15 provides more detail of how the expected credit loss allowance is measured.

Impairment on financial assets by asset class is as follows:	**Consolidated**		**Bank**	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Loans and receivables from customers (note 15)	183,352	101,882	171,200	90,861
Treasury and Central Bank Bills (note 12)	8,125	(1,865)	7,949	(1,865)
Other financial asset (note 14)	9,796	(834)	9,862	(904)
	201,273	**99,183**	**189,011**	**88,092**

7. Income Tax

Accounting Policy

Current Tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by the reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is accounted for using the balance sheet liability method. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the Statement of Financial Position. In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities which affects neither taxable income nor accounting profit.

7. Income Tax (continued)

Accounting Policy (continued)

Deferred tax (continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax is recognised as an expense or income in the Statement of Comprehensive Income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity.

Critical accounting assumptions and estimates

The Group operates in multiple tax jurisdictions and significant judgement is required in determining the current tax liability in the multiple tax jurisdictions. There are many transactions with uncertain tax outcomes and provisions are determined based on the expected outcomes.

	Consolidated		**Bank**	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Income tax expense				
Current tax	366,976	368,467	343,853	348,760
Deferred tax	(36,156)	(8,675)	(32,452)	(9,510)
Current year	330,820	359,792	311,401	339,250
Adjustment to prior year estimates	4,797	2,764	2,368	3,189
	335,617	**362,556**	**313,769**	**342,439**
Tax calculated at 30% of bank profit before tax	321,966	356,480	321,966	356,480
Tax calculated at respective subsidiary tax rates	14,664	10,759	-	-
Expenses not deductible for tax	7,233	6,072	845	995
Tax loss not recognised	1,024	5,548	-	-
Income not recognized for tax purposes	(14,067)	(19,067)	(11,410)	(18,225)
Adjustment to prior year estimates	4,797	2,764	2,368	3,189
	335,617	**362,556**	**313,769**	**342,439**
Tax recoverable				
At 1 January	27,588	12,753	30,275	17,020
Income tax provision	(366,976)	(368,467)	(343,853)	(348,760)
Adjustment to prior year estimates	(138)	579	-	1,004
Other tax related items	(459)	(564)	(6)	(2,826)
Foreign tax paid	20,321	18,412	-	-
Tax payments made	352,551	364,875	346,003	363,837
At 31 December	**32,887**	**27,588**	**32,419**	**30,275**

7. Income Tax (continued)

All amounts are expressed in K'000	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Specific allowance for losses on Loans and receivables from customers	67,101	56,215	64,594	53,558
General allowance for losses on Loans and receivables from customers	162,889	137,768	155,764	131,960
Employee related provisions	25,361	26,721	23,785	25,944
Prepaid expenses	(1,156)	(1,349)	(1,213)	(1,323)
Other provisions	42,279	47,422	46,649	45,396
Property, plant and equipment	(65,333)	(70,969)	(23,300)	(30,223)
Unrealised foreign exchange gains	(957)	(1,876)	(957)	(1,876)
Accruals	24,924	25,372	19,283	22,650
At 31 December	**255,108**	**219,304**	**284,605**	**246,086**
Represented by:				
Deferred tax asset	290,484	250,846	284,605	246,086
Deferred tax liability	(35,376)	(31,542)	-	-
At 31 December	**255,108**	**219,304**	**284,605**	**246,086**
Deferred taxes movement:				
At 1 January	219,304	208,444	246,086	234,391
Current year movement	36,156	8,675	32,452	9,510
Adjustment to prior year estimates	4,935	2,185	2,368	2,185
Other movements	(5,287)	-	3,699	-
At 31 December	**255,108**	**219,304**	**284,605**	**246,086**

8. Earnings per Ordinary Share

Accounting Policy

Earnings per share is determined by dividing the profit or loss attributable to owners of the Bank by the weighted average number of participating shares outstanding during the reporting year, adjusted for shares which are bought back by BSP.

	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Net profit attributable to shareholders (K'000)	806,218	890,363	759,452	845,828
Weighted average number of ordinary shares in use (000)	467,235	467,242	467,235	467,242
Basic and diluted earnings per share (expressed in toea)	**172.6**	**190.6**	**162.5**	**181.0**

Basic earnings per ordinary share is calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year. Bank of South Pacific Limited has no dilutive potential ordinary shares. Consequently, basic earnings per ordinary share equals diluted earnings per share.

9. Reconciliation of Operating Cash Flow

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Reconciliation of operating profit after tax to operating cash flow before changes in operating assets				
Operating profit after tax	806,218	890,363	759,452	845,828
Add: Tax expense	335,617	362,556	313,769	342,439
Operating profit before income tax	**1,141,835**	**1,252,919**	**1,073,221**	**1,188,267**
Major non cash amounts				
Depreciation	75,202	80,959	68,257	63,405
Amortisation of computer development costs	25,597	28,173	25,375	22,577
Net (Gain)/loss on sale of fixed assets	(707)	(2,088)	(587)	33
Impairment on financial assets	201,273	99,183	189,011	88,092
Movement in payroll provisions	(3,795)	9,956	8,104	8,391
Impairment of fixed assets	640	1,975	640	1,975
Net changes in assets and liabilities	(161,866)	(30,850)	(106,737)	27,366
Operating cash flow before changes in operating assets & liabilities	**1,278,179**	**1,440,227**	**1,257,284**	**1,400,106**

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days maturity.

Cash and balances with Central Banks (note 10)	2,897,195	1,816,564	2,379,542	1,510,406
Amounts due from other banks (note 11)[1]	1,187,461	1,022,469	1,130,805	997,816
Amounts due to other banks (note 17)	(126,270)	(83,931)	(229,098)	(162,145)
	3,958,386	**2,755,102**	**3,281,249**	**2,346,077**

[1]The Group undertakes thorough compliance and due diligence reviews before entering into any correspondent banking relationships. Amounts due from other banks includes deposit of K51.609 million held with counter-party Banks that are not available for use by the Group.

Financial Instruments: Financial Assets

Accounting Policy

Recognition

Loans and receivables are recognized on settlement date, when cash is advanced to the borrowers.

Modification of loans

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on de-recognition.

If the terms are not substantially different, the renegotiation or modification does not result in de-recognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

De-recognition

Financial assets are de-recognised when the rights to receive cash flows from the asset have expired.

There may be situations where the Group has partially transferred the risks and rewards of ownership and has neither transferred nor retained substantially all the risks and rewards of ownership. In such situations, the asset continues to be recognised on the balance sheet to the extent of the Group's continuing involvement in the asset.

Classification and measurement

Financial assets are grouped into the following classes: cash and balances with central banks and financial assets measured at fair value through income statement (FVIS), investment securities, loans, other financial assets and life insurance assets.

Financial assets are classified based on a) the business model within which the assets are managed, and b) whether the contractual cash flows of the instrument represent solely payment of principal and interest (SPPI).

Financial Instruments: Financial Assets (continued)

Accounting Policy (continued)

Classification and measurement (continued)

The Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model the Group considers factors including how performance and risks are managed, evaluated and reported and the frequency and volume of, and reason for, sales in previous periods and expectations of sales in future periods.

When assessing whether contractual cash flows are SPPI, interest is defined as consideration primarily for the time value of money and the credit risk of the principal outstanding. The time value of money is defined as the element of interest that provides consideration only for the passage of time and not consideration for other risks or costs associated with holding the financial asset. Terms that could change the contractual cash flows so that they may not meet the SPPI criteria include contingent and leverage features, non-recourse arrangements, and features that could modify the time value of money.

Debt instruments

If the debt instruments have contractual cash flows which represent SPPI on the principal balance outstanding they are classified at:

- amortised cost if they are held within a business model whose objective is achieved through holding the financial asset to collect these cash flows; or
- fair value through other comprehensive income (FVOCI) if they are held within a business model whose objective is achieved either through collecting these cash flows or selling the financial asset; or
- FVIS if they are held within a business model whose objective is achieved through selling the financial asset.

Debt instruments are measured at FVIS where the contractual cash flows do not represent SPPI on the principal balance outstanding or where it is designated at FVIS to eliminate or reduce an accounting mismatch. Debt instruments at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. They are presented net of provisions for expected credit losses determined using the ECL model.

Debt instruments at FVOCI are measured at fair value with unrealised gains and losses recognised in other comprehensive income except for interest income, impairment charges and foreign exchange gains and losses, which are recognised in the Statement of Comprehensive Income. Impairment on debt instruments at FVOCI is determined using the ECL model and is recognised in the Statement of Comprehensive Income with a corresponding amount in other comprehensive income. There is no reduction of the carrying value of the debt security which remains at fair value. The cumulative gain or loss recognised in other comprehensive income is subsequently recognised in the Statement of Comprehensive Income when the instrument is derecognised.

Debt instruments at FVIS are measured at fair value with subsequent changes in fair value recognised in the Statement of Comprehensive Income.

Equity securities

Equity securities are measured at FVOCI where they:

- are not held for trading; and
- an irrevocable election is made by the Group.

Otherwise, they are measured at FVIS.

Equity securities at FVOCI are measured at fair value with unrealised gains and losses recognised in other comprehensive income, except for dividend income which is recognised in the Statement of Comprehensive Income.

Financial Instruments: Financial Assets (continued)

Accounting Policy (continued)

Equity securities (continued)

The cumulative gain or loss recognised in other comprehensive income is not subsequently recognised in the Statement of Comprehensive Income when the instrument is disposed.

Equity securities at FVIS are measured at fair value with subsequent changes in fair value recognised in the Statement of Comprehensive Income.

Derivative financial instruments and acceptances

Forward foreign exchange contracts entered into for trading purposes are initially recognised at fair value and subsequently re-measured at fair value based upon the forward rate. Gains and losses on such contracts are taken to the Statement of Comprehensive Income.

Acceptances comprise undertakings by the Group to pay bills of exchange drawn on customers. The Group expects most acceptances to be settled simultaneously with the reimbursement from the customers. Customer acceptances are accounted for as off-balance sheet transactions and are disclosed as contingent liabilities and commitments.

The Group does not actively enter into or trade in complex forms of derivative financial instruments such as currency and interest rate swaps and options.

10. Cash and Operating Balances with Central Banks

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Notes, coins and cash at bank	466,069	513,241	412,729	496,694
Balances with Central Banks other than statutory deposit	2,431,126	1,303,323	1,966,813	1,013,712
At 31 December	**2,897,195**	**1,816,564**	**2,379,542**	**1,510,406**

11. Amounts Due from Other Banks

Items in the course of collection	11,944	29,692	11,944	29,693
Placements with other banks	1,175,517	992,777	1,118,861	968,123
At 31 December	**1,187,461**	**1,022,469**	**1,130,805**	**997,816**

12. Treasury and Central Bank Bills

Treasury and Central Bank bills – face value	2,940,164	2,513,084	2,908,416	2,478,589
Unearned interest	(91,413)	(50,788)	(91,414)	(50,787)
Less allowance for impairment	(15,839)	(7,714)	(15,663)	(7,714)
	2,832,912	2,454,582	2,801,339	2,420,088

12. Treasury and Central Bank Bills (continued)

All amounts are expressed in K'000	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Financial assets carried at fair value through profit and loss:				
Treasury bills at fair value	8,094	4,915	-	-
At 31 December	**2,841,006**	**2,459,497**	**2,801,339**	**2,420,088**
Allowance for impairment				
At 1 January	7,714	9,579	7,714	9,579
Provision/(release) for impairment	8,125	(1,865)	7,949	(1,865)
At 31 December	**15,839**	**7,714**	**15,663**	**7,714**

13. Cash Reserve Requirement with Central Banks

The Bank and the Group complies with the Cash Reserve Requirement ("CRR") set by the regulatory authorities of the jurisdictions that it operates in. The CRR specifies that a bank must hold an amount equal to a percentage of its total customer deposits in the form of cash in an account maintained by the respective Central Banks. The Bank and Group complies with this requirement on an ongoing basis. CRR requirements applicable for each jurisdiction at balance date were: PNG 7% (2019: 10%), Fiji 10% (2019: 10%), Solomon Islands 5% (2019: 7.5%), Samoa 4.5% (2019: 4.5%), Tonga 10% (2019: 10%) and Vanuatu 5.25% (2019: 5.25%).

14. Other Financial Assets

Inscribed stock – issued by Central Bank	2,696,749	1,357,845	2,668,385	1,577,701
Less allowance for impairment	(14,966)	(5,170)	(14,808)	(4,946)
	2,681,783	**1,352,675**	**2,653,577**	**1,572,755**
Financial assets carried at fair value through profit and loss:				
Government inscribed stock	291,042	513,024	-	-
Equity securities	269,400	255,372	-	-
At 31 December	**3,242,225**	**2,121,071**	**2,653,577**	**1,572,755**
Allowance for impairment				
At 1 January	5,170	6,004	4,946	5,850
Provision/(release) for impairment	9,796	(834)	9,862	(904)
At 31 December	14,966	5,170	14,808	4,946

15. Loans and receivables from customers

Accounting Policy

Loans are originated by providing funds directly to the borrower and are recognised when cash is advanced to borrowers. Loans are subsequently measured at amortised cost using the effective interest rate method where they have contractual cash flows which represent SPPI on the principal balance outstanding and they are held within a business model whose objective is achieved through holding the loans to collect these cash flows. They are presented net of any provisions for ECL.

	Consolidated		**Bank**	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Overdrafts	812,271	1,008,876	737,484	933,819
Lease financing	278,813	295,381	246,595	258,659
Term loans	10,340,695	9,903,563	9,503,636	9,114,411
Mortgages	2,813,399	2,605,311	2,350,019	2,159,668
Policy loans	105,193	88,280	-	-
Gross loans and receivables from customers net of reserved interest	**14,350,371**	**13,901,411**	**12,837,734**	**12,466,557**
Less allowance for losses on loans and receivables from customers	(843,711)	(700,604)	(779,493)	(646,587)
At 31 December	**13,506,660**	**13,200,807**	**12,058,241**	**11,819,970**

The spread of the loans are detailed in the maturity analysis table in Note 22. The loans are well-diversified across various sectors and are further analysed in Note 22. Allowance for losses includes K50.082m (Bank K44.963m), 2019: K29.976m (Bank K28.192m) provision taken up for interest recognized on stage 3 loans.

Lease financing

The Bank and the Group provide lease financing to a broad range of clients to support financing needs in acquiring movable assets such as motor vehicles and plant and equipment. Finance leases are included within Loans and receivables from customers and are analysed as follows:

Gross investment in finance lease receivable				
Not later than 1 year	54,550	23,152	49,863	19,241
Later than 1 year and not later than 5 years	253,168	309,154	220,139	269,514
	307,718	**332,306**	**270,002**	**288,755**
Unearned future finance income				
Not later than 1 year	(2,290)	(1,319)	(2,115)	(1,116)
Later than 1 year and not later than 5 years	(26,615)	(35,606)	(21,292)	(28,980)
	(28,905)	(36,925)	(23,407)	(30,096)
Present value of minimum lease payments receivable	**278,813**	**295,381**	**246,595**	**258,659**

15. Loans and receivables from customers (continued)

All amounts are expressed in K'000	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Present value of minimum lease payments receivable is analysed as follows:				
Not later than 1 year	52,260	21,833	47,748	18,125
Later than 1 year and not later than 5 years	226,553	273,548	198,847	240,534
At 31 December	**278,813**	**295,381**	**246,595**	**258,659**

Allowance for Expected Credit Losses

Accounting Policy

Impairment under IFRS 9 applies to all financial assets at amortised costs, lease receivables and credit commitments.

The ECL determined under IFRS 9 is recognised as follows:

- Loans (including lease receivables), debt securities at amortised cost and due from subsidiaries: as a reduction of the carrying value of the financial asset through an offsetting provision account;
- Credit commitments: as a provision

Measurement

The Group calculates the provisions for ECL based on a three stage approach. ECL are a probability-weighted estimate of the cash shortfalls expected to result from defaults over the relevant timeframe. They are determined by evaluating a range of possible outcomes and taking into account the time value of money, past events, current conditions and forecasts of future economic conditions.

The models use three main components to determine the ECL including:

- Probability of default (PD): the probability that a counterparty will default;
- Loss given default (LGD): the loss that is expected to arise in the event of a default; and
- Exposure at default (EAD): the estimated outstanding amount of credit exposure at the time of the default.

<u>Model stages</u>

The three stages are as follows:

Stage 1: 12 months ECL - performing

For financial assets where there has been no significant increase in credit risk since origination, a provision for 12 months ECL is recognised.

Stage 2: Lifetime ECL – performing

For financial assets where there has been a significant increase in credit risk since origination but where the asset is still performing, a provision for lifetime ECL is recognised.

Stage 3: Lifetime ECL – non-performing

For financial assets that are non-performing a provision for lifetime ECL is recognised. Indicators include a breach of contract with the Group such as a default on interest or principal payments, a borrower experiencing significant financial difficulties or observable economic conditions that correlate to defaults on a group of loans.

15. Loans and receivables from customers (continued)

Collective and individual assessment

Expected credit losses are estimated on a collective basis for exposures in Stage 1, Stage 2 and Stage 3 exposures below specified thresholds and on an individual basis for Stage 3 exposures that meet specified thresholds.

Expected life

In considering the lifetime time frame for expected credit losses in stages 2 and 3, the standard generally requires use of the remaining contractual life adjusted where appropriate for prepayments, extension and other options. For certain revolving credit facilities which include both a drawn and undrawn component (e.g. credit cards and revolving lines of credit), the Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit our exposure to credit losses to the contractual notice period. For these facilities, lifetime is based on historical behaviour.

Movement between stages

Assets may move in both directions through the stages of the impairment model. Assets previously in stage 2 may move back to stage 1 if it is no longer considered that there has been a significant increase in credit risk. Similarly, assets in stage 3 may move back to stage 1 or stage 2 if they are no longer assessed to be non-performing.

Off-Balance Sheet amounts

Any off-balance sheet items, such as loan commitments, are considered for impairment both on an individual and collective basis.

Definition of default

The definition of default used in measuring expected credit losses is aligned to the definition used for internal credit risk management purposes. The default occurs when there are indicators that a debtor is unlikely to fully satisfy contractual credit obligations to the Group, or the exposure is 90 days past due. Financial assets, including those that are well secured, are considered credit impaired for financial reporting purposes when they meet the definition of default. In subsequent periods, any recoveries of amounts previously written-off are credited to credit impairment charge in the Statement of Comprehensive Income.

Critical accounting assumptions and estimates

Key judgements include when a significant increase in credit risk has occurred and estimation of forward looking macroeconomic information. Other factors which can impact the provision include the borrower's financial situation, the realisable value of collateral, the Group's position relative to other claimants, the reliability of customer information and the likely cost and duration of recovering the loan.

Significant increase in credit risk

Determining when a financial asset has experienced a significant increase in credit risk since origination is a critical accounting judgement which is primarily based on changes in internal customer risk grades since origination of the facility. Judgement is involved in setting the rules to determine whether there has been a significant increase in credit risk since initial recognition of a loan, resulting in the financial asset moving from 'stage 1' to 'stage 2', this increases the ECL calculation from an allowance based on the probability of default in the next 12 months, to an allowance for lifetime expected credit losses. Subsequent decreases in credit risk combined with transition from stage 2 to stage 1 may similarly result in significant changes in the estimate. The setting of precise trigger points requires

15. Loans and receivables from customers (continued)

judgement. The change in an internal customer risk grade is based on both quantitative and qualitative factors. The change in the internal customer risk grade that the Group uses to represent a significant increase in credit risk is based on a sliding scale. This means that a higher credit quality exposure at origination would require a more significant downgrade compared to a lower credit quality exposure before it is considered to have experienced a significant increase in credit risk.

A backstop is applied and the financial instrument is considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

Customers in hardship arrangements are normally treated as an indication of a significant increase in credit risk but the deferral of payments under the current COVID-19 relief packages has not, in isolation, been treated as an indication of SICR. The Group has classified these relief packages into different categories of risk, which have been assessed for an increased likelihood of a risk of default to determine whether a SICR has occurred.

The Group does not apply the low credit risk exemption which assumes investment grade facilities do not have a significant increase in credit risk.

Probability weighting of each scenario

The Group considers three future macroeconomic scenarios including a base case scenario along with upside and downside scenarios. Probability weighting of each scenario is determined by management considering the risks and uncertainties surrounding the base case scenario, as well as specific portfolio considerations where required. This is further expanded in note 22.

- Base case scenario
  This scenario utilises external economic forecasts used for strategic decision making and forecasting.
- Upside scenario
  This scenario represents a modest improvement on the base case scenario.
- Downside scenario
  This scenario represents a moderate recession.

Forward looking macroeconomic information

The measurement of ECL for each stage and the assessment of significant increase in credit risk consider information about past events and current conditions as well as reasonable and supportable projections of future events and economic conditions. The estimation of forward-looking information is a critical accounting judgement. The macroeconomic variables used in these scenarios, based on current economic forecasts, include (but are not limited to) change in real gross domestic product growth rates and unemployment rates.

The macroeconomic scenarios are weighted based on the Group's best estimate of the relative likelihood of each scenario. The weighting applied to each of the three macroeconomic scenarios takes into account historical frequency, current trends, and forward looking conditions.

The macroeconomic variables and probability weightings of the three macroeconomic scenarios are subject to the approval of the Group Chief Financial Officer and Group Chief Risk Officer.

Where appropriate, adjustments will be made to modelled outcomes to reflect reasonable and supportable information not already incorporated in the models.

Judgements can change with time as new information becomes available which could result in changes to the provision for expected credit losses.

15. Loans and receivables from customers (continued)

The loss allowance recognised in the period is impacted by a variety of factors, as described below and as detailed in the following table:

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Provision for impairment				
Movement in allowance for losses on loans and receivables from customers:				
Balance at 1 January	700,604	633,567	646,587	589,238
Net new and increased provisioning	143,823	79,064	132,807	65,049
Loans written off against provisions / (Write back of provisions no longer required)	(716)	(12,027)	99	(7,700)
At 31 December	**843,711**	**700,604**	**779,493**	**646,587**
Provision for impairment is represented by:				
Collective provision for on balance sheet	517,456	429,932	477,553	394,382
Individually assessed or specific provision	272,821	223,299	250,278	206,721
Total provisions for on balance sheet exposure	**790,277**	**653,231**	**727,831**	**601,103**
Collective provision for off balance sheet exposure	53,434	47,373	51,662	45,484
At 31 December	**843,711**	**700,604**	**779,493**	**646,587**
Loan impairment expense				
Net collective provision funding	79,045	17,552	77,377	13,478
Net new and increased individually assessed provisioning	64,778	61,512	55,430	51,571
Total new and increased provisioning	**143,823**	**79,064**	**132,807**	**65,049**
Recoveries during the year	(56,495)	(64,042)	(54,633)	(58,178)
Net (write back) / write off	96,024	86,860	93,026	83,990
At 31 December	**183,352**	**101,882**	**171,200**	**90,861**

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Net financial assets originated, which includes additional allowances for new financial instruments recognised during the period, net of releases for financial instruments de-recognised in the period;
- Movement in risk parameters and other changes arising from regular refreshing of inputs to models, foreign exchange retranslations for assets denominated in foreign currencies and other movements;
- Management temporary adjustments taken up during the reporting period relating to the impact of COVID-19 on ECL have been reflected as transfers from State 1 to Stage 2.

The impact of the factors on the groups exposure and loss allowance is detailed in the following table:

15. Loans and receivables from customers (continued)

All amounts are expressed in K'000

EAD - Loans and receivables from customers	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
1 January 2019	**11,560,656**	**1,253,275**	**350,285**	**13,164,216**
Transfers to/(from)				
Stage 1	(413,939)	334,851	56,142	(22,946)
Stage 2	135,032	(187,033)	36,394	(15,607)
Stage 3	-	697	(847)	(150)
Net financial assets originated	858,825	(32,641)	(50,286)	775,898
Total movement in EAD during 2019	**579,918**	**115,874**	**41,403**	**737,195**
31 December 2019	**12,140,574**	**1,369,149**	**391,688**	**13,901,411**

ECL - Loans and receivables from customers				
1 January 2019	**185,687**	**231,124**	**179,222**	**596,033**
Transfers to/(from)				
Stage 1	(11,328)	52,332	16,866	57,870
Stage 2	5,278	(25,077)	13,013	(6,786)
Stage 3	-	71	(54)	17
Net financial assets originated	33,979	911	2,063	36,953
Movements due to risk parameter and other changes	(25,868)	(17,177)	24,216	(18,829)
Total net P&L charge during 2019	**2,061**	**11,060**	**56,104**	**69,225**
Loans written off against provision/(write back of provision no longer required)	-	-	(12,027)	(12,027)
31 December 2019	**187,748**	**242,184**	**223,299**	**653,231**

EAD - Loans and receivables from customers				
1 January 2020	**12,140,574**	**1,369,149**	**391,688**	**13,901,411**
Transfers to/(from)				
Stage 1	(1,087,236)	979,312	89,196	(18,728)
Stage 2	81,201	(153,301)	57,290	(14,810)
Stage 3	-	1,158	(1,422)	(264)
Net financial assets originated	576,289	(45,644)	(47,883)	482,762
Total movement in EAD during the year	**(429,746)**	**781,525**	**97,181**	**448,960**
31 December 2020	**11,710,828**	**2,150,674**	**488,869**	**14,350,371**

ECL – Loans and receivables from customers				
1 January 2020	**187,748**	**242,184**	**223,299**	**653,231**
Transfers to/(from)				
Stage 1	(31,099)	122,691	19,936	111,528
Stage 2	1,296	(20,265)	13,204	(5,765)
Stage 3	-	93	(108)	(15)
Net financial assets originated	38,744	(6,917)	5,694	37,521
Movements due to risk parameter and other changes	(12,912)	(4,107)	11,512	(5,507)
Total net P&L charge during 2019	**(3,971)**	**91,495**	**50,238**	**137,762**
Loans written off against provision/(write back of provision no longer required)	-	-	(716)	(716)
31 December 2020	**183,777**	**333,679**	**272,821**	**790,277**

15. Loans and receivables from customers (continued)

Total off balance sheet exposures are predominantly classified under stage 1 as at balance date.

All amounts are expressed in K'000	2020 Stage 1		2019 Stage 1	
	Gross exposure	**Loss allowance**	**Gross exposure**	**Loss allowance**
Balance 1 January	2,567,433	47,373	2,232,389	37,534
Net increase/(decrease)	416,711	6,061	335,044	9,839
Balance at 31 December	**2,984,144**	**53,434**	**2,567,433**	**47,373**

Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

The Group may write-off financial assets that are still subject to enforcement activity. The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

16. Other Assets

	Consolidated		Bank	
	2020	**2019**	**2020**	**2019**
Financial Assets				
Funds in transit and other assets[1]	140,638	194,315	102,794	146,054
Accrued interest – Government inscribed stock	61,272	37,446	60,688	36,709
Accrued interest – loans and receivables from customers	75,289	63,620	66,305	56,826
Intercompany account	-	-	3,026	6,960
Outstanding premiums	21,030	17,681	-	-
Prepayments	38,723	32,524	33,921	27,815
Accounts receivable	4,642	3,571	2,938	2,254
Tax receivable	32,887	27,588	32,419	30,275
	374,481	**376,745**	**302,091**	**306,893**
Non-Financial Assets				
Inventory	11,649	17,837	-	-
Investment in Joint Ventures	202,546	202,040	27,879	20,787
Intangible Assets	220,846	196,206	207,216	177,601
Investment properties	257,690	168,360	-	-
	692,731	**584,443**	**235,095**	**198,388**
At 31 December	**1,067,212**	**961,188**	**537,186**	**505,281**

[1] Funds in transit includes interbank transactions which are in the process of clearance.

Financial Instruments: Financial Liabilities

Accounting Policy

Recognition

Financial liabilities are recognised when an obligation arises.

Classification and subsequent measurement

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities arising from the transfer of financial assets which did not qualify for de-recognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments

De-recognition

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

The exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

Financial guarantee contracts and loan commitments

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance (calculated as described in note 15);
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

Expected credit loss on loan commitments provided by the Group are measured as the amount of the loss allowance (calculated as described in note 15). The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision liability.

17. Amount Due to Other Banks

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Vostro account balances	57,529	47,083	76,185	66,786
Other borrowings	68,741	36,848	152,913	95,359
At 31 December	**126,270**	**83,931**	**229,098**	**162,145**

18. Customer Deposits

On demand and short term deposits	17,990,094	15,322,280	17,097,544	14,605,182
Term deposits	3,663,930	4,016,776	3,006,807	3,376,574
At 31 December	**21,654,024**	**19,339,056**	**20,104,351**	**17,981,756**

The deposits are diversified across industries and regions with the maturity profile of deposits included in note 23.

19. Other Liabilities

Insurance liabilities				
Premiums received in advance	29,144	6,329	-	-
Outstanding claims	23,894	18,679	-	-
Claims incurred but not reported (IBNR)	2,146	2,297	-	-
Other insurance liabilities	151,491	132,768	-	-
At 31 December	**206,675**	**160,073**	**-**	**-**
Creditors and accruals	104,891	184,941	70,801	122,218
Items in transit and all other liabilities	463,555	399,916	554,437	520,720
Borrowings[1]	245,614	116,817	245,614	116,817
Other provisions	209,437	203,662	195,346	186,574
At 31 December	**1,230,172**	**1,065,409**	**1,066,198**	**946,329**

[1]A loan amounting to K242.215 million (USD 70 million) was drawn down in 2020 with quarterly interest repayments commencing in the third quarter. The Bank pre-paid an existing obligation of K78.215 million (USD 22.5 million) at the same time.

20. Contingent Liabilities and Commitments

Commitments for capital expenditure				
Amounts with firm commitments, and not reflected in the accounts	44,120	55,829	29,753	51,313
Off balance sheet financial instruments				
Letters of credit	97,420	121,600	96,366	117,057
Guarantees and indemnities issued	289,579	366,170	290,123	341,373
Commitments to extend credit	2,599,995	2,088,924	2,509,139	2,003,881
	2,986,994	**2,576,694**	**2,895,628**	**2,462,311**

Contingent liabilities includes forward exchange contracts of K2.880m which is not part of the credit exposure.

20. Contingent Liabilities and Commitments (continued)

Legal Proceedings

A number of legal proceedings against the Group were outstanding as at 31 December 20. Based on information available at 31 December 2020, the Group estimates a contingent liability of K17.7 million (2019: K15.8 million) in respect of these proceedings.

The Bank operates in a number of regulated markets and is subject to regulatory reviews and inquiries. From time to time these may result in fines or other regulatory enforcement actions. As at reporting date there are no matters of this nature for which the Bank expects to result in a material economic outflow of resources.

Risk Management

21. Risk Management Framework and Controls

All business operations must deal with a variety of operational and financial risks. The business activities of a bank expose it to very critical and specific risks, which are principally related to the Group's primary financial intermediary role in the financial markets, including the use of financial instruments including derivatives. These risks (risk of an adverse event in the financial markets that may result in loss of earnings) include liquidity risk, foreign exchange risk, interest rate risk and credit risk.

The Group accepts deposits from customers at both fixed and floating rates and for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. These margins are achieved and increased by consolidating short-term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to optimise its interest margins by obtaining above average returns, net of provisions, through lending to commercial and retail borrowers with a range of credit standing. In addition to directly advancing funds to borrowers, the Group also enters into guarantees and other commitments such as letters of credit, performance bonds, and other bonds.

The Group also enters into transactions denominated in foreign currencies. This activity generally requires the Group to take foreign currency positions in order to exploit short term movements in the foreign currency market. The Board places limits on the size of these positions. The Group also has a policy of using offsetting commitments for foreign exchange contracts, effectively minimising the risk of loss due to adverse movements in foreign currencies.

Risk in the Group is managed through a system of delegated limits. These limits set the maximum level of risk that can be assumed by each operational unit and the Group as a whole. The limits are delegated from the Board of Directors to executive management and hence to the respective operational managers.

The risk management framework establishes roles, responsibilities and accountabilities of the Asset and Liability Committee, the Credit Committee, the Operational Risk Committee and the Executive Committee, the specific management committees charged with the responsibility for ensuring the Group has appropriate systems, policies and procedures to measure, monitor and report on risk management. The framework also includes policies and procedures which detail formal feedback processes to these management committees, to the Board Audit and Compliance Committee, Board Risk Committee and ultimately to the Board of Directors.

22. Credit Risk and Asset Quality

22.1 Credit risk

The Group incurs risk with regard to loans and receivables due from customers and other monies or investments held with financial institutions. Credit risk is the likelihood of future financial loss resulting from the failure of clients or counter-parties to meet contractual obligations to the Group as they fall due.

Credit risk is managed by analysing the risk spread across various sectors of the economy and by ensuring risk is diversely spread by personal and commercial customer. Individual exposures are measured using repayment performance, reviews and statistical techniques. Comprehensive credit standards and approval limits have been formulated and approved by the Credit Committee. The Credit Committee (which reports to the Board through the Executive and Chief Executive Officer) is responsible for the development and implementation of credit policy and loan portfolio review methodology. The Credit Committee is the final arbiter of risk management and loan risk concentration.

The Group has in place processes that identify, assess and control credit risk in relation to the loan portfolio, to assist in determining the appropriateness of provisions for loan impairment. These processes also enable assessments to be made of other classes of assets that may carry an element of credit risk. The Group assigns quality indicators to its credit exposures to determine the asset quality profile.

22.1.1 Credit risk measurement

Loans and advances (incl. loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD).

Credit risk grading

The Group uses an internal credit risk grading system that reflects its assessment of the probability of default of individual counterparties. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Group Chief Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The Group's rating method comprises 11 rating levels for instruments not in default (1 to 11) and three default classes (12 to 14). The master scale assigns each rating category a specified range of probabilities of default, which is stable over time. The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

Group Internal Scale	S&P Letter Grade	Description
1	BBB+	Standard Monitoring
2	BBB	
3	BBB-	
4	BB+	
5	BB	
6	BB-	
7	B+	
8	B	
9	B-	

22. Credit Risk and Asset Quality (continued)

22.1.1 Credit risk measurement (continued)

Group Internal Scale	S&P Letter Grade	Description
10	CCC+	Special Monitoring
11	CCC	
12	CCC-	Substandard
13	D-I	Doubtful
14	D-II	Loss

22.1.2 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition, as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.
- If a significant increase in credit risk since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 22.1.2.1 for a description of how the Group determines when a significant increase in credit risk has occurred.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 22.1.2.2 for a description of how the Group defines credit-impaired and default.

Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 22.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.

- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 22.1.2.3 includes an explanation of how the Group has incorporated this in its ECL models.

The following diagram summarises the impairment requirements under IFRS 9.

Change in credit quality since initial recognition

Stage 1	Stage 2	Stage 3
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

22.1.2.1 Significant increase in credit risk

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

- Qualitative Criteria - if the instrument meets one or more of the following criteria:
  - Significant adverse changes in business, financial and/or economic conditions in which the borrower operates
  - Actual or expected forbearance or restructuring

22. Credit Risk and Asset Quality (continued)

22.1.2.1 Significant increase in credit risk (continued)

- Actual or expected significant adverse change in operating results of the borrower
- Significant change in collateral value (secured facilities only) which is expected to increase risk of default
- Early signs of cash flow/liquidity problems such as delay in servicing of trade creditors/loans

- Quantitative criteria - applies to performing loans risk graded at 10 or 11 as per BSPs credit rating system which are 'watch list' categories. By definition, these have experienced a SICR event since inception hence need to be classified as Stage 2, with lifetime PDs applicable. This criteria applies regardless of whether loans in these two RGs are in arrears or not.

- Backstop - A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments. The Group has not used the low credit risk exemption for any financial instrument in the year ending 31 December 2020.

22.1.2.2 Definition of default and credit-impaired assets

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit- impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent
- The borrower is in breach of financial covenant(s)
- An active market for that financial asset has disappeared because of financial difficulties
- Concessions have been made by the lender relating to the borrower's financial difficulty
- It is becoming probable that the borrower will enter bankruptcy
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

22. Credit Risk and Asset Quality (continued)

22.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12-month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.
- Loss Given Default (LGD) represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD).

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. These assumptions vary by product type. Model adjustments are also included within the ECL allowance. Model adjustments are used in circumstances where it is judged that the existing inputs, assumptions and model techniques do not capture all relevant risk factors. The emergence of new macroeconomic, microeconomic factors, changes to parameters or credit risk data not incorporated into current parameters are examples of such circumstances.

The Group used statistical models to convert historical PDs into forward looking lifetime PDs. The conversion process looks at the historical relationship between long-term PDs for a particular year and the observed (annual) default rate for the same year (called the 'Z-factor') and a set of systematic factors for the year. The Group has performed historical analysis and identified the key economic variables (systematic factors) impacting credit risk and expected credit losses which are as follows:

- GDP Growth (%)
- Change in Unemployment (%)
- Change in Equity Index (%)
- Change in Energy Index (%)
- Change in Non-Energy Index (%)
- Change in the Proportion of Downgrades (%)

These are then compared to the expected systematic factors and long-term PDs for a future year to estimate the PiT PDs for that future year. Forecasts of these economic variables (the "base economic scenario") are provided by the Group's Strategy team and provide the best estimate view of the economy over the next five years. Z-factors are estimated for five years based on forecast systematic data and all future years from year 6 are adjusted using Z- factors which diminish in magnitude from the one estimated for year 5.

Economic variable assumptions

The period-end assumptions used for the ECL estimate as at 31 December 2020 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

22. Credit Risk and Asset Quality (continued)

Economic variable assumptions (continued)

		2020	2021	2022	2023	2024
GDP Growth (%)	Base	3.40%	3.40%	3.40%	3.40%	3.40%
	Upside	3.65%	3.65%	3.65%	3.65%	3.65%
	Downside	1.20%	1.20%	2.90%	3.00%	2.80%
Change in Unemployment (% total lab force) (%)	Base	-3.00%	-3.00%	-2.00%	-2.00%	-2.00%
	Upside	-4.00%	-4.00%	-3.00%	-3.00%	-3.00%
	Downside	0.00%	0.00%	0.00%	0.00%	0.00%
Change in Equity Index (%)	Base	-3.51%				
	Upside	-3.54%				
	Downside	-3.51%				
Change in Energy Index (%)	Base	7.75%	10.07%	2.45%	2.39%	2.34%
	Upside	8.14%	10.58%	2.57%	2.51%	2.45%
	Downside	7.36%	9.57%	2.33%	2.27%	2.22%
Change in Non-Energy Index (%) *(Per World Bank commodities price forecast)*	Base	0.12%	-0.24%	-0.24%	-0.24%	-0.24%
	Upside	0.13%	-0.25%	-0.25%	-0.25%	-0.25%
	Downside	0.11%	-0.23%	-0.23%	-0.23%	-0.23%
Change in the Proportion of Downgrades (%)	Base	3.32%				
	Upside	-2.00%				
	Downside	10.00%				

The weightings assigned to each economic scenario at 31 December 2020 were as follows:

Scenario	Base	Upside	Downside
Weight	50.00%	10.00%	40.00%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on an annual basis.

Sensitivity Analysis

The most significant assumptions affecting the ECL allowance are as follows:

i) GDP given the significant impact on business performance and collateral valuations; and

ii) Change in proportion of downgrades given that it is “BSP specific” and addresses potential signs of stress both within credit markets in general and in client specific portfolios.

iii) Change in scenario weighting given the uncertainty surrounding the economic impact of COVID-19.

22. Credit Risk and Asset Quality (continued)

***Sensitivity Analysis** (continued)*

Set out below are the changes to the ECL as at 31 December 2020 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions:

All amounts are expressed in K'000	2020		2019	
	[-25%]	**[+10%]**	**[-20%]**	**[+10%]**
GDP Growth Rate	37,287	(11,041)	42,060	(19,342)

(GDP growth rate assumptions tested at 75% and 110% for all 3 scenarios)

	[-7%]	**[+20%]**	**[-5%]**	**[+20%]**
Change in proportion of downgrades	(945)	8,533	(1,088)	5,662

(Upside scenario increased from -2% to-7% (2019:-5%), downside scenario increased from 10% to 20%)

	2020	**2019**
Change in Scenario weighting	(39,735)	(32,714)

(Upside scenario increased from 10% to 20%, downside scenario decreased from 40% to 20% and base scenario increased from 50% to 60%).

Change in Scenario weighting	11,090	-

(Upside scenario decreased from 10% to 5%, downside scenario increased from 40% to 45% and base scenario remaining at 50%).

22.1.2.4 Grouping of instruments for losses measured on a collective basis

For expected credit loss provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous.

In performing this grouping, there must be sufficient information for the group to be statistically credible. Where sufficient information is not available internally, the Group has considered benchmarking internal/external supplementary data to use for modelling purposes. The characteristics and any supplementary data used to determine groupings are outlined below:

Retail – Groupings for collective measurement

- Loan to value ratio band
- Risk Grade
- Product type (e.g. Residential/Buy to Let mortgage, Overdraft, Credit Card)

22. Credit Risk and Asset Quality (continued)

22.1.3 Credit risk exposure

22.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

All amounts are expressed in K'000

	2020				2019
ECL staging	**Stage 1 12-month**	**Stage 2 Lifetime**	**Stage 3 Lifetime**	**Total**	**Total**
Credit grade					
Standard monitoring	11,710,828	1,676,312	-	13,387,140	13,006,714
Special monitoring	-	474,362	-	474,362	503,009
Default	-	-	488,869	488,869	391,688
Gross carrying amount	**11,710,828**	**2,150,674**	**488,869**	**14,350,371**	**13,901,411**
Loss allowance	(183,777)	(333,679)	(272,821)	(790,277)	(653,231)
Net Carrying amount	**11,527,051**	**1,816,995**	**216,048**	**13,560,094**	**13,248,180**

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 15 'Expected credit loss measurement'. The gross carrying amount includes off balance sheet items which are in scope for impairment.

The total balance of investment securities measured at amortised cost (K5,936.049 million) is classified as Stage 1 with a credit grade of 'standard monitoring'. Total loss allowance carried against this balance is K30.805 million.

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment (i.e. FVPL):

Maximum exposure to credit risk

All amounts are expressed in K'000	**2020**	**2019**
Trading assets		
• Equity Securities	269,400	255,372

22.1.3.2 Collateral and other credit enhancements

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable; and
- Charges over financial instruments such as debt securities and equities.

22. Credit Risk and Asset Quality (continued)

22.1.3.2 Collateral and other credit enhancements (continued)

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial instruments.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses.

Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

31 December 2020 **Consolidated** *All amounts are expressed in K'000*	**Gross exposure**	**Impairment allowance**	**Carrying amount**	**Fair value of collateral held**
Credit-impaired assets				
Loans to individuals:				
• Overdrafts	7,730	1,758	5,972	13,685
• Credit cards	389	198	191	-
• Term loans	21,399	9,252	12,147	25,031
• Mortgages	100,294	40,996	59,298	159,690
Loans to corporate entities:				
• Large corporate customers	274,994	179,981	95,013	215,659
• Small and medium-sized enterprises (SMEs)	83,475	40,464	43,011	137,283
• Others	588	172	416	1,351
Total credit-impaired assets	**488,869**	**272,821**	**216,048**	**552,699**
31 December 2019				
Total credit-impaired assets	**391,688**	**223,299**	**168,389**	**413,838**

22.1.4 Credit Quality – Prudential guidelines

The Bank of Papua New Guinea has maintained a revised prudential standard for asset quality since October 2003. The revised standard specifies more detailed criteria for the classification of loans into various grades of default risk and corresponding loss provision levels as a consequence of those gradings.

An analysis by credit quality of loans outstanding at 31 December 2020 is as follows:

22. Credit Risk and Asset Quality (continued)

22.1.4 Credit Quality – Prudential guidelines (continued)

31 December 2020

Consolidated

All amounts are expressed in K'000	Overdrafts	Term loans	Mortgages	Lease financing	Policy loans	Total
Neither past due nor impaired	**747,218**	**9,699,015**	**2,441,397**	**264,445**	**105,193**	**13,257,268**
Past due but not impaired						
- Less than 30 days	48,722	244,109	133,554	4,594	-	430,979
- 30 to 90 days	3,727	167,932	92,966	2,734	-	267,359
	52,449	**412,041**	**226,520**	**7,328**	**-**	**698,338**
Individually impaired loans						
- Less than 30 days	5,226	4,216	7,113	109	-	16,664
- 30 to 90 days	-	20,684	8,118	238	-	29,040
- 91 to 360 days	776	88,930	16,431	976	-	107,113
- More than 360 days	6,602	115,809	113,820	5,717	-	241,948
	12,604	**229,639**	**145,482**	**7,040**	**-**	**394,765**
Total gross loans and receivables from customers	**812,271**	**10,340,695**	**2,813,399**	**278,813**	**105,193**	**14,350,371**
Less impairment provisions	(43,962)	(737,439)	(50,801)	(11,509)	-	(843,711)
Net loans and receivables from customers	**768,309**	**9,603,256**	**2,762,598**	**267,304**	**105,193**	**13,506,660**

22.1.5 Credit related commitments

These instruments are used to ensure that funds are available to a customer as required. The Group deals principally in the credit related commitments set out below.

Guarantees and standby letters of credit, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same risk as loans.

Documentary and trade letters of credit are written undertakings by the Group on behalf of a customer, authorising a third party to draw drafts on the Group for specified amounts under specified terms and conditions. They are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a conventional loan.

Commitments to extend credit represent undrawn portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. Whilst the potential exposure to loss equates to the total undrawn commitments, the likely amount of loss is less than the total commitment since the commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of these commitments because longer term commitments generally carry a greater degree of credit risk than shorter term commitments.

22. Credit Risk and Asset Quality (continued)

22.1.6 Economic sector risk concentrations

Economic sector risk concentrations within the customer loan portfolio are as follows:

All amounts are expressed in K'000

Consolidated **As at 31 December**	**2020**	**%**	**2019**	**%**
Commerce, finance and other business	7,123,057	53	7,159,863	54
Private households	3,232,599	24	2,987,459	23
Government and public authorities	157,811	1	252,134	2
Agriculture	434,215	3	327,151	2
Transport and communication	1,218,790	9	1,311,306	10
Manufacturing	383,725	3	332,344	3
Construction	956,463	7	830,550	6
Net loan portfolio balance	**13,506,660**	**100**	**13,200,807**	**100**

22.1.7 Loan segment concentration

Concentration by customer loan segments are as follows:

Consolidated **As at 31 December**	**2020**	**%**	**2019**	**%**
Corporate / Commercial	8,025,709	59	7,703,341	58
Government	2,247,793	17	2,510,817	19
Retail	3,233,158	24	2,986,649	23
Net loan portfolio balance	**13,506,660**	**100**	**13,200,807**	**100**

22.1.8 Impact of overlays on the provision for ECL

The following table attributes the breakup between modelled ECL and other economic overlays. Where there is increased uncertainty regarding the required forward-looking economic conditions under IFRS 9, or limitations of the historical data used to calibrate the models to current stressed environments, overlays are typically used to address areas of potential risk not captured in the underlying modelled ECL.

All amounts are expressed in K'000	**2020**	**2019**
Modelled provision for ECL	433,620	401,704
Overlays	137,270	74,445
Total	**570,890**	**476,149**

22.1.8.1 COVID-19 overlay

Where there is increased uncertainty regarding the required forward-looking economic conditions under IFRS 9, or limitations of the historical data used to calibrate the models to current stressed environments, overlays are used to address areas of potential risk not captured in the underlying modelled ECL.

22. Credit Risk and Asset Quality (continued)

22.1.8.1 COVID-19 overlay

The COVID-19 pandemic has had, and continues to have, an impact on businesses around the world and the economic environments in which they operate. There also exists significant uncertainty regarding the duration and severity of COVID-19 impacts and the associated disruption to the economy and our customers. While the impacts on the broader economy are included in the assumptions used in the economic scenarios and the weightings applied to these scenarios, these general economy wide impacts may not fully reflect the specific impact on individual customers, and therefore the potential risk is not captured in the underlying modelled ECL. As overlays require the application of expert judgment, they are documented and subject to comprehensive internal governance and oversight.

The Group's COVID-19 overlay as of 31 December 2020 is K138.08 million.

The repayment holiday and interest only arrangements are normally treated as an indication of a significant increase in credit risk but the repayment holidays under the current COVID-19 relief packages in isolation have not been treated as an indication of SICR.

As highlighted by the IASB in its guidance document 'IFRS 9 and COVID-19' issued on 27 March 2020, in these changed circumstances it may not be appropriate to apply previously established approaches to assessing significant increase in credit risk for payment holidays in a mechanistic manner.

These relief packages are available to customers who require assistance because of COVID-19 and who otherwise had up to date payment status prior to the onset of COVID-19. The relief packages allow for repayment holidays for up to 6 months. During this period, the deferred interest will be capitalized and the deferred principal along with the capitalized interest, will be repaid over the remaining term of the loan. These packages have been designed to provide short-term cash flow support while the most significant COVID-19 restrictions are in place. Further extensions were based on local Central Banks approvals. The extension will not be automatic and will require up-to-date financial information on each borrower to confirm that there is a reasonable prospect to repay the loan.

As the situation has evolved since March 2020, the Group has classified the relief packages into different categories of risk. Each of these categories are assigned a corresponding IFRS 9 staging level based on whether SICR is deemed to have occurred because of the increased likelihood of a risk of default. The group has identified a proportion of relief packages as higher credit risk and has identified a SICR event to have occurred on these customers. An overlay estimation has been done on this base of customers.

The Group continues to monitor our lending portfolios closely and reassess our provisioning levels as the situation around COVID-19 evolves. At the cessation of the COVID-19 support packages, it is likely that some customers will move into Stage 2.

22.1.8.2 COVID-19 relief packages

The customers under COVID-19 relief packages at 31 December 2020 is K1.626 billion. These loans and the related provision for ECL are as follows:

All amounts are expressed in K'000	**Total Credit Exposures**	**Expected Credit Loss**
Stage 1	659,147	48,021
Stage 2	966,858	44,003
Stage 3	-	-
Total	**1,626,005**	**92,024**

23. Liquidity Risk

Liquidity risk is the risk of being unable to meet financial obligations as they fall due. The Board, through the Asset and Liability Committee, sets liquidity policy to ensure that the Group has sufficient funds available to meet all its known and potential obligations.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of banking activities. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

Short-term mismatch of asset and liability maturity at 31 December 2020

The maturity profile of material Assets and Liabilities as at 31 December 2020 is shown in the following schedule. The mismatching of maturity of assets and liabilities indicates an apparent negative net "current" asset position. However, as stated in the preceding paragraph, mismatched positions are established and managed to achieve profit opportunities that arise from them, particularly in a normal yield curve environment. Accordingly, this mismatched maturity position is considered manageable by the Group, and does not impair the ability of the Group to meet its financial obligations as they fall due.

Maturity of assets and liabilities

All amounts are expressed in K'000

Consolidated As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and balances with Central Banks	3,973,012	-	-	-	483,467	4,456,479
Treasury and Central Bank bills	611,384	616,990	1,702,704	2,533	4,277	2,937,888
Amounts due from other banks	1,092,892	59,819	34,750	-	-	1,187,461
Loans and receivables from customers	2,038,752	324,571	2,360,167	5,917,381	5,875,628	16,516,499
Other financial assets	2,390,783	351,479	736,769	2,027,860	1,897,463	7,404,354
Total assets	**10,106,823**	**1,352,859**	**4,834,390**	**7,947,774**	**8,260,835**	**32,502,681**
Liabilities						
Amounts due to other banks	12,478	89,738	24,054	-	-	126,270
Customer deposits	18,616,789	971,280	1,583,504	413,582	346,655	21,931,810
Lease liability	-	-	-	44,968	164,038	209,006
Other liabilities	2,379,124	428	5,287	9,725	106,883	2,501,447
Other provisions	198,939	875	4,311	249	5,063	209,437
Total liabilities	**21,207,330**	**1,062,321**	**1,617,156**	**468,524**	**622,639**	**24,977,970**
Net liquidity gap	**(11,100,507)**	**290,538**	**3,217,234**	**7,479,250**	**7,638,196**	**7,524,711**

As at 31 December 2019						
Total assets	8,109,293	2,070,054	5,164,106	6,685,164	6,261,178	28,289,795
Total liabilities	16,040,140	1,194,142	1,802,509	719,961	2,021,445	21,778,197
Net liquidity gap	**(7,930,847)**	**875,912**	**3,361,597**	**5,965,203**	**4,239,733**	**6,511,598**

24. Operational Risk

Operational risk is the potential exposure to unexpected financial or non-financial losses arising from the way in which the Group conducts its business. Examples of operational risks include employee errors, systems failures, fire, floods, or similar losses to physical assets, fraud, or criminal activity. Operational risk is managed through formal policies, documented procedures, business practices and compliance monitoring.

An operational risk management function is responsible for the maintenance of these policies, procedures practices and monitoring the organization's compliance with them. The Operational Risk Committee coordinates the management process across the organization.

An independent internal audit function also conducts regular reviews to monitor compliance with approved BPNG standards and examines the general standard of control.

The Operational Risk Committee and the internal audit function mandatorily report to the Board Risk and Compliance Committee.

25. Foreign Exchange Risk

Foreign exchange risk is the risk to earnings caused by a change in foreign exchange rates on open currency positions. The objective of foreign exchange risk management within the Group is to minimise the impact on earnings of any such movement.

The Group accepts foreign currency denominated transactions and therefore has exposure to movements in foreign currency. The Group has a policy to offset these transactions to minimise daily exposure. As foreign exchange contracts generally consist of offsetting commitments, they involve only limited foreign exchange risk to the Group and material loss is not envisaged.

Currency concentration of assets, liabilities, and off-balance sheet items

All amounts are expressed in K'000

Consolidated As at 31 December 2020	**PGK**	**FJD**	**SBD**	**USD**	**Other**	**Total**
Assets						
Cash and balances with Central Banks	2,150,591	1,059,431	636,025	2,370	608,062	**4,456,479**
Treasury and Central Bank bills	2,778,202	12,116	19,114	-	31,574	**2,841,006**
Amounts due from other banks	115,956	330,746	14,000	384,461	342,298	**1,187,461**
Loans and receivables from customers	7,917,985	3,305,723	513,556	528,501	1,240,895	**13,506,660**
Other financial assets	2,662,225	551,794	159	-	28,047	**3,242,225**
Other assets	1,388,100	733,124	57,722	1,594	109,066	**2,289,606**
Total assets	**17,013,059**	**5,992,934**	**1,240,576**	**916,926**	**2,359,942**	**27,523,437**
Liabilities						
Amounts due to other banks	(75,598)	(36,677)	(10,031)	-	(3,964)	**(126,270)**
Customer Deposits	(14,225,150)	(3,712,304)	(926,891)	(549,558)	(2,240,121)	**(21,654,024)**
Other liabilities	(527,650)	(1,416,424)	(30,238)	(265,584)	(69,642)	**(2,309,538)**
Total liabilities	**(14,828,398)**	**(5,165,405)**	**(967,160)**	**(815,142)**	**(2,313,727)**	**(24,089,832)**
Net on-balance sheet position	**2,184,661**	**827,529**	**273,416**	**101,784**	**46,215**	**3,433,605**
Off-balance sheet position	*25,393*	*-*	*-*	*(155,724)*	*137,131*	*6,800*
Credit commitments	*2,267,067*	*556,094*	*46,965*	*-*	*116,868*	*2,986,994*
31 December 2019						
Total Assets	15,207,153	4,941,049	1,193,401	740,480	2,445,035	24,527,118
Total Liabilities	(13,326,239)	(4,424,064)	(946,797)	(655,738)	(2,057,247)	(21,410,085)
Net on-balance sheet position	**1,880,914**	**516,985**	**246,604**	**84,742**	**387,788**	**3,117,033**
Off-balance sheet position	*798*	*-*	*-*	*(139,868)*	*140,009*	*939*
Credit commitments	*1,879,065*	*517,433*	*60,433*	*-*	*119,763*	*2,576,694*

25. Foreign Exchange Risk (continued)

The following table presents sensitivities of profit or loss and equity to possible changes in exchange rates applied at the end of the reporting period, relative to the functional currency of the respective Group entities, with all other variables held constant:

All amounts are expressed in K'000	2020		2019	
	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
USD strengthening by 5% (2019 – 1%)	7,664	7,664	356	356
USD dollar weakening by 15% (2019 – 1%)	(2,068)	(2,068)	(349)	(349)
AUD strengthening by 5% (2019 – 1%)	(399)	(399)	(36)	(36)
AUD dollar weakening by 15% (2019 – 1%)	108	108	35	35

In the normal course of trading, the Group enters into forward exchange contracts. The Group does not actively enter into or trade in, complex forms of derivative financial instruments such as currency and interest rate swaps and options.

Exposures in foreign currencies arise where the Group transacts in foreign currencies. This price risk is minimised by entering into counterbalancing positions for material exposures as they arise. Forward and spot foreign exchange contracts are used.

Forward exchange contracts outstanding at 31 December 2020 stated at the face value of the respective contracts are:

All amounts are expressed in K'000

As at 31 December 2020		USD	AUD	EURO	GBP	JPY	Other	Total
	FCY	(47,232)	(3,567)	(1,069)	(5)	(86,102)	(844)	-
Selling	**Kina**	(165,728)	(9,641)	(4,610)	(22)	(2,929)	(2,962)	(185,892)
	FCY	2,851	18,660	30	40	60,100	29,780	-
Buying	**Kina**	10,004	50,438	129	191	2,045	104,491	167,298

As at 31 December 2019		USD	AUD	EURO	GBP	JPY	Other	Total
	FCY	(49,183)	(2,529)	(900)	(21)	(181,179)	(2,110)	-
Selling	**Kina**	(167,576)	(6,039)	(3,437)	(88)	(5,525)	(7,188)	(189,853)
	FCY	8,132	14,800	20	1,200	137,500	34,444	-
Buying	**Kina**	27,708	35,338	76	5,125	4,193	117,357	189,797

26. Interest Rate Risk

Interest rate risk in the balance sheet arises from the potential for a change in interest rate to have an adverse effect on the revenue earnings in the current reporting period and future years. As interest rates and yield curves change over time the Group may be exposed to a loss in earnings due to the effects of interest rates on the structure of the balance sheet. Sensitivity to interest rates arises from mismatches in the re-pricing dates, cash flows and other characteristics of the assets and their corresponding liability funding.

26. Interest Rate Risk (continued)

These mismatches are actively managed as part of the overall interest rate risk management process governed by the Assets and Liabilities Committee (ALCO), which meets regularly to review the effects of fluctuations in the prevailing levels of market interest rates on the financial position and cash flows of the Group. The objective of interest rate risk control is to minimise these fluctuations in value and net interest income over time, providing secure and stable sustainable net interest earnings in the long term. The table below illustrates the interest sensitivity of assets and liabilities at the balance date.

Interest sensitivity of assets, liabilities and off balance sheet items – re-pricing analysis

All amounts are expressed in K'000

Consolidated As at 31 December 2020	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing
Assets						
Cash and Central Banks assets	711,765	-	-	-	-	2,185,430
Treasury and Central Bank bills	609,603	590,534	1,631,207	5,386	4,276	-
Amounts due from other banks	341,561	51,540	2,181	-	-	792,179
Statutory deposits - Central Banks	-	-	-	-	-	1,559,284
Loans and receivables from customers	10,874,738	112,213	397,917	321,126	1,705,563	95,103
Other Financial Assets	642,205	209,532	577,043	1,258,350	757,641	-
Other assets	11,463	98,510	583	-	-	1,976,504
Total assets	**13,191,335**	**1,062,329**	**2,608,931**	**1,584,862**	**2,467,480**	**6,608,500**
Liabilities						
Amounts due to other banks	28,387	11,382	24,053	-	-	62,448
Customer deposits	8,545,533	878,736	1,375,840	146,657	-	10,707,258
Other liabilities	238	-	-	74,872	85,527	1,944,399
Other provisions	5,507	200	-	-	-	198,795
Total liabilities	**8,579,665**	**890,318**	**1,399,893**	**221,529**	**85,527**	**12,912,900**
Interest sensitivity gap	**4,611,670**	**172,011**	**1,209,038**	**1,363,333**	**2,381,953**	**(6,304,400)**

Interest sensitivity of assets, liabilities and off balance sheet items – re-pricing analysis

As at 31 December 2019	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing
Total assets	13,007,025	1,114,574	2,781,083	1,461,656	376,863	5,785,917
Total liabilities	8,709,354	1,082,072	1,628,037	299,468	73,019	9,618,135
Interest sensitivity gap	**4,297,671**	**32,502**	**1,153,046**	**1,162,188**	**303,844**	**(3,832,218)**

Given the profile of assets and liabilities as at 31 December 2020 and prevailing rates of interest, a 100bps increase in market rates will result in a K46.4 million increase in net interest income, whilst a 100bps decrease in rates will result in a K54.4 million decrease in net interest income.

27. Fair Values of Financial and Non-Financial Assets and Liabilities

There is no material difference between the fair values and carrying values of the financial assets and liabilities of the Group.

The table below analyses the Group's financial instruments carried at fair value, by levels in the fair value hierarchy.

27. Fair Values of Financial and Non-Financial Assets and Liabilities (continued)

The different levels have been defined as follows:
- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Consolidated

All amounts are expressed in K'000

As at 31 December 2020	**Level 1**	**Level 2**	**Level 3**	**Total**
a) Financial assets				
Equity security	-	265,727	3,673	269,400
Treasury bills	-	8,094	-	8,094
Government inscribed stock	-	291,042	-	291,042
Non-financial assets				
Land & Buildings	-	-	701,627	701,627
Assets subject to operating lease	-	-	36,434	36,434
Total assets	**-**	**564,863**	**741,734**	**1,306,597**
b) Financial liabilities				
Policy liability	-	-	1,043,990	1,043,990
Total liabilities	**-**	**-**	**1,043,990**	**1,043,990**
As at 31 December 2019	**Level 1**	**Level 2**	**Level 3**	**Total**
a) Financial assets				
Equity security	-	252,277	3,095	255,372
Treasury bills	-	4,915	-	4,915
Government inscribed stock	-	513,024	-	513,024
Non-financial assets				
Land & Buildings	-	-	708,284	708,284
Assets subject to operating lease	-	-	48,133	48,133
Total assets	-	**770,216**	**759,512**	**1,529,728**
b) Financial liabilities				
Policy liability	-	-	890,147	890,147
Total liabilities	-	-	**890,147**	**890,147**

Consolidated

Financial asset at fair value through profit & loss	**2020**	**2019**
Opening balance	3,095	2,696
Total gains and losses recognized in:		
- Profit & loss	578	399
- Other comprehensive income	-	-
Closing balance	**3,673**	**3,095**

27. Fair Values of Financial and Non-Financial Assets and Liabilities (continued)

There were no changes in valuation technique for Level 3 recurring fair value measurements during the year ended 31 December 2020. Property, plant and equipment represents commercial land and buildings owned by the Group based on valuations provided by independent valuers.

The valuation is based on the capitalisation method with an assessment of the property based on its potential earning capacity. There is an increased level of uncertainty with the valuation obtained for the financial year 2020 accounts given the volatile economic climate driven by COVID-19. A higher degree of caution should be attached to the valuation than would normally be the case, noting that the value is current at the date of the valuation only. The assessed value may change materially and unexpectedly over a relatively short period of time due to the impact of COVID-19.

Capital and Dividends

28. Ordinary Shares

Accounting Policy

Share issue costs

External costs directly attributable to the issue of new shares are deducted from equity net of any related income taxes.

Number of shares in '000s, Book value in K'000	**Number of shares**	**Book value**
At 31 December 2018/1 January 2019	**467,246**	**372,364**
Share buyback	(6)	(54)
At 31 December 2019/1 January 2020	**467,240**	**372,310**
Share buyback	(11)	(121)
At 31 December 2020	**467,229**	**372,189**

In May 2014, the Directors introduced a share-buyback scheme of up to K15 million. The share-buyback commenced in July 2014 and was extended to such time when the allocated K15 million buyback was utilised, or if the Board wishes, any time before that. As at 31 December 2020, a total of K9.313m has been bought back under this scheme.

Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are declared.

Dividends for the year, declared after the balance sheet date, are dealt with in the subsequent events note.

	Consolidated		**Bank**	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Dividends paid on ordinary shares				
Interim ordinary dividend (2020: 25 toea; 2019: 38 toea)	117,604	177,551	116,808	177,551
Final ordinary dividend (2019: 96 toea; 2018: 101 toea)	451,751	476,389	448,546	471,915
	569,355	**653,940**	**565,354**	**649,466**

29. Retained Earnings and Other Reserves

Retained earnings

All amounts are expressed in K'000	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
At 1 January	2,394,382	2,156,873	2,173,836	1,976,138
Net profit for the year	806,218	890,363	759,452	845,828
Dividends paid	(451,587)	(476,389)	(448,546)	(471,915)
Interim Dividends paid	(117,604)	(177,551)	(116,808)	(177,551)
Disposal of assets – Asset revaluation	741	4,933	741	4,933
BSP Life policy reserve	(7,692)	(3,597)	(7,692)	(3,597)
(Gain) attributable to minority interest	(2,209)	(250)	-	-
At 31 December	**2,622,249**	**2,394,382**	**2,360,983**	**2,173,836**
Other reserves comprise:				
Asset revaluation reserve	129,063	142,819	115,828	130,725
Capital reserve	635	635	635	635
Equity component of Fiji Class Shares	21,578	21,578	-	-
General reserve	52,267	44,503	52,267	44,503
Foreign currency translation reserve	234,973	136,978	131,995	78,614
	438,516	**346,513**	**300,725**	**254,477**

Retained earnings

	Consolidated 2020	Consolidated 2019	Bank 2020	Bank 2019
Movement in reserves for the year:				
Revaluation reserve				
At 1 January	142,819	149,829	130,725	137,708
Asset revaluation increment/(decrement)	(18,914)	(5,719)	(20,055)	(5,714)
Transfer asset revaluation reserve to retained earnings	(1,032)	(4,933)	(1,032)	(4,933)
Deferred tax on disposal of properties	6,190	3,642	6,190	3,664
At 31 December	**129,063**	**142,819**	**115,828**	**130,725**
Capital reserve				
At 1 January	635	635	635	635
At 31 December	**635**	**635**	**635**	**635**
General reserve				
At 1 January	44,503	40,920	44,503	40,920
BSP Life policy reserve	7,692	3,597	7,692	3,597
Fiji Government green bond revaluation	72	(14)	72	(14)
At 31 December	**52,267**	**44,503**	**52,267**	**44,503**
Exchange reserve				
At 1 January	136,978	126,358	78,614	73,121
Movement during the year	97,995	10,620	53,381	5,493
At 31 December	**234,973**	**136,978**	**131,995**	**78,614**

29. Retained Earnings and Other Reserves (continued)

Equity component of convertible notes

On 20 April 2010, the Group issued 3,064,967 Fiji Dollars (FJD) denominated mandatory convertible notes through its wholly owned subsidiary BSP Convertible Notes Limited (BSP CN) at an issue price of FJD5.25 (K7.30) per note.

The notes mandatorily converted to Fiji Class Shares on 20 April 2013 based on a conversion ratio of 1:1. Key rights of Fiji Class Shareholders are as follows:

(i) The right to receive dividend equal to the amount of dividend to be paid on BSP Ordinary Shares.

(ii) The same voting rights as a BSP Ordinary Share and effected through a special voting share held by the Chairman of BSP.

(iii) The Fiji Class Share may be exchanged on a one for one basis into BSP Ordinary Shares at a subsequent date and at the option of BSP on the occurrence of certain prescribed events.

30. Capital Adequacy

The Group is required to comply with various prudential standards issued by the Bank of Papua New Guinea (BPNG), the official authority for the prudential supervision of banks and similar financial institutions in Papua New Guinea. Additionally, subsidiaries and branches in Fiji, Solomon Islands, Cook Islands, Samoa, Tonga, Vanuatu, Cambodia and Laos are required to adhere to prudential standards issued by the Reserve Bank of Fiji (RBF), Central Bank of Solomon Islands (CBSI), The Financial Supervisory Commission (FSC), Central Bank of Samoa (CBS), National Reserve Bank of Tonga (NRBT), Reserve Bank of Vanuatu (RBV), the National Bank of Cambodia (NBC) and Bank of Lao P.D.R.. One of the most critical prudential standards is the capital adequacy requirement. All banks are required to maintain at least the minimum acceptable measure of capital to risk-weighted assets to absorb potential losses. The BPNG follows the prudential guidelines set by the Bank of International Settlements under the terms of the Basel Accord. The BPNG revised prudential standard 1/2003, Capital Adequacy, prescribes ranges of overall capital ratios to measure whether a bank is under, adequately, or well capitalised, and also applies the leverage capital ratio. The Group complies with the prevailing prudential requirements for total capital and leverage capital. As at 31 December 2020, the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for a 'well-capitalised' bank. The minimum capital adequacy requirements set out under the standard are: Tier 1 8%, total risk based capital ratio 12% and the leverage ratio 6%.

The measure of capital used for the purposes of prudential supervision is referred to as base capital. Total base capital varies from the balance of capital shown on the Statement of Financial Position and is made up of tier 1 capital (core) and tier 2 capital (supplementary). Tier 1 capital is obtained by deducting from equity capital and audited retained earnings (or losses), intangible assets including deferred tax assets. Tier 2 capital cannot exceed the amount of tier 1 capital, and can include subordinated loan capital, specified asset revaluation reserves, un-audited profits (or losses) and a small percentage of general loan loss provisions. The leverage capital ratio is calculated as Tier 1 capital divided by total assets on the balance sheet.

Risk weighted assets are derived from on-balance sheet and off-balance sheet assets. On balance sheet assets are weighted for credit risk by applying weightings (0, 20, 50 and 100 per cent) according to risk classification criteria set by the BPNG. Off-balance sheet exposures are risk weighted in the same way after converting them to on-balance sheet credit equivalents using BPNG specified credit conversion factors.

30. Capital Adequacy (continued)

The Group's capital adequacy level is as follows (unaudited):

All amounts are expressed in K'000	Balance sheet / notional amount 2020	2019	Risk-weighted amount 2020	2019
Balance sheet assets (net of provisions)				
Currency	4,456,479	3,583,165	95,677	69,942
Loans and receivables from customers	13,506,660	13,230,783	10,824,914	10,539,279
Investments and short term securities	6,083,231	4,580,568	229,235	224,510
All other assets	3,477,067	3,132,602	1,978,591	1,839,673
Off-balance sheet items	2,986,994	2,576,694	242,027	286,666
Total	**30,510,431**	**27,103,812**	**13,370,444**	**12,960,070**

Capital Ratios	Capital (K'000) 2020	2019	Capital Adequacy Ratio (%) 2020	2019
a) Tier 1 capital	2,787,626	2,526,509	20.8%	19.5%
Total Capital	3,095,927	2,848,773	23.2%	22.0%
b) Leverage Capital Ratio			10.3%	10.5%

Group Structure

31. Insurance

Life and General Insurance Business

The Group's consolidated Financial Statements include the assets, liabilities, income and expenses of the life and general insurance businesses. The Group's Insurance business is made up of Life Insurance Contracts, Medical Insurance and Term Life Insurance.

(a) Recognition and Measurement

Short Term Insurance Contracts

These contracts include the Term Life and Medical policies sold and underwritten by BSP Health Care (Fiji) Limited and Term life policies sold by BSP Life (PNG) Limited.

These contracts protect the Group's customers from the consequences of events such as death, disability, medical emergency. Benefits paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder. There are no maturity or surrender benefits.

For all these contracts, premiums are recognised as revenue (earned premiums) proportionally over the period of coverage. The portion of premium received on in-force contracts that relates to unexpired risks at the Statement of Financial Position date is reported as the unearned premium liability.

Premiums are shown before deduction of commission.

31. Insurance (continued)

Claims and loss adjustment expenses are charged to profit or loss as incurred based on the estimated liability for compensation owed to contract holders or beneficiary. They include direct and indirect claims settlement costs and arise from events that have occurred up to the Statement of Financial Position date even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are based on the sum insured or cost of approved medical services plus an allowance for claims incurred but not reported based on statistical analysis and related claim expenses. Case estimates are used to estimate the expected ultimate cost of more complex claims that may be affected by external factors (such as court decisions).

Long Term Insurance Contracts

These contracts insure human life events (for example death, survival, disability and critical illness) over a long duration; and are sold and underwritten by BSP Life (Fiji) Limited and BSP Life (PNG) Limited. Guaranteed benefits paid on occurrence of the specified insurance event are fixed and for participating polices declared bonuses are also payable. Most of the policies have maturity and surrender benefits.

For all these contracts, premiums are recognised as revenue when they become payable by the contract holder. Premiums are shown before deduction of commission.

Approximately 90% of the above contracts in the Group's portfolio contain a Discretionary Participation Feature (DPF). This feature entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits in the form of reversionary bonuses.

The liability for long term insurance contracts (principally Life Insurance) has been determined in accordance with LPS 1.04 Valuation of Policy Liabilities, issued by the Australian Prudential Regulation Authority.

The policy liability is calculated in a way that allows for the systematic release of planned profit margins as services are provided to policy owners and the revenues relating to those services are received (Margin on Services methodology). Services used to determine profit recognition include the cost of expected insurance claims and the allocation of future bonuses. The liability is generally determined as the present value of all future expected payments, expenses, taxes and profit margins reduced by the present value of all future expected premiums and take into consideration projected future bonuses. The liabilities are recalculated at each balance date using best estimate assumptions. These assumptions are revisited regularly and adjusted for actual experiences on claims, expense, mortality and investment returns. The policy liabilities also include policy owner retained earnings.

(b) Methods and Assumptions

Key assumptions used in determining the Policy Liabilities for policies for the insurance business are as follows:

(i) Discount Rates

For contracts in Statutory Fund 1 which have a DPF, the discount rate used is linked to the assets which back those contracts. For 31 December 2020 this was 5.95% per annum. For contracts without DPF and Accident Business, the Fiji Insurance business at 31 December 2020 used a rate of 5.95% per annum. The pricing rates were used given market subjectivity. The PNG life insurance business at 31 December 2020 used the accumulation methodology for contracts without DPF.

ii) Investment and Maintenance Expenses

Future maintenance and investment expenses are based on the budgeted expenses. Future inflation has been assumed to be 4.00% per annum for determining future expenses for both the Fiji and life business.

iii) Taxation

The rates of taxation enacted at the date of the valuation are assumed to continue into the future for both the Fiji and life business.

31. **Insurance** (continued)

(iv) Mortality and Morbidity

The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the BSP Life (PNG) and BSP Life (Fiji). Estimates are made as to the expected number of deaths for each of the years in which the BSP Life (PNG and Fiji) are exposed to risk. The BSP Life (Fiji) bases these estimates on standard industry and national mortality tables that reflect recent historical mortality experience, adjusted, where appropriate, to reflect the

Group's own experience. The estimated number of deaths determines the value of the benefit payments. The main source of uncertainty is that epidemics and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which BSP Life (Fiji) has significant exposure to mortality risk. However, continuing improvements in medical care and social conditions could result in improvements in longevity in excess of those allowed for in the estimates used to determine the liability for contracts where BSP Life (Fiji) is exposed to longevity risk. For contracts without fixed mortality risk charges, it is assumed that BSP Life (Fiji) will be able to increase mortality risk charges in future years in line with emerging mortality experience.

Projected future rates of mortality for insured lives are based on the Fiji Mortality Statistics table FJ90-94 Male, modified for local experience.

As there is no reliable mortality table available for PNG, BSP Life PNG bases these estimates on an internal mortality table that has regard to population and insured mortality in Fiji and the limited information relating to mortality in PNG that is publicly available. This is reassessed each year having regard to the company's own experience. The estimated number of deaths determines the value of the benefit payments. Mortality in PNG is subject to considerable uncertainty from wide-ranging lifestyle changes, such as in eating, smoking and exercise habits and epidemics that could result in future mortality being significantly different than assumed

(v) Rates of Discontinuance

Pricing assumptions for the incidence of withdrawal and discontinuance vary duration.

(vi) Basis of Calculation of Surrender Values

Surrender values are based on the provisions specified in the policy contracts and legislation. For the PNG life business, surrender values are determined by the Company in accordance with the provisions specified in the policy contracts and legislation.

(vii) Discretionary Participating Business

For most participating business, bonus rates are set such that, over long periods, the returns to contract holders are commensurate with the investment returns achieved on the pool of assets which provide security for the contract, together with other sources of profit arising from this business. Profits from these policies are split between contract holders and shareholders in accordance with the policy conditions which allow for shareholders to share in allocations at a maximum rate of 20%.

Assumed future bonus rates included in the liability for the long term insurance contracts were set such that the present value of the liabilities equates to the present value of assets supporting the business together with assumed future investment returns, allowing for the shareholder's right to participate in distributions.

(c) Reinsurance

Contracts entered into by the Group with Reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group, are classified as reinsurance contracts.

31. **Insurance** (continued)

As the reinsurance agreements provide for indemnification by the Reinsurers against loss or liability, reinsurance income and expenses are recognised separately in profit or loss when they become due and payable in accordance with the reinsurance agreements.

Reinsurance recoveries are recognised as claim recoveries in profit or loss. This is netted off against the claim expenses. Reinsurance premiums are recognised as Reinsurance Expenses.

Insurance

The accounting policies of the consolidated entity, which have been applied in determining the financial information shown below, are the same as those applied in the consolidated financial statements. The summarised income statement for BSP Life (Group) is presented below as per the respective subsidiary accounts. The consolidated profit includes insurance profit and investment earnings on shareholders fund.

	Consolidated	
All amounts are expressed in K'000	**2020**	**2019**
Net insurance premium income	199,172	158,390
Outward reinsurance expense	(4,142)	(3,221)
Net premium income	**195,030**	**155,169**
Investment income	220,666	210,325
Other income	995	2,723
Total operating income	**416,691**	**368,217**
Claims, surrenders and maturities	(121,396)	(120,287)
Claim recoveries	194	550
Net claims incurred	**(121,202)**	**(119,737)**
Commission	(15,776)	(14,312)
Increase in policy liabilities	(74,324)	(59,746)
Interest expenses	(564)	(513)
Other operating expenses	(148,765)	(148,710)
Total operating expenses	**(239,429)**	**(223,281)**
Share of profit of associates and jointly controlled entities	(26,535)	5,476
Profit from ordinary activities before tax	**29,525**	**30,675**
Income tax expense/ (benefit) attributable to profit from ordinary activities	(6,642)	(3,471)
Profit after Income tax expense	**22,883**	**27,204**

The balance sheets as at 31 December 2020 categorised by Shareholder Fund and Assets Supporting Policy Liability are shown below. The allocation between the two funds is maintained notionally as the funds are invested as a single pool of assets.

31. **Insurance** (continued)

	Consolidated					
	2020			2019		
All amounts are expressed in K'000	**Policy Related Fund**	**Share-holder Fund**	**Total**	**Policy Related Fund**	**Share-holder Fund**	**Total**
Assets						
Cash and Cash Equivalents	128,709	24,260	**152,969**	49,424	7,558	**56,982**
Equity security investments	338,148	65,754	**403,902**	337,933	67,819	**405,752**
Debt security investments	395,671	77,751	**473,422**	399,493	83,750	**483,243**
Property investments	303,052	59,116	**362,168**	211,382	42,554	**253,936**
Other assets	76,863	15,042	**91,905**	71,888	12,043	**83,931**
Total assets	**1,242,443**	**241,923**	**1,484,366**	**1,070,120**	**213,724**	**1,283,844**
Liabilities						
Policy liabilities	1,043,990	-	**1,043,990**	890,147	-	**890,147**
Other liabilities	127,170	24,321	**151,491**	112,888	19,880	**132,768**
Total liabilities	**1,171,160**	**24,321**	**1,195,481**	**1,003,035**	**19,880**	**1,022,915**
Shareholders' equity						
Equity & retained earnings	71,283	217,602	**288,885**	67,085	193,844	**260,929**
Total shareholders' equity	**71,283**	**217,602**	**288,885**	**67,085**	**193,844**	**260,929**
Total equity and liabilities	**1,242,443**	**241,923**	**1,484,366**	**1,070,120**	**213,724**	**1,283,844**

	Consolidated	
All amounts are expressed in K'000	**2020**	**2019**
Policy Liabilities		
Opening balance	890,147	818,198
Translation movement	73,433	11,221
Increase in policy liabilities	74,324	59,746
Increase in policy liabilities on revaluation of land	6,086	982
Total policy liabilities	**1,043,990**	**890,147**

Insurance reserves are maintained in accordance with levels prescribed by the Regulators.

Insurance and Financial Risk Management

The Group is committed to the management of risk to achieve sustainability of service to its customers, employment of its staff and profits to its shareholders and therefore, takes on controlled amounts of risk when considered appropriate. The risk management framework is targeted at ensuring that the Group maintains sufficient capital at a level which exceeds the minimum solvency requirements prescribed by the Regulators.

The Group is exposed to financial as well as insurance risks. The Group's risk management strategy is set by the Board of Directors. Implementation of risk management strategy and the day to day management of risk is the responsibility of the Executive Management.

Insurance Risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and is unpredictable. The principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities.

31. Insurance (continued)

Insurance Risk (continued)

This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual numbers and quantum of claims and benefits will vary from year to year from the level established using actuarial methods.

The Group's objectives in managing risks arising from insurance business are:

- To ensure risk appetite decisions are made within the context of corporate goals and governance structures;
- To ensure that an appropriate return on capital is made in return for accepting insurance risk;
- To ensure that strong internal controls embed underwriting to risk within the business;
- To ensure that internal and external solvency and capital requirements are met; and
- To use reinsurance as a component of insurance risk management strategy.

Terms and conditions of insurance contracts

The nature of terms of insurance contracts written is such that certain external variables can be identified on which related cash flows for claim payments depend. The table below provides an overview of the long-term insurance contracts:

Type of Contract	Detail of Contract Terms and Conditions	Nature of Compensation for Claims	Key Variables that affect the timing and uncertainty of Future Cash Flows
Non-participating life insurance contracts with fixed and guaranteed terms (Term Life and Disability)	Benefits paid on death, ill health or maturity that are fixed and guaranteed and not at the discretion of the insurer. Premiums may be guaranteed through the life of the contract, guaranteed for a specified term or variable at the insurer's discretion.	Benefits, defined by the insurance contract, are determined by the contract and are not directly affected by the performance of underlying assets or the performance of the contracts as whole.	− Mortality − Morbidity − Discontinuance rates − Expenses − Market rates on underlying assets
Life insurance contracts with discretionary participating benefits (endowment and whole of life)	These policies include a clearly defined initial guaranteed sum which is payable on death. The guaranteed amount is a multiple of the amount that is increased throughout the duration of the policy by the addition of regular bonuses annually which, once added, are not removed.	Benefits arising from the discretionary participation feature are based on the performance of a specified pool of contracts or a specified type of contract.	− Mortality − Morbidity − Market risk − Discontinuance rates − Expenses − Market rates on underlying assets

Variations in claim levels will affect reported profit and equity. The impact may be magnified if the variation leads to a change in actuarial assumptions which cannot be absorbed within the present value of planned margins for a group of related products.

Insurance risk may arise through the reassessment of the incidence of claims, the trend of future claims and the effect of unforeseen diseases or epidemics. In addition, in the case of morbidity, the time to recovery may be longer than assumed.

31. **Insurance** (continued)

Concentrations of insurance risk arise due to:

- Large sums assured on certain individuals. The largest exposures all relate to mortality. The largest single exposure for the Life business is K11.701m of which K11.185m is reinsured (2019: K11.121m of which K9.533m is reinsured). This relates to life insurance lines.

- The largest single lump sum exposure for the health insurance business is K8.604m, of which K8.431m is reinsured. The largest single net exposure is K1.067m. This relates to health insurance lines.

- Geographic concentrations due to employee Company schemes. The largest single scheme exposure is K121.654m, of which K58.848m is reinsured. BSP Life (PNG) participates in the Term Life reinsurance programme.

Insurance risk is controlled by ensuring underwriting standards adequately identify potential risk and diversify the type and amount of insurance risks accepted, retaining the right to amend premiums on risk policies where appropriate and through the use of reinsurance and proactive claims handling. The experience of the Group's Life Insurance business is reviewed regularly.

32. Investment in Subsidiaries

Name of subsidiary	Principal activity	Place of incorporation and operation		Balance of investment	
			Ownership %	2020	2019
BSP Capital Limited	Fund Management/ Investment Banking	PNG	100%	2,448	2,448
BSP Life (Fiji) Limited	Life Insurance	Fiji	100%	87,599	87,599
BSP Life (PNG) Limited	Life Insurance	PNG	100%	25,000	25,000
BSP Convertible Notes Limited	Capital Raising	Fiji	100%	371	371
BSP Finance Limited	Credit Institution	PNG	100%	89,318	82,503
Bank of South Pacific Tonga Ltd	Bank	Tonga	100%	71,610	71,610
Bank South Pacific (Samoa) Ltd	Bank	Samoa	98.7%	70,712	70,712
Bank South Pacific Vanuatu Ltd	Bank	Vanuatu	100%	38,020	38,020
At 31 December				**385,078**	**378,263**
Represented by:					
At 1 January				378,263	347,597
Additional capital				6,815	30,666
At 31 December				**385,078**	**378,263**

Other

33. Fiduciary Activities

The Group especially through BSP Capital Limited conducts investment fund management and other fiduciary activities as responsible entity, trustee, custodian or manager for investment funds and trusts, including superannuation. These funds are not consolidated, as the Group does not have direct or indirect control. Where the funds incur liabilities in respect of these activities, and the primary obligation is incurred in an agency capacity for the fund or clients rather than its own account, a right of indemnity exists against the assets of the applicable fund or trust. As these assets are sufficient to cover the liabilities and it is therefore not probable that the Group will be required to settle the liabilities, the investments in the assets and liabilities of these activities are not included in the Financial Statements

34. Related Party Transactions

Related parties are considered to be enterprises or individuals with whom the Group is especially related because either they or the Bank are in a position to significantly influence the outcome of transactions entered into with the Group, by virtue of being able to control, dominate or participate in a fiduciary capacity, in decision-making functions or processes. The Group conducted transactions with the following classes of related parties during the year:

- Directors and/or parties in which the director has significant influence
- Key management personnel and other staff and/or parties in which the individual officer has significant influence

A number of banking transactions are entered into with these related parties in the normal course of business, and include loans, deposits, property rentals, share transfers and foreign currency transactions. These transactions are carried out on commercial terms and market rates. For the year ended 31 December 2020, balances and transactions of accounts for Directors, including companies in which directorships were held by BSP directors, were as follows:

	Consolidated	
All amounts are expressed in K'000	**2020**	**2019**
Customer Deposits		
Opening balances	45,220	30,925
Net movement	(17,921)	14,295
Closing balance	**27,299**	**45,220**
Interest paid	7	17
Loans and receivables from customers		
Opening balances	914,468	899,451
Loans issued	173,405	61,750
Interest	22,358	66,032
Charges	2,379	3,869
Loan repayments	(160,040)	(116,634)
Outgoing Director	(313,776)	-
Closing balance	**638,794**	**914,468**

Subsidised transactions are provided for staff. Such transactions include marginal discounts on interest rates, and specific fee concessions. These benefits are mainly percentage-based on market rates and fees, and as such, staff accounts are always subject to underlying market trends in interest rates and fees. As at 31 December 2020, staff account balances were as follows:

Housing loans	220,407	192,749
Other loans	80,979	68,197
	301,386	**260,946**
Cheque accounts	6,159	6,643
Savings accounts	15,671	20,824
	21,830	**27,467**

35. Events Occurring After Balance Sheet Date

There have been no adjusting events after the end of the reporting period.

36. Directors and Executive Remuneration

Directors' remuneration

Directors of the company received remuneration including benefits during 2020 as detailed below:

All amounts are expressed in Kina

Name of Director	Meetings attended / total held	Appointed/ (Resigned)	Total remuneration 2020 Bank	2020 Subsidiaries	2020 Total	2019 Total
Sir K. Constantinou, OBE	10/10	-	561,304	300,000	861,304	921,304
R. Fleming, CSM*	10/10	-	-	-	-	-
G. Robb, OAM	10/10	-	340,027	120,000	460,027	463,152
F. Talao	0/10	(Dec 2019)	-	-	-	378,152
E. B Gangloff	10/10	-	343,152	60,000	403,152	403,152
A. Mano	3/10	(Jun 2020)	214,239	45,000	259,239	340,652
A. Sam	10/10	-	333,777	-	333,777	330,652
Dr. F Lua'iufi	9/10	-	305,652	60,000	365,652	305,652
S. Davis	10/10	-	330,652	-	330,652	330,652
R. Bradshaw	10/10	-	318,152	-	318,152	305,652
P. Kevin	8/8	Apr 2020	239,339	-	239,339	-
F. Bouraga	0/0	Dec 2020	40,400	-	40,400	-
			3,026,694	**585,000**	**3,611,694**	**3,779,020**
Shareholder Approved Cap					**4,500,000**	**4,500,000**

* Managing Director / Chief Executive Officer receives no fees for his services as Director during the year. Other members of BSP executive management who serve as directors of subsidiaries of BSP Group receive no fees for their services as Director.

Executive Remuneration

The specified executives as at 31 December 2020 were:

Robin Fleming, CSM	Frank van der Poll	Ronesh Dayal	Mike Hallinan
Nuni Kulu	Peter Beswick	Rohan George	Kili Tambua
Hari Rabura	Andy Roberts	Daniel Faunt	

All amounts are expressed in K'000

Year	Salary	Short term incentive	Value of benefits	Long term incentive	Leave encashment	Final entitlements[1]	Total
2020 executive remuneration	16,016	2,213	1,466	-	97	2,037	**21,829**
2019 executive remuneration	14,375	3,787	979	4,509	489	-	**24,139**

[1]*Final entitlements paid were for executives who exited the Bank in 2020 and constitutes statutory leave pay outs.*

36. Directors and Executive Remuneration (continued)

Executive remuneration

The number of employees or former employees whose income from the Bank was equal to or greater than K100,000 during the year, are classified in income bands of K10,000 as follows:

Remuneration *K'000*	**2020 No.**	**2019 No.**	**Remuneration** *K'000*	**2020 No.**	**2019 No.**	**Remuneration** *K'000*	**2020 No.**	**2019 No.**
100 – 110	122	53	530 – 540	2	2	1030 – 1040	1	-
110 – 120	71	61	540 – 550	4	-	1050 – 1060	2	-
120 – 130	76	47	550 – 560	1	1	1060 – 1070	2	2
130 – 140	43	31	560 – 570	1	-	1070 – 1080	1	1
140 – 150	47	29	570 – 580	2	2	1080 – 1090	2	-
150 – 160	33	17	580 – 590	-	1	1090 – 1100	1	-
160 – 170	19	20	590 – 600	1	2	1100 – 1110	1	-
170 – 180	25	23	600 – 610	1	1	1110 – 1120	1	1
180 – 190	26	16	610 – 620	2	3	1120 – 1130	-	1
190 – 200	21	11	620 – 630	2	1	1130 – 1140	-	1
200 – 210	13	15	630 – 640	2	-	1140 – 1150	2	1
210 – 220	20	14	640 – 650	1	1	1150 – 1160	1	-
220 – 230	13	9	650 – 660	3	2	1170 – 1180	1	-
230 – 240	9	8	660 – 670	1	2	1180 – 1190	-	1
240 – 250	12	16	680 – 690	1	1	1190 –1200	1	1
250 – 260	10	4	690 – 700	1	-	1200 – 1210	-	1
260 – 270	11	4	700 – 710	-	1	1210 – 1220	-	1
270 – 280	4	5	710 – 720	2		1220 – 1230	-	1
280 – 290	5	-	720 – 730	-	1	1240 – 1250	1	-
290 – 300	3	5	730 – 740	1	1	1250 – 1260	1	-
300 – 310	12	4	740 – 750	-	1	1260 – 1270	-	1
310 – 320	1	5	750 – 760	-	1	1270 – 1280	1	-
320 – 330	9	-	760 – 770	1		1280 – 1290	-	1
330 – 340	3	2	770 – 780	-	2	1350 – 1360	1	1
340 – 350	1	1	780 – 790	1	3	1360 – 1370	1	-
350 – 360	4	2	790 – 800	1	3	1370 – 1380	1	-
360 – 370	1	2	810 – 820	2	-	1390 – 1400	1	-
370 – 380	4	5	820 – 830	2	1	1400 – 1410	1	1
380 – 390	3	-	840 – 850	2	1	1410 – 1420	1	
390 – 400	5	1	850 – 860	2		1420 – 1430	1	-
400 – 410	7	2	860 – 870	1	1	1430 – 1440	-	1
410 – 420	3	1	870 – 880	1	2	1470 – 1480	-	1
420 – 430	5	11	880 – 890	1	1	1480 – 1490	1	-
430 – 440	4	2	890 – 900	3	1	1590 – 1600	-	1
440 – 450	3	3	900 – 910	-	1	1610 – 1620	1	-
450 – 460	3	1	910 – 920	2	-	1650 – 1660	-	1
460 – 470	2	4	930 – 940	-	2	1680 – 1690	-	1
470 – 480	4	3	960 – 970	-	1	1720 – 1730	-	1
480 – 490	3	2	970 – 980	2	-	1980 – 1990	2	-
490 – 500	6	4	980 – 990	-	1	2070 – 2080	-	1
500 – 510	2	3	990 – 1000	1	-	2410 – 2420	-	1
510 – 520	-	2	1000 – 1010	-	1	2240 – 2250	1	-
520 – 530	6	4	1020 – 1030	-	1	4840 – 4850	1	-
						7480 – 7490	-	1
						Total	**756**	**523**

Remuneration disclosures have been updated to reflect entitlements applicable to respective years. Short term incentives and long term incentives for executives are paid post availability of audited accounts in the subsequent year and have been aligned accordingly. Prior year disclosures were based on the period each entitlement was received.

37. Remuneration of Auditor

	Consolidated		Bank	
All amounts are expressed in K'000	**2020**	**2019**	**2020**	**2019**
Financial statement audits	5,054	4,347	3,749	3,126
Other services	434	514	434	463
	5,488	**4,861**	**4,183**	**3,589**

The external auditor PricewaterhouseCoopers is also engaged in providing other services to the Bank and Group as required and as permitted by prudential standards. The provision of other services included taxation.

Independent auditor's report

To the shareholders of Bank of South Pacific Limited

Report on the audit of the financial statements of the Bank and the Group

Our opinion

We have audited the financial statements of Bank of South Pacific Limited (the Bank), which comprise the statements of financial position as at 31 December 2020, and the statements of comprehensive income, statements of changes in shareholders' equity and statements of cash flows for the year then ended, and the notes to the financial statements which include a summary of significant accounting policies and other explanatory information for both the Bank and the Group. The Group comprises the Bank and the entities it controlled at 31 December 2020 or from time to time during the financial year.

In our opinion the accompanying financial statements:

- comply with International Financial Reporting Standards and other generally accepted accounting practice in Papua New Guinea; and
- give a true and fair view of the financial position of the Bank and the Group as at 31 December 2020, and their financial performance and cash flows for the year then ended.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our opinion.

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

Independence

We are independent of the Bank and Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)*, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other services for the Group in the areas of audit-related and tax advice services. The provision of these other services has not impaired our independence as auditor of the Bank and the Group.

Our audit approach

An audit is designed to provide reasonable assurance about whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the management structure of the Bank and the Group, their accounting processes and controls and the industries in which they operate.

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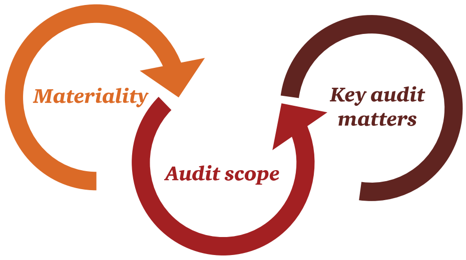

Materiality	Audit scope	Key audit matters

• For the purpose of our audit of the Group we used overall group materiality which represents approximately 5% of the Group's profit before taxes.
• We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the financial statements as a whole.
• We chose Group profit before taxes as, in our view, it is the metric against which the performance of the Group is most commonly measured and is a generally accepted benchmark.
• We selected 5% based on our professional judgement noting that it is also within the range of commonly acceptable related thresholds.
	• We (PwC Papua New Guinea) conducted the audit over all of the Group's operations in Papua New Guinea (PNG) which is the most significant to the Group, and directed the scope of the audit of other subsidiaries included in the Group financial statements sufficient to express an opinion on the financial statements as a whole.
	• For the Group's activities in Fiji, Solomon Islands, Samoa, Tonga, Cambodia, Cook Islands, and Vanuatu the audit work was performed by other PwC network firms or other firms operating under our instructions.
	• Our audit focused on where the directors made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events.
		• Amongst other relevant topics, we communicated the following key audit matters to the Board Audit & Compliance Committee:
		  • Loan loss provisioning
		  • IT General Control Environment
		• These matters are further described in the Key audit matters section of our report.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements for the current year. The key audit matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We have determined the matters described below to be key matters to be communicated in our report. Further, commentary on the outcomes of the particular audit procedures is made in that context.

Key audit matter	How our audit addressed the key matter
Loan loss provisioning - Refer to Note 15 of the financial statements for a description of the accounting policies and to Note 22 for an analysis of credit risk Due to the magnitude of the loans and advances balances and the extent of management judgement inherent in the impairment calculations, impairment of loans and advances is an area of significance in the current year audit of the Bank and its subsidiaries. IFRS 9 *Financial Instruments* (IFRS 9) is a complex accounting standard which has required considerable judgement and interpretation in its application. The key areas of judgement included: • The determination of the impairment in applying IFRS 9, which is reflected in the allowance for losses on loans, advances and other receivables (refer to Note 15 and Note 22) • The identification of exposure for which there has been a significant increase in credit risk • Assumptions used in the expected credit loss model such as valuation of collateral and assumptions made on future values, financial condition of counterparties, expected future cash flows and forward looking macroeconomic factors • The need to apply additional model adjustments to reflect current or future external factors that are not appropriately captured by the expected credit loss model The developing COVID 19 pandemic has meant assumptions regarding economic outlook and the consequential impact on the Bank's customers is uncertain, increasing the degree of judgement required in calculating the loan loss provisions. This includes judgements regarding the impact of COVID 19 on forward looking information, including variables used in macroeconomic scenarios and their associated weightings.	The procedures we performed to support our audit conclusions, included: • Consideration of the appropriateness of accounting policies and assessment of the loan impairment methodology applied, compared to the requirements of IFRS 9. This included obtaining an understanding and assessment of the reasonableness of the key outputs of the model, as well as key judgements and assumptions used by management in implementation of the model, the mathematical accuracy of the IFRS 9 provisioning model and a particular focus on the impact of COVID 19. • Reviewing the design and operating effectiveness of key controls around the credit origination processes, the credit monitoring processes and the credit inspection unit's customer loan file reviews. • Review of the impairment methodology to establish the critical fields used in the computation of Stage 1 and Stage 2 provisions. On a sample basis testing the critical fields identified to have an impact on the expected credit loss provision by agreeing this back to source documentation. • For loans and advances in Stage 1 and Stage 2, critically examining the model methodology for consistency and appropriateness. This included evaluation of the appropriateness of the estimates made on the Probability of Default, Loss Given Default and Exposure at Default. This also included assessing the appropriateness of probability-weighted and staging criteria. • For Stage 3 loans and advances, audit procedures were carried out over the completeness of the credit watch list and delinquencies, assumptions made in the valuation of collateral and recovery cash flows. • For model adjustments, we considered the basis for and data used to determine the adjustments. This included making an independent assessment of both the credit environment and the macro-environment in which the Group operates. • For IFRS 9 related disclosures in the financial statements, we reviewed the accuracy and completeness in line with the Bank's accounting policies and IFRS 9 requirements.
IT General Control Environment We focused on this area because the Group is heavily dependent on complex IT systems for the capture, processing, storage and extraction of significant volumes of transactions.	 For significant financial statement line items, we gained an understanding of the business processes, key controls and IT systems used to generate and support those line items.

Key audit matter	How our audit addressed the key matter
There are some areas of the audit where we seek to place reliance on system functionality including certain automated controls, system calculations and reports. Our reliance on these is dependent on the Group's IT General Control (ITGC) environment, in particular, user access maintenance and changes to IT systems being authorised and made in an appropriate manner.	Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key ITGCs which support the continued integrity of the in-scope IT systems. Our procedures over ITGCs focused on user access and change management and we also carried out tests, on a sample basis, of system functionality that was key to our audit approach. Where we identified design or operating effectiveness matters relating to ITGCs and system functionality relevant to our audit, we performed alternative or additional audit procedures.

Information other than the financial statements and auditor's report

The directors are responsible for the other information. The other information comprises the Directors' Report (but does not include the financial statements and the auditors' report thereon), which we obtained prior to the date of this auditor's report, and the annual report, which is expected to be made available after that date. Our opinion on the financial statements does not cover the other information and we do not, and will not, express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of the directors for the financial statements

The directors are responsible, on behalf of the Bank for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and other generally accepted accounting practice in Papua New Guinea and the Companies Act 1997 and for such internal control as the directors determine is necessary to enable the preparation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Bank or the Group or to cease operations or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements of the Group. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements for the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulations preclude public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

The Companies Act 1997 requires that in carrying out our audit we consider and report on the following matters. We confirm in relation to our audit of the financial statements for the year ended 31 December 2020:

- We have obtained all the information and explanations that we have required;
- In our opinion, proper accounting records have been kept by the Bank as far as appears from an examination of those records.

Who we report to

This report is made solely to the Bank's shareholders, as a body, in accordance with the Companies Act 1997. Our audit work has been undertaken so that we might state to the Bank's shareholders those matters which we are required to state to them in an auditor's report and for no other purpose. We do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholders, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers

Peter Buchholz
Partner
Registered under the Accountants Act 1996

Port Moresby
24 February 2021