

# **Bank of South Pacific Limited and Subsidiaries**

## **Financial Statements**

**For the year ended**

**31 December 2012**



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# Directors' Report

for the Year Ended 31 December 2012

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The Directors take pleasure in presenting the Consolidated Financial Statements of the Bank of South Pacific Limited and its subsidiaries (Bank and the Group) for the year ended 31 December 2012. In order to comply with the provision 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. The Group's activities includes the provision of commercial banking and finance services, stock broking and fund management and life business services throughout Papua New Guinea and the Pacific region. BSP is a bank listed on the Port Moresby Stock Exchange (POMSoX), 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 Bank and the Group are licensed to operate in the Solomon Islands, Fiji Islands and Niue. The registered office is at Douglas Street, Port Moresby.

## Review of operations

For the year ended 31 December 2012, the Bank's profit after tax was K399.588 million (2011: K348.989 million profit). The Group's profit after tax was K407.744 million (2011: K355.947 million).

## Dividends

Dividend payment totaling K258.994 million was paid in 2012 (2011: K223.526 million). A detailed breakup of this is provided in note 22.

## Directors and officers

The following were directors of the Bank of South Pacific Limited at 31 December 2012:

Mr. K Constantinou, OBE	Mr. T E Fox, OBE	Ms. F Talao
Mr. G Aopi, CBE	Mr. J G Jeffery, CBE	Dr. I Temu
Sir. N Bogan	Mr. C C Procter	
Mr I B Clyne	Mr. G Robb	

Details of directors' tenure and directors and executives' remuneration during the year are provided in Note 26 of the Notes to the Consolidated Financial Statements.

The company secretary is Mary Johns.

## Independent Audit Report

The consolidated financial statements have been audited and should be read in conjunction with the independent audit report on page 50. Details of amounts paid to the auditors for audit and other services are shown in Note 5 of the Notes to the consolidated financial statements.

## Donations

Donations and sponsorship by the Group during the year amounted to K4,192,404 (2011: K3,878,985).

# Directors' Report

for the Year Ended 31 December 2012

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## Interests Register

Transactions recorded in the Interests Register are disclosed in Note 29 of the Notes to the Consolidated Financial Statements.

## Change in accounting policies

No changes in accounting policies occurred during the year.

For, and on behalf of, the Directors.

Dated and signed in accordance with a resolution of the directors in Port Moresby this 20<sup>th</sup> day of March 2013.



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Kostas Constantinou, OBE  
Chairman



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Ian B Clyne  
Group Chief Executive Officer/Director

# Statement by the Directors

for the Year Ended 31 December 2012

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The directors declare that:

- (a) in the Directors' opinion, 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
- (b) in the Directors' opinion, the attached consolidated 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.

## Additional Statutory Information

The results of the Bank and the Group's 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 consolidated 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.

No contingent liability has arisen since the end of the financial year, which continues to exist at the date of this report, other than those, disclosed in the consolidated financial statements.

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 consolidated financial statements misleading.

No contingent liability other than that disclosed in the notes to the attached consolidated 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.

Dated and signed in accordance with a resolution of the directors at Port Moresby this 20<sup>th</sup> day of March 2013.



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Kostas Constantinou, OBE  
Chairman



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Ian B. Clyne  
Group Chief Executive Officer/Director

# Statement of Comprehensive Income

for the Year Ended 31 December 2012

	Note	Consolidated		Bank	
		2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>					
Interest income	2	743,086	666,320	743,145	672,781
Interest expense	2	(61,532)	(68,841)	(61,619)	(75,330)
<b>Net interest income</b>		<b>681,554</b>	<b>597,479</b>	<b>681,526</b>	<b>597,451</b>
Banking fee and commission income	3	253,869	202,136	251,462	198,589
Other banking income	4	273,178	220,793	273,849	228,378
<b>Net banking operating income</b>		<b>1,208,601</b>	<b>1,020,408</b>	<b>1,206,837</b>	<b>1,024,418</b>
Net insurance premium income		144,823	161,938	-	-
Increase (decrease) in policy liabilities		(20,347)	(33,589)	-	-
Claims, surrender and maturities		(47,742)	(54,895)	-	-
<b>Net insurance operating income</b>		<b>76,734</b>	<b>73,454</b>	<b>-</b>	<b>-</b>
<b>Total net operating income before impairment and operating expenses</b>		<b>1,285,335</b>	<b>1,093,862</b>	<b>1,206,837</b>	<b>1,204,418</b>
Impairment expense	12	(70,952)	(25,234)	(70,952)	(25,234)
Operating expenses	5	(680,257)	(600,138)	(600,448)	(532,989)
<b>Profit before income tax</b>		<b>534,126</b>	<b>468,490</b>	<b>535,437</b>	<b>466,195</b>
Income tax expense	6	(137,552)	(119,039)	(135,849)	(117,206)
<b>Net profit after income tax</b>		<b>396,574</b>	<b>349,451</b>	<b>399,588</b>	<b>348,989</b>
Non-controlling interests	8	11,170	6,496	-	-
<b>Net profit for the year</b>		<b>407,744</b>	<b>355,947</b>	<b>399,588</b>	<b>348,989</b>
<b>Other comprehensive income</b>					
Exchange difference on translation of foreign operations	23	3,487	19,772	(1,053)	20,541
Net value gain on revaluation of share options	23	1,288	1,270	1,289	1,270
Net movement in asset revaluation	23	9,810	91,517	9,810	91,517
<b>Other comprehensive income for the year, net of tax</b>		<b>14,585</b>	<b>112,559</b>	<b>10,046</b>	<b>113,328</b>
<b>Total comprehensive income for the year</b>		<b>422,329</b>	<b>468,506</b>	<b>409,634</b>	<b>462,317</b>
<b>Earnings per share – basic &amp; diluted (toea)</b>	22	<b>86.9</b>	<b>75.1</b>	<b>85.2</b>	<b>73.6</b>

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

# Statement of Financial Position

As at 31 December 2012

<i>All amounts are expressed in K'000</i>	Note	Consolidated		Bank	
		2012	2011	2012	2011
<b>ASSETS</b>					
Cash and balances with Central Bank	9	1,806,597	1,188,048	1,764,275	1,086,766
Treasury & Central Bank bills	10	3,237,517	3,316,410	3,237,517	3,316,410
Amounts due from other banks	11	327,563	313,410	327,563	313,410
Loans and advances to customers	12	4,804,626	4,300,913	4,750,793	4,235,974
Property, plant and equipment	13	744,292	622,903	718,279	597,522
Assets subject to operating lease	13	69,226	68,936	69,226	68,936
Other financial assets	15	1,557,950	1,352,601	1,354,659	1,268,801
Investment in associates and joint ventures	8	65,729	54,957	12,563	12,563
Investment in subsidiaries		-	-	215,517	215,517
Intangibles	7	2,243	21,933	-	-
Investment properties	14	56,755	60,308	-	-
Asset held for sale	14	3,706	-	-	-
Deferred tax assets	6	111,141	87,625	110,401	87,336
Other assets	16	545,757	293,249	452,600	215,006
<b>Total assets</b>		<b>13,333,102</b>	<b>11,681,293</b>	<b>13,013,393</b>	<b>11,418,241</b>
<b>LIABILITIES</b>					
Amounts due to other banks	17	72,775	77,889	90,828	95,820
Amounts due to customers	18	10,860,522	9,366,281	10,920,691	9,446,389
Subordinated debt securities	19	75,525	75,525	75,525	75,525
Other liabilities	20	714,735	628,871	285,157	220,910
Provision for income tax	6	13,112	77,961	13,022	73,684
Deferred tax liabilities	6	34,560	19,028	28,358	18,627
Other provisions	21	95,980	91,550	91,198	87,682
<b>Total liabilities</b>		<b>11,867,209</b>	<b>10,337,105</b>	<b>11,504,779</b>	<b>10,018,637</b>
<b>SHAREHOLDERS EQUITY</b>					
Ordinary shares	22	384,814	426,444	384,814	426,444
Assigned capital	23	-	-	24,883	24,883
Retained earnings	23	870,148	721,398	838,292	697,698
Other reserves	23	210,931	196,346	260,625	250,579
<b>Total shareholders' equity</b>		<b>1,465,893</b>	<b>1,344,188</b>	<b>1,508,614</b>	<b>1,399,604</b>
<b>Total equity and liabilities</b>		<b>13,333,102</b>	<b>11,681,293</b>	<b>13,013,393</b>	<b>11,418,241</b>

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

# Statement of Changes In Shareholders' Equity

As at 31 December 2012

<b>Bank</b>	<b>Notes</b>	<b>Share capital</b>	<b>Assigned Capital</b>	<b>Reserves</b>	<b>Retained earnings</b>	<b>Total</b>
<i>All amounts are expressed in K'000</i>						
<b>Balance as at 1 January 2011</b>	22 & 23	461,633	-	69,339	578,372	1,109,344
Net profit/(loss)	23	-	-	-	348,989	348,989
Dividend paid	22	-	-	-	(223,526)	(223,526)
Deferred income 2011		-	-	-	(307)	(307)
Prior year adjustments		-	-	-	(5,830)	(5,830)
Share buyback	22	(35,189)	-	-	-	(35,189)
Assigned capital – Fiji		-	24,883	-	-	24,883
Other comprehensive income		-	-	113,328	-	113,328
Capital adequacy reserve – Fiji		-	-	67,912	-	67,912
<b>Balance at 31 December 2011</b>	22 & 23	<b>426,444</b>	<b>24,883</b>	<b>250,579</b>	<b>697,698</b>	<b>1,399,604</b>
Net profit	23	-	-	-	399,588	399,588
Dividend paid	22	-	-	-	(259,994)	(259,994)
Share buyback	22	(41,630)	-	-	-	(41,630)
Other comprehensive income		-	-	10,046	-	10,046
<b>Balance at 31 December 2012</b>	22 & 23	<b>384,814</b>	<b>24,883</b>	<b>260,625</b>	<b>838,292</b>	<b>1,508,614</b>
<b>Group</b>						
<b>Balance as at 1 January 2011</b>	22 & 23	<b>461,633</b>	-	<b>83,787</b>	<b>588,977</b>	<b>1,134,397</b>
Net profit	23	-	-	-	355,947	355,947
Dividend paid	22	-	-	-	(223,526)	(223,526)
Share buyback	22	(35,189)	-	-	-	(35,189)
Other Comprehensive income		-	-	112,559	-	112,559
<b>Balance at 31 December 2011</b>	22 & 23	<b>426,444</b>	-	<b>196,346</b>	<b>721,398</b>	<b>1,344,188</b>
Net profit	23	-	-	-	407,744	407,744
Dividend paid	22	-	-	-	(258,994)	(258,994)
Share buyback	22	(41,630)	-	-	-	(41,630)
Other Comprehensive income		-	-	14,585	-	14,585
<b>Balance at 31 December 2012</b>	23 & 23	<b>384,814</b>	-	<b>210,931</b>	<b>870,148</b>	<b>1,465,893</b>

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



# Statement of Cash Flow

As at 31 December 2012

	Notes	Consolidated		Bank	
		2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>					
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>					
Interest received		740,819	681,599	739,443	670,606
Fees and other income		638,579	534,491	524,618	426,261
Interest paid		(71,974)	(77,097)	(70,626)	(75,747)
Amounts paid to suppliers and employees		(565,607)	(669,331)	(452,221)	(482,100)
<b>Operating cash flow before changes in operating assets</b>	27	<b>741,817</b>	<b>469,662</b>	<b>741,214</b>	<b>539,020</b>
Decrease/(increase) in loans		(571,582)	(372,982)	(585,771)	(254,547)
Decrease/(increase) in bills receivable and other assets		(257,224)	(3,475)	(239,171)	(3,475)
(Decrease)/increase in deposits		1,465,780	1,463,007	1,474,302	1,439,572
(Decrease)/increase in bills payable and other liabilities		57,261	45,102	57,377	19,660
<b>Net cash flow from operations before income tax</b>		<b>1,436,052</b>	<b>1,601,314</b>	<b>1,447,951</b>	<b>1,740,230</b>
Income taxes paid		(238,675)	(119,878)	(233,720)	(119,590)
<b>Net cash flow from operating activities</b>		<b>1,197,377</b>	<b>1,481,436</b>	<b>1,214,231</b>	<b>1,620,640</b>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>					
Decrease/(increase) in government securities		(70,246)	(898,299)	(6,965)	(834,886)
Expenditure on property, plant & equipment		(210,383)	(239,714)	(205,460)	(234,600)
Proceeds from disposal of property, plant & equipment		(3,822)	7,016	(3,818)	7,016
Proceeds from other investments		25,215	23,345	-	-
Movement in share trading activities		8,252	(10,291)	-	-
Additional funding in associate		-	(513)	-	-
<b>Net cash flow from investing activities</b>		<b>(250,984)</b>	<b>(1,118,456)</b>	<b>(216,243)</b>	<b>(1,062,470)</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>					
Share buyback	22	(41,630)	(35,189)	(41,630)	(35,189)
Client management trust		(7,243)	4,345	-	-
Settlement of amount due to holding company		-	(583)	-	-
Dividends paid	22	(258,994)	(223,526)	(258,994)	(223,526)
<b>Net cash flow from financing activities</b>		<b>(307,867)</b>	<b>(254,953)</b>	<b>(300,624)</b>	<b>(258,715)</b>
<b>Net Increase/(decrease) in cash and cash equivalents</b>		<b>638,526</b>	<b>108,027</b>	<b>697,364</b>	<b>299,455</b>
Effect of exchange rate movements on cash and cash equivalents		(710)	(4,910)	(710)	(4,910)
Cash and cash equivalents at the beginning of the year		1,423,569	1,320,452	1,304,356	1,009,811
<b>Cash and Cash Equivalents at the end of the year</b>	27	<b>2,061,385</b>	<b>1,423,569</b>	<b>2,001,010</b>	<b>1,304,356</b>

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

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## 1. Accounting Policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below:

### A. Basis of presentation and general accounting policies

The consolidated financial statements of the Bank of South Pacific Limited (the Bank) and the Group are prepared in accordance with International Financial Reporting Standards 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 and financial instruments.

Estimates and assumptions have been used to achieve conformity with generally accepted accounting principles in the preparation of these consolidated 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 consolidated financial statements are presented in Papua New Guinea Kina, expressed in thousands of Kina.

### B. Consolidation

The consolidated financial statements incorporate the assets and liabilities of all controlled entities of the Bank and the Group as at 31 December 2012, 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:

- acquisition cost is measured at fair value of assets transferred, equity issued, liabilities assumed and any directly attributable costs of the transaction;
- 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. Investment in Associates and joint ventures

#### Investments in Associates

Associates are entities over which the Group has significant, but not controlling influence, generally accompanied by a shareholding of between 20% - 50% of voting rights.

In the consolidated financial statements, these investments are accounted for under the equity method, where:

- The investment is initially recognised at cost;
- The Group's share of profits or losses are recognised in the statement of comprehensive income.

#### Interests In Joint Ventures

A joint venture is a contractual arrangement whereby the bank together with other parties undertake an economic activity that is subject to joint control that is when the strategic financial and operating policy decisions relating to the activities require the unanimous consent of the parties sharing control. Joint venture arrangements that involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities.

Where the Group undertakes its activities under joint venture arrangements directly, the Group's share of jointly controlled assets and any liabilities incurred jointly with other venturers are recognised in the financial statements of the jointly controlled entity. The Group reports its interests in jointly controlled entities at cost, except when the investment is classified as held for sale, in which case it is accounted for under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## D. Revenue

### Interest income and expense

Interest income and expense are recognized in the statement of comprehensive income on an accrual basis using the effective yield method. The income arising from the various forms of installment credit has been determined using the effective interest method.

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

### Short term insurance contracts

These contracts are the Term Life, Medical and Travel policies sold and underwritten by BSP Health Care (Fiji) Limited.

These contracts protect the Group's customers from the consequences of events such as death, medical emergency or loss on travel. Guaranteed 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 Balance Sheet date is reported as the unearned premium liability. Premiums are shown before deduction of commission.

Claims and loss adjustment expenses are charged to income 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 Balance Sheet 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 estimated using the input of assessments for individual cases reported to the Group and statistical analyses for the claims incurred but not reported, and 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 or survival) over a long duration. They protect the Group's customers from the consequences of events such as death, disability or critical illness. Guaranteed benefits paid on occurrence of the specified insurance event are fixed or linked to the level of bonus declared to the contract holder. 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 generated benefits, additional benefits or 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.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## **E. Fee and commission income**

Fees and commissions are generally recognised on an accrual basis when the service has been provided. All other risk related fees that constitute cost recovery are taken to income when levied. Non-refundable front-end loan fees are capitalized and deferred over the expected term of the financial instrument.

## **F. Borrowing expenses**

Expenses associated with the borrowing of funds are charged to the statement of comprehensive income in the period in which they are incurred.

## **G. Loans and provisions for loan impairment**

Loans are originated by providing funds directly to the borrower and are recognised when cash is advanced to borrowers.

All loans and advances receivable are subject to continuous management review. A specific provision for loan impairment is established if there is objective evidence that the Bank and the Group will not be able to collect all amounts due under the terms of loans. The amount of the provision approximates the difference between the carrying amount and the recoverable amount, which is the current best estimate of the present value of expected future cash flows arising from the asset. All bad debts are written off against the 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.

General provisions for impairment are maintained to cover incurred losses unidentified at balance date in the overall portfolio of loans and advances. 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.

## **H. Goodwill**

Goodwill represents the excess of the cost of any acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired as at the exchange transaction. Goodwill is reported in the statement of financial position as an intangible asset.

In determining the estimated useful life of goodwill, management considers various factors including net selling price of the acquired business, existing market share, potential growth opportunities, and other factors inherent in the acquired business. This assessment is reviewed at each balance date, so that any indication of impairment with implications for the recoverability of goodwill can be tested, and adjustments to the carrying value of goodwill made if necessary.

## **I. Computer systems development costs**

Costs incurred to develop and enhance the Bank and the Group's computer systems are capitalised to the extent that benefits do not relate solely to revenue that has already been brought to account and will contribute to the future earning capacity of the economic entity. These costs are amortised over the estimated economic life of four years using the straight-line method. Costs associated with maintaining computer software programs are recognised as an expense when incurred.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## J. Property, plant and equipment

Land and buildings are measured at fair value. Fair value is determined on the basis of regular independent valuation prepared by external valuation experts, based on discounted cash flows or capitalisation of net income (as appropriate). The fair values are recognised in the consolidated financial statements of the consolidated entity, and are reviewed at the end of each reporting period to ensure that the carrying value of land and buildings is not materially different from their fair values.

Any revaluation increase arising on the revaluation of land and buildings is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in profit or loss, in which case the increase is credited to the statement of comprehensive income to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land and buildings is charged as an expense in statement of comprehensive income to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Depreciation on revalued buildings is charged to statement of comprehensive income. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the asset revaluation reserve, net of any related deferred taxes, is transferred directly to retained earnings.

Depreciation is provided on property, plant and equipment, including freehold buildings but excluding land. Depreciation is calculated on a straight line basis so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter, using the straight line method. The estimated useful lives, residual values and depreciation method is reviewed at the end of each annual reporting period.

The following basis and method of depreciation is used:

Class of asset	Method	Rate
Property (excluding land)	Straight line basis	2 - 3% p.a
Plant and equipment	Straight line basis	10 - 25% pa
Equipment under operating lease	Straight line basis	20% pa

Gains or losses on disposals (being the difference between the carrying value at the time of sale or disposal and the proceeds received) are taken into account in determining operating profit for the year. Where the carrying value of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Repairs and maintenance are taken into account in determining operating profit when the expenditure is incurred.

## K. Leases

### Bank is lessee

All leases entered into by the Bank and the Group are operating leases. Total payments made are charged to the statement of comprehensive income reflecting the pattern of benefits derived from the leased assets.

### Bank is lessor

Finance leases are included in Loans and Advances to Customers and are accounted for under the finance method whereby income is taken to account over the life of the lease in proportion to the outstanding investment balance.

Assets subject to operating leases are separately disclosed in the statement of financial position, according to the nature of the asset. These assets are stated at cost less accumulated depreciation. The assets are depreciated on a straight line basis over the life of the operating lease. Lease income is recognised on a straight line basis over the term of the lease.

## L. Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise notes and coins, and balances due to and from other banks.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## M. Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

## N. Employee benefits

A liability is required for benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

Liabilities recognised in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Liabilities recognised in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to reporting date.

### Post employment benefits - defined contribution plans

A defined contribution plan is a pension plan under which the Bank and the Group pays fixed contributions into a separate fund, and there is no recourse to the Bank and the Group for employees if the fund has insufficient assets to pay employee benefits relating to service up to the balance sheet date.

The Bank and the Group pays contributions to publicly or privately administered superannuation plans on a mandatory, contractual or voluntary basis in respect of services rendered up to balance sheet date by all Papua New Guinean staff members. The contributions are at the current rate of employees' gross salary. Once the contributions have been paid, the Bank and the Group have no further payment obligations for post-employment benefits from the date an employee ceases employment with the Bank and the Group.

## O. Income tax

### 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 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. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

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.

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 reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank 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 Bank intends to settle its current tax assets and liabilities on a net basis.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## O. Income tax (continued)

### 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.

## P. Investments

Investments are classified into the following categories: held for trading, held-to-maturity and available-for-sale. Trading reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealers margin. Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; Management determines the appropriate classification of its investments at the time of the purchase.

All purchases and sales of investments are recognised on the trade date, which is the date that the Bank and the Group commits to purchase or sell the asset. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments are included in the statement of comprehensive income in the period in which they arise.

## Q. Foreign currency

The consolidated financial statements of the Bank are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of these consolidated 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 consolidated 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.

## R. Share capital

### Share issue costs

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

### 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.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## R. Share capital (continued)

### Share options

The fair value of the employee services received in exchange for the grant of options is recognised as an expense. The total amount to be expected rateably over the vesting period is determined by reference to the fair value of the options determined at the grant date, excluding the impact of any non-market vesting conditions (for example profitability). Non-market conditions are included in assumptions about the number of options expected to become exercisable or the number of shares that the employee will ultimately receive. This estimate is revised at each balance sheet date and the difference is charged or credited to the statement of comprehensive income, with a corresponding adjustment to equity. The proceeds received on exercise of the options net of any directly attributable transactions costs are credited to equity.

## S. Asset impairment

At each reporting date, the Bank and the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Bank and the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. An impairment of goodwill is not subsequently reversed.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

## T. Non-current assets held for sale

Non-current assets (and disposal groups) classified as held for sale are measured, with certain exceptions, at the lower of carrying amount and fair value less costs to sell.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for such a sale and the sale is highly probable. The sale of the asset (or disposal group) must be expected to be completed within one year from the date of classification, except in the circumstances where sale is delayed by events or circumstances outside the Company's control and the Company remains committed to a sale.

## U. Convertible notes

Convertible notes issued by the company are regarded as compound instruments, consisting of a liability component equivalent to the 3 year fixed coupon amount and an equity component equivalent to the balance. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible loan notes and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the company, is included in equity.



# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## U. Convertible notes (continued)

The interest expense on the liability component is calculated by applying the coupon rate of 7% to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible notes.

## V. Derivative financial instruments and acceptances

Forward foreign exchange contracts entered into for trading purposes are initially recognized at cost 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 Bank and the Group to pay bills of exchange drawn on customers. The Bank and 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 Bank and 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.

## W. Comparatives

Comparative figures have been adjusted to conform to changes in presentation in the current year.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

2. Net interest income	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
<b>Interest income</b>				
Cash and short term funds	6,417	7,764	6,417	7,764
Treasury bills, Central Bank bills and other financial assets	237,558	213,381	237,558	213,381
Loans and advances	496,988	442,251	497,047	448,712
Other	2,123	2,924	2,123	2,924
	<b>743,086</b>	<b>666,320</b>	<b>743,145</b>	<b>672,781</b>
Less:				
<b>Interest expense</b>				
Customer deposits	44,606	57,580	44,693	64,069
Other banks	8,023	1,484	8,023	1,484
Subordinated debt securities	8,854	8,581	8,854	8,581
Other borrowings	49	1,196	49	1,196
	<b>61,532</b>	<b>68,841</b>	<b>61,619</b>	<b>75,330</b>
	<b>681,554</b>	<b>597,479</b>	<b>681,526</b>	<b>597,451</b>
<b>3. Banking fee and commission income</b>				
<b>Fee and commission income</b>				
Credit related	67,808	52,404	67,808	52,404
Trade and international related	11,894	8,930	11,894	8,930
Electronic banking related	34,505	24,005	34,505	24,005
Brokerage and fee income	2,407	3,547	-	-
Other	138,175	115,156	138,175	115,156
	<b>254,789</b>	<b>204,042</b>	<b>252,382</b>	<b>200,495</b>
Less:				
<b>Fee and commission expenses</b>				
Agencies	920	1,906	920	1,906
	<b>920</b>	<b>1,906</b>	<b>920</b>	<b>1,906</b>
	<b>253,869</b>	<b>202,136</b>	<b>251,462</b>	<b>198,589</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

4. Other banking income	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
Foreign exchange related	223,708	192,812	223,708	192,812
Other	49,470	27,981	50,141	35,566
	<b>273,178</b>	<b>220,793</b>	<b>273,849</b>	<b>228,378</b>
<b>Included in other income:</b>				
Profit/(loss) on sale of fixed assets	498	508	498	508
Change in fair value of assets held through profit and loss	5,922	18,497	-	-
Foreign Exchange related income includes gains and losses from spot and forward contracts and translated foreign currency assets				
<b>5. Other operating expenses</b>				
Administration	211,510	171,270	153,448	126,390
Auditors remuneration	2,496	1,494	1,423	1,225
Computing	34,983	36,240	34,983	36,240
Depreciation	57,968	52,497	54,806	49,442
Amortization of computer development	785	512	785	512
Non-executive Directors costs	1,013	623	1,013	623
Non-lending losses	15,386	26,875	15,386	26,875
Premises and equipment	55,742	49,924	55,742	49,924
	<b>379,883</b>	<b>339,435</b>	<b>317,586</b>	<b>291,231</b>
<b>Staff costs</b>				
Defined contribution plans	9,348	8,258	8,346	7,389
Statutory benefit contributions	9,334	6,170	9,334	6,170
Wages and salaries	211,490	189,113	197,227	173,222
Other	70,202	57,162	67,955	54,977
	<b>300,374</b>	<b>260,703</b>	<b>282,862</b>	<b>241,758</b>
	<b>680,257</b>	<b>600,138</b>	<b>600,448</b>	<b>532,989</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 6. Income tax

<b>Income tax expense</b>	<b>Consolidated</b>		<b>Bank</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<i>All amounts are expressed in K'000</i>				
Current tax	180,190	166,960	178,622	162,405
Deferred tax	(8,970)	(56,048)	(14,936)	(54,844)
Current year	171,220	110,912	163,686	107,561
Income tax under/(over) provided in previous years	(33,668)	8,127	(27,837)	9,645
	<b>137,552</b>	<b>119,039</b>	<b>135,849</b>	<b>117,206</b>
Tax calculated at 30% of profit before tax (2012: 30%)	160,631	139,859	160,631	139,859
Tax calculated at 20% of profit before tax - subsidiary	2,757	3,536	-	-
Expenses not deductible for tax	3,734	(19,487)	3,056	(13,008)
Net insurance income not subject to tax	4,098	3,179	-	-
Impact of change in tax rate – Fiji subsidiary	-	79	-	-
Income tax under/(over) provided in previous years	(33,668)	(8,127)	(27,838)	(9,645)
	<b>137,552</b>	<b>119,039</b>	<b>135,849</b>	<b>117,206</b>
<b>Provision for income tax</b>				
At 1 January	(77,961)	(30,484)	(73,684)	(28,513)
Income tax provision	(180,190)	(166,960)	(178,622)	(162,405)
Previous years over/(under) provided	6,364	(108)	5,564	1,492
Foreign tax paid	4,955	3,849	-	-
Tax payments made	233,720	115,742	233,720	115,742
<b>At 31 December</b>	<b>(13,112)</b>	<b>(77,961)</b>	<b>(13,022)</b>	<b>(73,684)</b>
<b>Deferred taxes</b>				
Specific allowance for losses on loans and advances	44,912	40,548	44,912	40,548
General allowance for losses on loans and advances	19,504	8,105	19,504	8,105
Employee related provisions	21,573	13,068	15,783	12,780
Prepaid expenses	(1,112)	(599)	(1,112)	(599)
Other provisions	18,164	18,604	22,052	18,605
Depreciation and amortization	(29,952)	(8,767)	(22,588)	(8,767)
Unrealised foreign exchange gains	(4,658)	(9,262)	(4,658)	(9,262)
Deferred expenditure	8,150	6,900	8,150	7,299
	<b>76,581</b>	<b>68,597</b>	<b>82,043</b>	<b>68,709</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 6. Income tax (continued)

Represented by:	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
Deferred tax asset	111,141	87,625	110,401	87,336
Deferred tax liability	(34,560)	(19,028)	(28,358)	(18,627)
<b>At 31 December</b>	<b>76,581</b>	<b>68,597</b>	<b>82,043</b>	<b>68,709</b>

### Movement in deferred tax is reconciled as follows:

	Consolidation				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing balance
<b>2012</b>					
Gross deferred tax liabilities	(19,028)	(13,046)	-	(2,486)	(34,560)
Gross deferred tax assets	87,625	22,016	1,500	-	111,141
	<b>68,597</b>	<b>8,970</b>	<b>1,500</b>	<b>(2,486)</b>	<b>76,581</b>

<b>2011</b>					
Gross deferred tax liabilities	(30,166)	20,077	(2,027)	(6,912)	(19,028)
Gross deferred tax assets	64,968	35,971	(13,314)	-	87,625
	<b>34,802</b>	<b>56,048</b>	<b>(15,341)</b>	<b>(6,912)</b>	<b>68,597</b>

	Bank				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing balance
<b>2012</b>					
Gross deferred tax liabilities	(18,627)	(7,245)	-	(2,486)	(28,358)
Gross deferred tax assets	87,336	22,181	884	-	110,401
	<b>68,709</b>	<b>14,936</b>	<b>884</b>	<b>(2,486)</b>	<b>82,043</b>

<b>2011</b>					
Gross deferred tax liabilities	(31,792)	20,077	-	(6,912)	(18,627)
Gross deferred tax assets	52,569	34,767	-	-	87,336
	<b>20,777</b>	<b>54,844</b>	<b>-</b>	<b>(6,912)</b>	<b>68,709</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 7. Intangible asset

	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
Gross carrying amount	2,243	21,933	-	-
Impairment adjustment	-	-	-	-
	<b>2,243</b>	<b>21,933</b>	-	-

The Directors have determined that the carrying value of the goodwill arising on consolidation as a result of elimination of BSP investment in its subsidiaries is considered not materially impaired. These subsidiaries trade on a going concern basis and their normal business operations are not exceptionally impaired.

## 8. Investments in Associates and Joint Ventures

Name of Associates	Principal activity	Place of incorporation and operation	Proportion of ownership and voting power held	
			2012	2011
Suva Central Limited	Property rental	Fiji	50%*	50%*
Richmond Limited	Hotel operation	Fiji	61.3%** , 50%***	61.3%** , 50%***
Williams and Gosling	Freight forwarding	Fiji	27.7%*	27.7%*

*\*both ownership and voting power held, \*\*ownership, \*\*\*voting power held.*

	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
<b>Associates</b>				
Investment in associate – equity	42,394	41,893	-	-
Movement	(398)	(5,995)	-	-
Share of profit/(loss) for year ended 31 December 2012	11,170	6,496	-	-
Net investment in associate	53,166	42,394	-	-
<b>Summarised financial information of associate:</b>				
Total assets	119,846	121,327	-	-
Total liabilities	(37,244)	(48,081)	-	-
<b>Net assets</b>	<b>82,602</b>	<b>73,246</b>	-	-
<b>Net profit/(loss)</b>	<b>18,932</b>	<b>10,916</b>	-	-
<b>Share of associate's profit/(loss)</b>	<b>11,170</b>	<b>6,496</b>	-	-
<b>Joint Ventures</b>				
Shares held in jointly owned entity – at costs	12,563	12,563	12,563	12,563
<b>Total investments in associates and joint ventures</b>	<b>65,729</b>	<b>54,957</b>	<b>12,563</b>	<b>12,563</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

9. Cash and balances with Central Bank	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
Notes, coins and cash at bank	423,238	388,553	380,916	287,271
Balances with Central Bank other than statutory deposit	510,161	213,260	510,161	213,260
Included in cash and cash equivalents	933,399	601,813	891,077	500,531
Statutory deposits with Central Bank	873,198	586,235	873,198	586,235
	<b>1,806,597</b>	<b>1,188,048</b>	<b>1,764,275</b>	<b>1,086,766</b>

## 10. Treasury and Central Bank bills

Treasury and Central Bank bills – face value	3,225,565	3,321,895	3,225,565	3,321,895
Premium/(discount) for interest receivable	11,952	(5,485)	11,952	(5,485)
	<b>3,237,517</b>	<b>3,316,410</b>	<b>3,237,517</b>	<b>3,316,410</b>

Treasury and Central Bank bills are debt securities issued by the Central Bank. These bills are classified as assets held for trading and carried at fair value.

## 11. Amounts due from other banks

Items in the course of collection	35,604	223,739	35,604	223,739
Placements with other banks	291,959	89,671	291,959	89,671
	<b>327,563</b>	<b>313,410</b>	<b>327,563</b>	<b>313,410</b>

## 12. Loans and advances to customers

Overdrafts	1,095,419	981,748	1,095,419	981,748
Lease financing	224,464	162,340	224,464	162,340
Term loans	2,638,291	2,439,997	2,617,631	2,408,660
Mortgages	1,028,791	846,383	1,028,000	845,400
Policy loans	38,194	38,517	-	-
Gross loans and advances net of reserved interest	5,025,159	4,468,985	4,965,514	4,398,148
Less allowance for losses on loans and advances	(220,533)	(168,072)	(214,721)	(162,174)
	<b>4,804,626</b>	<b>4,300,913</b>	<b>4,750,793</b>	<b>4,235,974</b>

The spread of the loans are detailed in the maturity analysis table on note 33. The loans are well-concentrated across various sectors and region and are further analysed on note 32.

### Lease financing

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

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 12. Loans and advances to customers (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
Gross investment in finance lease receivable				
Not later than 1 year	27,498	28,747	27,498	28,747
Later than 1 year and not later than 5 years	244,080	153,334	244,080	153,334
	<b>271,578</b>	<b>182,081</b>	<b>271,578</b>	<b>182,081</b>
Unearned future finance income				
Not later than 1 year	(719)	(615)	(719)	(615)
Later than 1 year and not later than 5 years	(46,395)	(19,126)	(46,395)	(19,126)
	<b>(47,114)</b>	<b>(19,741)</b>	<b>(47,114)</b>	<b>(19,741)</b>
Present value of minimum lease payment receivable	<b>224,464</b>	<b>162,340</b>	<b>224,464</b>	<b>162,340</b>
Present value of minimum lease payment receivable is analysed as follows:				
Not later than 1 year	26,779	28,132	26,779	28,132
Later than 1 year and not later than 5 years	197,685	134,208	197,685	134,208
	<b>224,464</b>	<b>162,340</b>	<b>224,464</b>	<b>162,340</b>
<b>Provision for impairment</b>				
Movement in allowance for losses on loans and advances:				
Balance at 1 January	168,072	158,678	162,174	107,278
Net new and increase provisioning	73,752	39,886	73,752	39,886
Others *	-	(16,356)	-	16,356
Loans written off against provisions / (Write back of provisions no longer required)	(21,291)	(14,136)	(21,205)	(1,346)
Balance at 31 December	<b>220,533</b>	<b>168,072</b>	<b>214,721</b>	<b>162,174</b>
Provision for impairment is represented by				
Collective provision	174,220	123,099	173,635	122,392
Individually assessed or specific provision	46,313	44,973	41,086	39,782
Balance at 31 December	<b>220,533</b>	<b>168,072</b>	<b>214,721</b>	<b>162,174</b>
*Others relates to the transfer of provisioning balance relating to the conversion of CNB to a branch of BSP in Fiji.				
<b>Loan impairment expense</b>				
Net collective provision funding	(65,013)	(27,015)	(65,013)	(27,015)
Net new and increase individually assessed provisioning	(8,739)	(12,871)	(8,739)	(12,871)
Total new and increase provisioning	<b>(73,753)</b>	<b>(39,886)</b>	<b>(73,753)</b>	<b>(39,886)</b>
Recoveries during the year	21,133	26,241	21,133	26,241
Net write back/(write off)	(18,333)	(11,589)	(18,333)	(11,589)
	<b>(70,952)</b>	<b>(25,234)</b>	<b>(70,952)</b>	<b>(25,234)</b>



# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 13. Property, plant and equipment

	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
<b>Carrying value</b>				
Capital Work in Progress	325,821	244,401	324,982	243,498
Premises	407,608	354,658	386,707	334,496
Accumulated depreciation	(76,888)	(58,119)	(70,004)	(53,238)
	<b>330,720</b>	<b>296,539</b>	<b>316,703</b>	<b>281,258</b>
Equipment	361,790	324,463	334,239	300,367
Accumulated depreciation	(274,039)	(242,500)	(257,645)	(227,601)
	<b>87,751</b>	<b>81,963</b>	<b>76,594</b>	<b>72,766</b>
	<b>744,292</b>	<b>622,903</b>	<b>718,279</b>	<b>597,522</b>

Reconciliation of carry value of property, plant and equipment is set out below:

### Capital WIP

At 1 January	244,401	94,061	243,498	77,815
Additions	230,398	534,104	221,783	531,684
Transfers	(148,978)	(383,764)	(140,299)	(366,001)
At 31 December	<b>325,821</b>	<b>244,401</b>	<b>324,982</b>	<b>243,498</b>

### Premises

At 1 January	296,539	181,675	281,258	174,855
Additions	51,841	19,449	52,634	19,271
Disposals	(422)	(292)	(422)	(292)
Net movement	-	4,565	-	5,570
Revaluation increases	-	100,568	-	90,843
Depreciation expense	(17,238)	(9,426)	(16,767)	(8,989)
At 31 December	<b>330,720</b>	<b>296,539</b>	<b>316,703</b>	<b>281,258</b>

### Equipment

At 1 January	81,963	88,418	72,766	59,354
Additions	44,140	24,270	39,177	19,883
Disposals	(5,617)	(9,290)	(5,305)	(8,889)
Net movement	-	13,092	-	34,327
Depreciation expense	(32,735)	(34,527)	(30,044)	(31,909)
At 31 December	<b>87,751</b>	<b>81,963</b>	<b>76,594</b>	<b>72,766</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 13. Property, plant and equipment (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
<b>Assets subject to operating lease</b>				
<b>Carrying value</b>				
Aircraft	123,326	115,041	123,326	115,041
Accumulated depreciation	(54,100)	(46,105)	(54,100)	(46,105)
	<b>69,226</b>	<b>68,936</b>	<b>69,226</b>	<b>68,936</b>
<b>Reconciliation of carry value of aircraft is set out below:</b>				
<b>Aircraft</b>				
At 1 January	68,936	77,480	68,936	77,480
Revaluation net increase	8,285	-	8,285	-
Depreciation	(7,995)	(8,544)	(7,995)	(8,544)
At 31 December	<b>69,226</b>	<b>68,936</b>	<b>69,226</b>	<b>68,936</b>
<b>Future minimum lease payments</b>				
Not later than 1 year	8,373	1,730	8,373	1,730
Later than 1 year and not later than 5 years	28,609	1,730	28,609	1,730
	<b>36,982</b>	<b>3,460</b>	<b>36,982</b>	<b>3,460</b>

The carrying amount of land and buildings and aircraft had they been recognised under the cost model are as follows:

Freehold land	14,531	14,531	11,434	11,434
Buildings	102,444	102,444	86,192	86,192
Aircraft	60,392	68,936	60,392	68,936
At 31 December	<b>177,367</b>	<b>185,911</b>	<b>158,018</b>	<b>166,562</b>

### Freehold land and buildings carried at fair value

An independent valuation of the Bank's land and buildings was performed by GDA Pacific Valuers to determine the fair value of the land and buildings. The valuation, which conforms to International Valuation Standards, was determined by reference to capitalization of the notional income stream approach on the Market Value basis. The last valuation was dated 31 December 2011.

### Assets subject to operating lease - aircraft

An independent valuation of the Bank's aircrafts was performed by Charles Taylor Aviation to determine the current realistic fair value for each of the aircraft. The valuation, which conforms to International Valuation Standards, takes into consideration the current global market variations for the specific types of aircrafts. The effective date of the valuation is 31 May 2012.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 14. Investment properties

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
Opening net book value	60,308	74,816	-	-
Net movement	1,112	(15,935)	-	-
Transfer to asset held for sale	(3,706)	-	-	-
Gain / (loss) on revaluation	(959)	1,427	-	-
<b>At 31 December</b>	<b>56,755</b>	<b>60,308</b>	-	-

## 15. Other financial assets

### Securities – held to-maturity:

Inscribed stock – issued by Central Bank 1,505,589 1,331,988 1,354,659 1,268,801

### Financial assets carried at fair value through profit and loss:

Equity securities 52,361 20,613 - -

**At 31 December 1,557,950 1,352,601 1,354,659 1,268,801**

The fair value hierarchy of the financial assets carried at fair value through profit and loss:

	Level 1	Level 2	Level 3	Total
<b>2012</b>				
Equity securities	-	51,278	1,083	52,361
	-	<b>51,278</b>	<b>1,083</b>	<b>52,361</b>
<b>2011</b>				
Equity securities	-	19,552	1,091	20,613
	-	<b>19,552</b>	<b>1,091</b>	<b>20,613</b>

The fair value hierarchy disclosure is in accordance with International Financial Reporting Standards requirements.

## 16. Other assets

Items in transit and other assets	428,730	175,185	372,716	128,253
Accrued income	76,079	65,123	76,079	65,123
Intercompany account	-	-	(11,454)	4,508
Computer development costs	3,126	4,144	3,126	4,144
Outstanding premiums	20,865	20,697	-	-
Inventory	5,575	4,337	-	-
Prepayments	14,824	12,349	14,824	12,349
Accounts receivable	(3,442)	11,414	(2,691)	629
	<b>545,757</b>	<b>293,249</b>	<b>452,600</b>	<b>215,006</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 17. Amounts due to other banks

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
Items in the course of collection	72,775	77,889	90,828	95,820

## 18. Amounts due to customers

On demand and short term deposits	9,012,413	7,614,630	9,016,405	7,618,664
Term deposits	1,848,109	1,751,651	1,904,286	1,827,725
	<b>10,860,522</b>	<b>9,366,281</b>	<b>10,920,691</b>	<b>9,446,389</b>

The majority of the amounts are due to be settled within twelve months of the balance sheet date as shown in the maturity analysis table on note 33. The deposits are well-diversed across industries and region.

## 19. Subordinated debt securities

At 31 December, there are K75.525 million of debt securities outstanding, expected to be settled more than 12 months after the balance sheet date. The notes were issued during 2009, with a maturity date in 2019, and interest is payable semi-annually at 11% per annum. They are valued at amortised cost. There have been no defaults of interest or other breaches with respect to these debt securities in 2012.

## 20. Other liabilities

Creditors and accruals	79,054	46,858	66,330	36,728
Items in transit and all other liabilities	223,079	194,787	218,827	184,182
Policy liabilities	399,627	376,743	-	-
Premiums received in advance	5,387	4,385	-	-
Outstanding claims	6,420	4,808	-	-
Claims incurred but not reported (IBNR)	1,168	1,290	-	-
	<b>714,735</b>	<b>628,871</b>	<b>285,157</b>	<b>220,910</b>
Policy liability is reconciled as follows:				
Opening balance	376,743	361,554	-	-
Adjustment to policy liability	-	(18,303)	-	-
Increase in policy liability	22,884	33,492	-	-
	<b>399,627</b>	<b>376,743</b>	<b>-</b>	<b>-</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 21. Other provisions

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
Staff related	57,069	46,478	52,287	42,609
Provision for non lending loss*	25,394	34,381	25,394	34,381
Provision for offshore creditors' GST	13,517	10,691	13,517	10,692
	<b>95,980</b>	<b>91,550</b>	<b>91,198</b>	<b>87,682</b>
<b>Staff related provisions:</b>				
At 1 January	46,478	43,746	42,609	34,568
Provisions charge	19,799	15,870	24,208	13,871
Payouts	(9,208)	(13,138)	(14,530)	(5,830)
At 31 December	<b>57,069</b>	<b>46,478</b>	<b>52,287</b>	<b>42,609</b>

### \* CDO Provisions (included under provision of non lending loss)

In 2008 and prior periods, BSP Capital Limited a subsidiary of the Bank, marketed certain collateralised debt obligation investment products issued or arranged by Lehman Brothers. The value of the notes was seriously impaired following the Global Financial Crisis of 2007-2008, particularly the demise of Lehman Brothers, which was the primary issuer or promoter in the majority of cases.

The balance as at 31 December 2012 is K1.760 million.

## 22. Ordinary shares – Bank

<i>Number of shares in '000s, Book value in K'000</i>	Number of shares	Book value
At 31 December 2010/1 January 2011	4,787,295	461,633
Share consolidation (10/1)	478,738	-
Share buyback	(4,856)	(35,189)
At 31 December 2011 / 1 January 2012	473,882	426,444
Share buyback	(4,681)	(41,630)
At 31 December 2012	<b>469,201</b>	<b>384,814</b>

At the company's annual general meeting held on 20 May 2011 in Port Moresby, the shareholders approved a reorganization of the company's capital through a share consolidation by which 10 existing BSP ordinary shares were consolidated into 1 BSP share.

In May 2011, the Directors agreed to introduce a share-buyback scheme of up to K40 million in conjunction with the 1 for 10 share consideration. The share-buyback commenced in July 2011. At the expiry of the first buyback scheme the Directors approved a further buyback program of K40 million which commenced on Friday 9 March 2012 for a period of 12 months.

The issued capital of Bank of South Pacific Limited comprises ordinary shares. Following is a summary of principal shareholders as at 31 December 2012 and their respective percentage holdings.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 22. Ordinary shares – Bank (continued)

<b>Major shareholders: % shareholding</b>	<b>2012</b>	<b>2011</b>
Independent Public Business Corporation	17.97	17.75
National Superannuation Fund Limited	11.06	10.93
Nambawan Super Limited	10.04	10.00
Petroleum Resources Kutubu Limited	9.84	9.72
Credit Corporation (PNG) Limited	7.85	8.06
Motor Vehicle Insurance Limited	6.66	6.58
PNG Sustainable Development Program Limited	6.25	6.17
IFC Capitalization(Equity) Fund LP	4.86	4.80
International Finance Corporation	4.86	4.80
Teachers Savings & Loans Society Limited	3.69	3.70
Comrade Trustee Services Limited	3.13	3.16
Tropicana Limited	1.06	1.05
	<b>87.27</b>	<b>86.72</b>
All Others	12.73	13.28
	<b>100.00</b>	<b>100.00</b>

<i>All amounts are expressed in K'000</i>	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Earnings per ordinary share</b>				
Net Profit attributable to shareholders (K'000)	407,744	355,947	399,588	348,989
Weighted average number of ordinary shares in use ('000)	469,201	473,882	469,201	473,882
Basic and diluted earnings /(loss) per share (expressed in toea)	<b>86.9</b>	<b>75.1</b>	<b>85.2</b>	<b>73.6</b>

Basic earning 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.

### Dividend paid on ordinary shares

Interim ordinary dividend (2012: 20 toea; 2011: 16 toea)	93,970	73,681	93,970	73,681
Final ordinary dividend (2011: 35 toea; 2010: 3.13 toea)	165,024	149,845	165,024	149,845
	<b>258,994</b>	<b>223,526</b>	<b>258,994</b>	<b>223,526</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 22. Ordinary shares – Bank (continued)

### Share Options - Executive Management Share Option Plan (EMSOP)

An Executive Management Share Option Plan was approved at the AGM of 2004, mandating the Board to conduct the plan under the terms agreed; Options granted in the years up to and including 2006, were exercisable for BSP shares; Since 2009, in light of the much improved capital situation of the company, the exercisability for shares was removed on options granted in 2007, and to preserve the incentive for executive management, it was replaced with an encashment equivalent to the value of the benefit available had the options been exercised. Options issued in each of the years since 2008, and respectively exercisable at every 2 years anniversary following the date of issue, have been exercised in this manner.

On July 2011, the Board granted 17,250,000 options over ordinary shares of Bank of South Pacific Limited to the executives (taking into account the 10/1 share consolidation in 2011, these are 1,725,000). The options had a vesting period of 1 July 2013, and an exercise price of K6.69. The overriding exercise conditions of these options are performance hurdles.

On July (approved in December 2012) 2012, the Board granted 2,150,000 options to the executives. These options have a vesting period of 1 July 2014 and an exercise price of K8.00.

The 2012 share options have been valued in compliance with IFRS 2 and classified as equity on the balance sheet. For accounting purposes, where an encashment of the benefit of exercise has occurred, those options have been treated as lapsed.

The following table provides details of outstanding EMSOP under the plan.

Options 2012 ('000)	Opening balance	Share consolidation	Granted	Vested	Forfeited	Others	Outstanding balance
2010	1,825	-	-	(1,825)	-	-	-
2011	1,725	1,725	-	-	-	-	1,725
2012	-	-	2,150	-	-	-	2,150
<b>Total</b>	<b>3,550</b>	<b>1,725</b>	<b>2,150</b>	<b>(1,825)</b>	-	-	<b>3,875</b>
<b>Weighted average exercise price</b>	6.69	6.69	8.00	6.50	-	-	7.35

  

Options 2011 ('000)	Opening balance	Share Split	Granted	Vested	Forfeited	Others	Outstanding balance
2010	18,250	1,825	-	-	-	-	1,825
2011	-	-	1,725	-	-	-	1,725
<b>Total</b>	<b>18,250</b>	<b>1,825</b>	<b>1,725</b>	-	-	-	<b>3,550</b>
<b>Weighted average exercise price</b>	0.65	6.50	6.69	-	-	-	6.69

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

23. Reserves and retained earnings	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
<b>Retained earnings</b>				
At 1 January	721,398	588,977	697,698	578,372
Net profit for the year	407,744	355,947	399,588	348,989
Dividend paid	(258,994)	(223,526)	(258,994)	(223,526)
Other adjustments	-	-	-	(6,137)
At 31 December	870,148	721,398	838,292	697,698
<b>Reserves comprise</b>				
Revaluation reserve	170,103	160,293	170,103	160,293
Capital reserve	635	635	68,547	68,547
Equity component of convertible notes	18,218	18,218	-	-
Options reserve	4,526	3,238	4,526	3,237
General reserve	2,875	2,875	2,875	2,875
Exchange reserve	14,574	11,087	14,574	15,627
	210,931	196,346	260,625	250,579
<b>Movement in reserves for the year:</b>				
<b>Revaluation reserve</b>				
At 1 January	160,293	68,776	160,293	68,776
Asset revaluation increment	12,296	98,429	12,296	98,429
Deferred tax on asset revaluation	(2,486)	(6,912)	(2,486)	(6,912)
At 31 December	170,103	160,293	170,103	160,293
<b>Capital reserve</b>				
At 1 January	635	635	68,547	635
BSP Fiji branch - capital adequacy reserve	-	-	-	67,912
At 31 December	635	635	68,547	68,547
<b>Options reserve</b>				
At 1 January	3,238	1,968	3,237	1,967
Movement during the year	1,288	1,270	1,289	1,270
At 31 December	4,526	3,238	4,526	3,237
<b>General reserve</b>				
At 1 January	2,875	2,875	2,875	2,875
At 31 December	2,875	2,875	2,875	2,875



# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 23. Reserves and retained earnings (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
<b>Exchange reserve</b>				
At 1 January	11,087	(8,685)	15,627	(4,914)
Movement during the year	3,487	19,772	(1,053)	20,541
At 31 December	14,574	11,087	14,574	15,627

### Exchange reserve

The movement in exchange reserve is a result of taking on alignment entries and month end entries of BSP's foreign branches in Solomon Islands, Fiji Islands and Niue. These treatments are in accordance with applicable accounting standards.

### 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. Each note entitles the holder to convert to ten (10) Fiji Class shares. On conversion all notes are redeemed for their face value and the proceeds of that redemption are applied as the subscription price for Fiji Class shares. Notes can only be redeemed in cash at the election of BSP CN Fiji with regulatory approval. The amount payable at redemption will be greater of the market value or face value of the note plus accrued interest. The notes will mandatorily convert to Fiji Class Shares on 20 April 2013.

The net proceeds received from the issue of the convertible notes have been split between the financial liability element and the equity component, representing the residual attributable to the option to convert the financial liability into equity of BSP CN.

The equity component of K18.218 million has been credited to equity (option premium on convertible notes).

At BSP's Annual General Meeting held on the 20 May 2011 in Port Moresby, the shareholders approved a reorganisation of the company's capital via a Share Consolidation by which 10 existing BSP ordinary shares were consolidated into 1 BSP share.

BSP Convertible Notes Limited (BCN) and BCN Noteholders are bound by the Mandatorily Convertible Notes Deed dated 5 March 2010. This sets the initial Conversion Ratio (that is, the number of Fiji Class Shares to which one Note will convert at Conversion Date) at 10:1. This Conversion Ratio is subject to change and adjustable in accordance with the Note Conditions should there be a change to BSP's capital structure.

Accordingly, as a result of the share consolidation, the Conversion Ratio has been adjusted in accordance with the Deed to 1:1. Therefore at Conversion Date (that is three years from the date of issue or on the occurrence of specified events in the Deed, whichever is earlier) each Note issued by BCN will convert to a single Fiji Class share.

The effective interest rate which is used to calculate the interest charged to the statement of comprehensive income was 7%.

Note holders have no right to vote at meetings of BSP Convertible Notes Limited.

### Statutory capital requirements in Fiji

As a requirement of the Reserve Bank of Fiji, BSP Fiji operations is required to maintain assigned capital of K24m (2011: K24m) and capital adequacy reserve of K68m (2011: K68m).

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 24. Contingent liabilities and commitments

### Off balance sheet financial instruments

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2012	2011	2012	2011
Standby letters of credit	18,051	57,678	18,051	57,678
Guarantees and indemnities issued	121,781	269,458	179,073	269,458
Trade letters of credit	86,963	118,751	86,963	118,751
Commitments to extend credit	1,290,923	643,791	1,178,340	643,791
	<b>1,517,718</b>	<b>1,089,678</b>	<b>1,462,427</b>	<b>1,089,678</b>

### Legal Proceedings

A number of legal proceedings against the Bank and the Group were outstanding as at 31 December 2012. No provision has been made as existing management information and professional advice indicate that it is unlikely that any significant loss will arise. Based on information available at 31 December 2012, the Bank and the Group estimates a contingent liability of K74.780 million (2011: K50.084 million) in respect of these proceedings.

### Statutory deposits with the Central Bank

Cash reserve requirement - 8% of all amounts due to customers (2011: 6%)

	<b>873,198</b>	<b>586,235</b>	<b>742,495</b>	<b>496,588</b>
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### Commitments for capital expenditure

Amounts with firm commitments, and not reflected in the accounts

	<b>24,646</b>	<b>39,556</b>	<b>24,646</b>	<b>39,556</b>
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### Operating lease commitments

Not later than 1 year	23,048	14,696	23,048	14,696
Later than 1 year and not later than 5 years	80,914	23,045	80,914	23,045
Later than 5 years	-	10,860	-	10,860
	<b>103,962</b>	<b>48,601</b>	<b>103,962</b>	<b>48,601</b>

## 25. Fiduciary activities

The Group especially through BSP Capital Limited conducts investment fund management, stock broking 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 incurs 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 consolidated financial statements.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 26. Directors and executive remuneration

### Directors remuneration

Directors of the company received remuneration including benefits during 2012 as detailed below:

*All amounts are in K*

Name of Director	Meetings attended / total held	Appointed/ (Resigned)	Base emolument	Bonus shares	Other compensation	Total remuneration	
						2012	2011
K. Constantinou, OBE	8/8	-	195,090	-	-	195,090	119,559
T. E. Fox, OBE	7/8	-	210,037	-	-	210,037	84,647
Dr. I. Temu	8/8	-	113,910	-	-	113,910	45,112
C. C. Procter	6/8	-	211,969	-	-	211,969	59,223
Sir N. Bogan	5/8	-	101,224	-	-	101,224	42,068
I. B. Clyne*	8/8	-	-	-	-	-	-
J. G. Jeffery, CBE	3/8	-	160,244	-	-	160,244	74,426
G. Aopi, CBE	6/8	-	116,043	-	-	116,043	47,927
G. Robb, OAM	6/8	20/04/12	207,104	-	-	207,104	-
F. Talao	6/8	20/04/12	108,869	-	-	108,869	-

Directors Kostas Constantinou and Gereia Aopi retired by rotation in accordance with Clause 15.3 of the Company's Constitution and being eligible, offered themselves for re-election by the shareholders on 18<sup>th</sup> May 2012 Annual General Meeting. Directors Freda Talao and Geoffrey Robb appointments as new Directors was affirmed by the Shareholders at this Annual Meeting.

Non-executive Board Members of the Board – Constantinou, Fox and Procter received an allowance of K45,000 as Board of Directors of BSP Capital Ltd which forms part of the Group. Directors Aopi and Temu resigned as Directors and Robin Fleming was appointed to the Board of BSP Capital Ltd.

\* 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.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 26. 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	2012		2011		Remuneration on K'000		2012		2011	
	No.	No.	No.	No.	No.	No.	No.	No.	No.	No.
100 - 110	28	24	350 - 360	3	1	650 - 660	3	-		
110 - 120	26	27	360 - 370	2	1	660 - 680	2	1		
120 - 130	16	16	370 - 380	2	2	680 - 690	1	5		
130 - 140	23	19	380 - 400	1	3	700 - 710	4	1		
140 - 150	10	9	410 - 420	2	-	710 - 720	1	1		
150 - 160	9	6	430 - 440	1	1	720 - 730	1	1		
160 - 170	5	6	440 - 450	2	3	730 - 740	-	1		
170 - 180	7	3	450 - 460	-	1	740 - 750	-	2		
180 - 190	5	4	460 - 470	1	2	750 - 760	2	2		
190 - 200	4	4	480 - 490	2	1	760 - 770	1	1		
200 - 210	4	5	490 - 500	3	1	770 - 800	-	1		
210 - 220	3	4	500 - 510	3	1	800 - 810	1	1		
220 - 230	3	1	510 - 520	5	1	810 - 870	3	1		
230 - 240	2	2	520 - 530	-	1	870 - 900	-	1		
240 - 250	5	4	530 - 540	3	1	900 - 940	-	1		
250 - 260	5	3	540 - 550	2	1	940 - 950	-	1		
260 - 270	5	1	550 - 560	2	1	950 - 960	1	1		
270 - 280	-	3	570 - 580	5	1	970 - 980	-	1		
280 - 290	5	-	580 - 590	2	-	1020 - 1030	-	1		
290 - 310	7	1	590 - 600	2	2	1050 - 1100	1	1		
310 - 320	2	2	610 - 620	4	1	1180 - 1190	-	1		
320 - 330	1	3	620 - 630	-	2	1200 - 1360	3	-		
330 - 340	1	1	630 - 640	1	3	1400 - 1410	-	1		
340 - 350	2	1	640 - 650	3	3	4500 - 4510	1	1		
<b>Total</b>							<b>254</b>	<b>211</b>		

Executives' remuneration stated includes exercised options.

### The specified executives during the year were:

Ian B Clyne	Robin Fleming	Robert Loggia	Ged Allen
Johnson Kalo	Peter Beswick	Frans Kootte	
Aho Baliki	Giau Duruba	Mark Railston	

### Specified executives' remuneration in aggregate (K'000)

	Primary		Non-monetary	Super	Post-employment		Equity options	Other benefits	Total
	Salary	Bonus			Prescribed benefits	Other			
<b>2012</b>	8,213	1,954	220	200	-	-	1,200	378	12,165
<b>2011</b>	7,502	2,244	266	173	-	-	-	230	10,415

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

27. Reconciliation of operating cash flow	Consolidated		Bank	
	2012	2011	2012	2011
<i>All amounts are expressed in K'000</i>				
<b>Reconciliation of operating profit/(loss) after tax to operating cash flow before changes in operating assets</b>				
Operating profit/(loss) after tax	407,744	355,947	399,588	348,989
Add: Tax Expense	137,552	119,039	135,849	117,207
Operating profit before income tax	<b>545,296</b>	<b>474,986</b>	<b>535,437</b>	<b>466,196</b>
<b>Major non cash amounts</b>				
Depreciation	89,775	52,497	86,601	49,442
Amortisation of deferred acquisition and computer development costs	785	512	785	512
Net (profit)/loss on sale of fixed assets	(3,817)	508	(3,817)	508
Sundry write off	-	20,253	-	20,133
Movement in forex income accrual	(710)	(6,248)	(710)	(4,910)
Movement in provision for doubtful debts	(70,952)	(24,904)	(70,952)	(25,234)
Movement in payroll provisions	9,587	4,229	9,587	4,229
Net effect of other accruals	171,853	(52,171)	184,283	28,144
Operating cash flow before changes in operating assets	<b>741,817</b>	<b>469,662</b>	<b>741,214</b>	<b>539,020</b>
<b>Cash and cash equivalents</b>				
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 Bank (note 9)	1,806,597	1,188,048	1,764,275	1,086,766
Due from other banks (note 11)	327,563	313,410	327,563	313,410
Due to other banks (note 17)	(72,775)	(77,889)	(90,828)	(95,820)
	<b>2,061,385</b>	<b>1,423,569</b>	<b>2,001,010</b>	<b>1,304,356</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 28 Segment information

Bank of South Pacific Limited and Group comprises two segments, these being the provision of banking services and products and stock broking services. 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 for management purposes are core banking segments of retail bank, wholesale bank which includes corporate and paramount strategic business units, insurance operations in Fiji, and BSP Capital's stock broking and fund management activities. The Bank of South Pacific Limited and Group's business segments operates in Papua New Guinea, Niue, Fiji and Solomon Islands. Inter segment adjustments reflects elimination entries in respect of inter segment income and expense allocations included funds transfer pricing.

*All amounts are expressed in K'000*

### Analysis by business segments:

#### Year ended 31 December 2012

	Retail	Wholesale	Fiji Bank	Insurance	BSP Capital	Others	Adjust Inter Segments	Total
Revenue	395,269	636,433	83,105	155,994	2,407	56,158	268,301	1,597,667
Costs	(258,909)	(326,565)	(78,522)	(142,209)	(6,315)	(33,878)	(205,973)	(1,052,371)
Operating results	136,360	309,868	4,583	13,785	(3,908)	22,280	62,328	545,296
Income tax expense								(137,552)
<b>Profit after tax</b>								<b>407,744</b>

#### Year ended 31 December 2011

	Retail	Wholesale	Fiji Bank	Insurance	BSP Capital	Others	Adjust Inter Segments	Total
Revenue	374,406	502,312	69,625	168,400	3,547	19,010	310,802	1,448,102
Costs	(289,291)	(201,087)	(65,416)	(155,645)	(7,481)	(38,394)	(215,802)	(973,116)
Operating results	85,115	301,225	4,209	12,755	(3,934)	(19,384)	95,000	474,986
Income tax expense								(119,039)
<b>Profit after tax</b>								<b>355,947</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 29. Related party transactions

Related parties are considered to be enterprises or individuals with whom the Bank and 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 Bank and the Group, by virtue of being able to control, dominate or participate in a fiduciary capacity, in decision-making functions or processes. The Bank and 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 2012, balances and transactions of accounts for Directors were as follows:

<i>All amounts are expressed in K'000</i>	<b>2012</b>	<b>2011</b>
<b>Deposits</b>		
Opening balances	208,359	44,439
Net movement	(68,802)	163,920
Closing balance	<b>139,557</b>	<b>208,359</b>
Interest paid	7,261	6,066
<b>Loans and advances</b>		
Opening balances	157,039	83,571
Loans issued	219,795	125,401
Interest	6,113	2,577
Charges	58,296	27,969
Loan repayments	(268,518)	(82,479)
Closing balance	<b>172,725</b>	<b>157,039</b>

Incentive-based transactions are provided for staff. Such transactions include marginal discounts on rates, and specific fee concessions. These incentives 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 2012, staff account balances were as follows:

<i>All amounts are expressed in K'000</i>	<b>2012</b>	<b>2011</b>
Housing loans	17,296	12,771
Other loans	16,674	16,657
	<b>33,970</b>	<b>29,428</b>
Cheque accounts	23,736	9,709
Foreign currency accounts	320	-
Savings accounts	11	4,209
	<b>24,067</b>	<b>13,918</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 29. Related party transactions (continued)

### Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
K. Constantinou, OBE	Director	Bank of South Pacific Ltd <sup>1</sup> , BSP Capital Ltd <sup>1</sup> , Airways Hotel & Apartment Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Hebou Constructions Ltd, Heritage Park Hotel Ltd, Gazelle International Hotel Ltd, Airlines PNG Ltd, Oil Search Ltd, Alotau International Hotel Ltd, Kimbe Bay Hotel Ltd, Grand Pacific Hotel Ltd, City Centre Development Ltd, Coastwatchers Court Ltd, Waigani Assets Ltd, Southern Seas Investments Ltd, Texas Chicken South Pacific Ltd.
	Shareholder	Airways Hotel & Apartment Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Texas Chicken South Pacific Ltd..
	Member	Australian Institute of Company Directors, PNG Institute of Directors, Pacific Games Authority <sup>1,6</sup> .
T. E. Fox, OBE, BEc	Director	Bank of South Pacific Ltd <sup>2</sup> , BSP Capital Ltd, Teyo No. 1 Ltd <sup>5</sup> , Akura Ltd.
	Shareholder	Bank of South Pacific Ltd, Teyo No. 1 Ltd, Citigold Corporation Ltd, Marengo Mining Corporation Ltd, New Guinea Energy Ltd, Akura Ltd.
	Trustee/Member	Institute of National Affairs <sup>8</sup> , PNG Institute of Directors.
Ian B. Clyne	Director	Bank of South Pacific Ltd <sup>9</sup> , BSP Capital Ltd, BSP Convertible Notes Ltd, BSP Rural Ltd, BSP Life Ltd.
	Member	Commercial Bankers Association, Australian Institute of Company Directors, PNG Institute of Directors.
J. G. Jeffery, CBE	Director	Bank of South Pacific Ltd, Jayliss Ltd.
	Shareholder	Highlands Pacific Ltd, Oil Search Ltd, Jayliss Ltd <sup>1</sup> .
	Member	PNG Institute of Directors.
G. Aopi, CBE, MBA	Director	Bank of South Pacific Ltd, Oil Search Ltd <sup>7</sup> , Steamships Trading Co Ltd, POMSoX Ltd, Marsh Ltd, Hiram Ltd, Wahinemo Ltd, FM Morobe Ltd, CDI Foundation.
	Shareholder	Bank of South Pacific Ltd, Oil Search Ltd <sup>7</sup> , Hiram Ltd, Wahinemo Ltd, Newcrest Ltd, Highlands Pacific Ltd, Melanesian Trustees (ICPNG), Kumul Asset Management.
	Member/Trustee	Institute of National Affairs, Business Council of PNG, PNG Chamber of Mines & Petroleum, Oil Search Health Foundation.
Dr I. Temu, PhD, MEc	Director	Bank of South Pacific Ltd, Tipi Enterprise Ltd, PNG Ports Corporation <sup>1</sup> .
	Shareholder	Telstra Ltd, Nautilus Minerals Niugini Ltd.
	Employee	Barrick Gold Ltd.
	Member	Divine Word University, Chamber of Mining & Petroleum.
C. C. Procter, MEc, FFin	Director	Bank of South Pacific Ltd, BSP Capital Ltd, Sun Hung Kai Ltd, Allied Overseas Ltd, Eurogold Ltd.
	Member	Australian Institute of Company Directors.



# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 29. Related party transactions (continued)

### Interest Register (continued)

Name	Nature of Interest	
Sir N. Bogan, KBE, LLB	Director	Bank of South Pacific Ltd, Nambawan Super Ltd <sup>1,5</sup> , In Touch Media Ltd <sup>1</sup> , Coprez Communications Ltd <sup>1</sup> , Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory, Ahi Holdings Ltd.
	Shareholder	In Touch Media Ltd, Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory.
	Member	Evangelical Lutheran Church Finance Committee.
G. Robb, MBA	Director	Bank of South Pacific Ltd, Lex Van Hessen Australian Holding Pty Ltd.
	Shareholder	St Barbara Ltd, Macquarie Bank Ltd, Woodside Petroleum Ltd.
	Member	Australian Institute of Company Directors.
F Talao	Director	Bank of South Pacific Ltd, National Airports Corporation Board, Airport City Development Ltd <sup>1</sup> .
	Member	External Stakeholders Advisory Panel to Morobe Mining Joint Venture, Australian Institute of Company Directors.

<sup>1</sup>Chairman, <sup>2</sup>Deputy Chairman, <sup>3</sup>Managing Director, <sup>4</sup>Executive Director, <sup>7</sup>General Manager, <sup>8</sup>Councillor

<sup>5</sup>Company is shareholder of Bank of South Pacific Limited, or shareholder of company that is shareholder

<sup>6</sup>Company has commercial banking facilities with Bank of South Pacific Limited, <sup>9</sup>Chief Executive Officer

## 30. Bank operations, risks and strategies in using financial instruments

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 Bank and the Group's primary financial intermediary role in the financial markets, including the use of financial instruments including derivatives. These market 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 Bank and 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 Bank and 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 Bank and the Group also enters into guarantees and other commitments such as letters of credit, performance bonds, and other bonds.

The Bank and the Group also enters into transactions denominated in foreign currencies. This activity generally requires the Bank and 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 Bank and 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 Bank and 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 Bank 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 Bank and 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 Audit, Risk and Compliance Committee of the Board, and ultimately to the Board of Directors.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 31. Capital adequacy

The Bank and 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. 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 Bank and the Group complies with the prevailing prudential requirements for total capital and leverage capital. As at 31 December 2012, the Bank and the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for well-capitalised. The minimum capital adequacy requirements set out under the standard are: Tier 1 8%, total risk base 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, unaudited 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.

The Bank and the Group's capital adequacy level is as follows:

<i>All amounts are expressed in K'000</i>	<b>Balance sheet / notional amount</b>		<b>Risk-weighted amount</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Balance sheet assets (net of provisions)</b>				
Currency	1,806,597	1,188,048	-	-
Loans and advances	4,804,626	4,300,913	4,594,014	4,050,768
Investments and short term securities	4,795,467	4,669,011	-	-
All other assets	1,926,412	1,523,321	1,847,900	1,390,108
<b>Off balance sheet items</b>	<b>1,517,718</b>	<b>1,089,678</b>	<b>316,934</b>	<b>352,353</b>
<b>Total</b>	<b>14,850,820</b>	<b>12,770,971</b>	<b>6,758,848</b>	<b>5,793,229</b>

<b>Audited Capital Ratios</b>	<b>Capital (K'000)</b>		<b>Capital Adequacy Ratio (%)</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
a) Tier 1 capital	1,185,382	1,166,608	17.4%	19.8%
Tier 1 + Tier 2 capital	1,516,086	1,425,207	22.3%	24.2%
b) <b>Leverage Capital Ratio</b>			9.0%	10.0%

## 32. Credit risk and asset quality

The Bank incurs risk with regards to loans and advances made to 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 Bank and the Group as they fall due.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 32. Credit risk and asset quality (continued)

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.

As indicated in Accounting Policy G – Loans and provision for loan impairment, the Bank and 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 Bank and the Group assigns quality indicators to its credit exposures to determine the asset quality profile.

Large credit exposures are also monitored as part of credit risk management. These are classified as the largest 25 individual accounts or groups of related counter-parties. As at 31 December 2012, the 25 largest exposures totaled K2.815 billion, accounting for over 56% of the Bank and 56% of the Group's total loan portfolio (2011: K2.317 billion, accounting for over 52.4% and 52.7% respectively).

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. Since its introduction, the Bank and the Group has complied with the requirement at all times.

### Credit related commitments

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

Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank and 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 Bank and the Group on behalf of a customer, authorising a third party to draw drafts on the Bank and 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 Bank and 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.

### Economic sector risk concentrations

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

*All amounts are expressed in K'000*

As at 31 December	2012	%	2011	%
Commerce, finance and other business	1,937,732	40	1,908,350	45
Private households	946,132	20	692,311	16
Government and public authorities	101,621	2	58,072	1
Agriculture	116,451	2	307,834	7
Transport & communication	723,624	15	550,568	13
Manufacturing	520,588	11	302,837	7
Construction	458,478	10	480,941	11
Net loan portfolio balance	4,804,626	100	4,300,913	100

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 33. 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 Bank and 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 2012

The maturity profile of material Assets and Liabilities as at 31 December 2012 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 Bank and the Group, and does not impair the ability of the Bank and the Group to meet its financial obligations as they fall due. The Directors are also of the view that the Bank and the Group is able to meet its financial obligations as they fall due for the following additional reasons:

- The Bank and the Group complies with the Minimum Liquid Asset Ratio ("MLAR") and Cash Reserve Requirement ("CRR") set by the regulatory authority, the Bank of Papua New Guinea ("BPNG"). The MLAR is the minimum ratio of liquid assets to total customer deposits considered by the regulator as sufficient to support exceptional liquidation by depositors, of their funds. The requirement to hold a minimum of 25% of the value of total customer deposits in the form of prescribed liquid assets was reduced to zero by the BPNG in September 2010. As at 31 December 2012, the Bank and the Group's Liquid Asset Ratio was approximately 38.92% (2011: 43.61%).
- The CRR specifies that a bank must hold an amount equal to 8% of its total customer deposits in the form of cash in an account maintained at the BPNG. The Bank and the Group complies with this daily requirement on an ongoing basis. The balance of the CRR account is shown in note 9, Cash and Balances with Central Bank, and note 27, Cash & Cash Equivalents.

### Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
<b>Assets</b>						
Cash and balances with Central Bank	1,806,597	-	-	-	-	1,806,597
Treasury & Central Bank bills	962,220	1,154,447	1,120,850	-	-	3,237,517
Due from other banks	327,563	-	-	-	-	327,563
Loans and advances	1,653,163	118,214	506,249	802,099	1,724,901	4,804,626
Investments	-	34,250	296,750	523,060	703,890	1,557,950
<b>Total assets</b>	<b>4,749,543</b>	<b>1,306,911</b>	<b>1,923,849</b>	<b>1,325,159</b>	<b>2,428,791</b>	<b>11,734,253</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 33. Liquidity risk (continued)

All amounts are expressed in K'000

As at 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
<b>Liabilities</b>						
Due to other banks	72,775	-	-	-	-	72,775
Due to customers	10,086,241	410,159	315,394	48,723	5	10,860,522
Other liabilities	690,298	46,365	-	-	75,525	812,188
Other provisions	65,696	49,791	-	-	6,237	121,724
<b>Total liabilities</b>	<b>10,915,010</b>	<b>506,315</b>	<b>315,394</b>	<b>48,723</b>	<b>81,767</b>	<b>11,867,209</b>
<b>Net liquidity gap</b>	<b>(6,165,467)</b>	<b>800,596</b>	<b>1,608,455</b>	<b>1,276,436</b>	<b>2,347,024</b>	<b>(132,956)</b>
<b>As at 31 December 2011</b>						
Total assets	3,528,665	1,547,197	1,748,162	2,455,295	1,192,063	10,471,382
Total liabilities	7,963,556	1,148,186	664,926	444,969	115,468	10,337,105
<b>Net liquidity gap</b>	<b>(4,434,891)</b>	<b>399,011</b>	<b>1,083,236</b>	<b>2,010,326</b>	<b>1,076,595</b>	<b>134,277</b>

## 34. Operational risk

Operational risk is the potential exposure to unexpected financial or non-financial losses arising from the way in which the Bank and 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 policy and regulatory environment and examines the general standard of control.

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

## 35. 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 Bank and the Group is to minimise the impact on earnings of any such movement.

The Bank and the Group accepts foreign currency denominated transactions and therefore has exposure to movements in foreign currency. The Bank and the Group has a policy to offset these transactions by minimising daily exposure. This is done through hedging material exposures as they arise. As foreign exchange contracts generally consist of offsetting commitments, they involve only limited foreign exchange risk to the Bank and the Group and material loss is not envisaged.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 35. Foreign exchange risk (continued)

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

*All amounts are expressed in K'000*

As at 31 December 2012	USD	AUD	EURO	PGK	Other	Total
<b>Assets</b>						
Cash and balances with Central Bank	28,311	(38,288)	208	1,824,608	(8,242)	<b>1,806,597</b>
Treasury & Central Bank bills	79,625	6,619	-	3,150,840	433	<b>3,237,517</b>
Due from other banks	95,053	202,222	16,481	(1,418)	15,225	<b>327,563</b>
Loans and advances	211,681	22,862	6,007	3,358,353	1,205,723	<b>4,804,626</b>
Other financial assets	-	-	-	943,393	614,557	<b>1,557,950</b>
Other assets	-	-	-	1,350,630	248,219	<b>1,598,849</b>
<b>Total assets</b>	<b>414,670</b>	<b>193,415</b>	<b>22,696</b>	<b>10,626,406</b>	<b>2,075,915</b>	<b>13,333,102</b>
<b>Liabilities</b>						
Due to other banks	-	-	-	(72,775)	-	<b>(72,775)</b>
Due to customers	(343,027)	(364,966)	(3)	(8,630,398)	(1,522,128)	<b>(10,860,522)</b>
Other liabilities	-	-	-	(445,879)	(488,033)	<b>(933,912)</b>
<b>Total liabilities</b>	<b>(343,027)</b>	<b>(364,966)</b>	<b>(3)</b>	<b>(9,149,052)</b>	<b>(2,010,161)</b>	<b>(11,867,209)</b>
<b>Net on-balance sheet position</b>	<b>71,643</b>	<b>(171,551)</b>	<b>22,693</b>	<b>1,477,354</b>	<b>65,754</b>	<b>1,465,893</b>
<b>Off-balance sheet net notional position</b>	<b>26,463</b>	<b>2,355</b>	<b>27,018</b>	<b>-</b>	<b>1,034,611</b>	<b>1,090,447</b>
<b>Credit commitments</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,517,718</b>	<b>-</b>	<b>-</b>
<b>31 December 2011</b>						
Total Assets	78,475	16,396	4,298	10,035,806	1,546,318	11,681,293
Total Liabilities	(33,615)	(98,536)	-	(8,643,714)	(1,561,240)	(10,337,105)
Net on-balance sheet position	44,860	(82,140)	4,298	1,392,092	(14,922)	1,344,188
Off-balance sheet net notional position	63,031	7,314	10,550	-	79,528	160,423
Credit commitments	-	-	-	1,089,678	-	-

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 36. 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 Bank and 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. 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 Bank and 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.

Given the profile of assets and liabilities as at 31 December 2012 and prevailing rates of interest, a 1% increase in rates will result in a K15.3 million increase in net interest income, whilst a 1% decrease in rates will result in a K45.2 million decrease in net interest income.

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

*All amounts are expressed in K'000*

As at 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non interest bearing
<b>Assets</b>						
Cash & Balances with Central Bank	-	-	-	-	-	1,806,597
Treasury & Central Bank bills	962,220	1,154,447	1,120,850	-	-	-
Due from other banks	327,563	-	-	-	-	-
Loans and advances	4,308,480	59,811	219,660	216,675	-	-
Investments	-	34,250	296,750	523,060	703,890	-
Other assets	-	-	-	-	-	1,598,849
<b>Total assets</b>	<b>5,598,263</b>	<b>1,248,508</b>	<b>1,637,260</b>	<b>739,735</b>	<b>703,890</b>	<b>3,405,446</b>
<b>Liabilities</b>						
Due to other banks	72,775	-	-	-	-	-
Due to customers	5,823,901	410,159	292,971	48,723	5	4,284,763
Other liabilities	-	-	-	-	75,525	714,735
Other provisions	-	-	-	-	-	143,652
<b>Total liabilities</b>	<b>5,896,676</b>	<b>410,159</b>	<b>292,971</b>	<b>48,723</b>	<b>75,530</b>	<b>5,143,150</b>
<b>Interest sensitivity gap</b>	<b>(298,413)</b>	<b>838,349</b>	<b>1,344,289</b>	<b>691,012</b>	<b>628,360</b>	<b>(1,737,704)</b>

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 36. Interest rate risk (continued)

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

As at 31 December 2011	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non interest bearing
<b>Assets</b>						
Cash and balances with Central Bank	-	-	-	-	-	1,188,048
Treasury and Central Bank bills	802,638	1,309,605	1,204,167	-	-	-
Due from other banks	313,410	-	-	-	-	-
Loans and advances	2,348,518	324,550	390,447	756,780	480,615	4
Investments	-	-	56,072	501,651	794,878	-
Other assets	-	-	-	-	-	1,209,910
<b>Total assets</b>	<b>3,464,566</b>	<b>1,634,155</b>	<b>1,650,686</b>	<b>1,258,431</b>	<b>1,275,493</b>	<b>2,397,962</b>
<b>Liabilities</b>						
Due to other banks	77,889	-	-	-	-	-
Due to customers	5,191,873	596,670	845,336	68,564	-	2,663,837
Other liabilities	-	-	-	-	75,525	817,410
<b>Total liabilities</b>	<b>5,269,762</b>	<b>596,670</b>	<b>845,336</b>	<b>68,564</b>	<b>75,525</b>	<b>3,481,247</b>
<b>Interest sensitivity gap</b>	<b>(1,805,196)</b>	<b>1,037,485</b>	<b>805,350</b>	<b>1,189,867</b>	<b>1,199,968</b>	<b>(1,083,285)</b>

### Effective interest rates as at 31 December

Amounts are expressed in % p.a.

	2012	2011
<b>Assets</b>		
Cash and Central Bank assets	6.75	7.75
Treasury and Central Bank bills	2.25	4.00
Due from other banks	3.00	7.00
Loans and advances	11.20	12.50
Investments	9.50	10.00
<b>Liabilities</b>		
Due to other banks	3.00	7.00
Due to customers	0.35	1.50



# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 37. Fair values of financial assets and liabilities

There is no material difference between the fair value and carrying value of the financial assets and liabilities of Bank of South Pacific Limited and the Group.

In the normal course of trading, the Bank and the Group enters into forward exchange contracts. The Bank and 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 Bank and 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 2012 stated at the face value of the respective contracts are:

*All amounts are expressed in respective FCY'000 and K'000*

As at 31 December 2012		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	(35,634)	(4,709)	(3,966)	-	(7,489)	-
	Kina	75,347	10,443	10,551	-	1,414	97,755
Buying	FCY	16,068	-	-	4,199	-	-
	Kina	(33,285)	-	-	(14,085)	-	(47,370)
As at 31 December 2011		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	(3,027)	(10,529)	(2,364)	(5,500)	(612)	-
	Kina	6,661	23,578	7,891	8,602	1,094	47,826
Buying	FCY	19,083	150	-	4,351	-	-
	Kina	(40,985)	(333)	-	(14,503)	-	(55,821)

## 38 Policy liabilities

Key assumptions used in determining this liability are as follows:

### Discount Rates

For contracts which have a Discretionary Participating Feature, the discount rate used is linked to the assets which back those contracts. For 31 December 2012 this was 4.69% per annum (31 December 2011: 4.21% per annum), based on 5 year government bond rate and expected earnings from the investment portfolio. For contracts without DPF, a rate of 3.2% per annum was used at 31 December 2012 (31 December 2011: 2.56% per annum). For Accident business a rate of 3.2% per annum was used at 31 December 2012 (31 December 2011: 2.56% per annum). These rates were based on the 5 year government bond.

### Investment and Maintenance Expenses

Future maintenance and investment expenses are based on budgeted expenses. Future inflation has been assumed to be 3.5% per annum (31 December 2011: 3.5% per annum) for determining future expenses.

### Taxation

The rates of taxation enacted or substantially enacted at the date of the valuation (i.e. 20%) are assumed to continue into the future.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

## 38 Policy liabilities (continued)

### Mortality and Morbidity

Projected future rates of mortality for insured lives are based on the Fiji Mortality Statistics tabled FJ90-94 Male. These are then adjusted by comparing with the Group's own experience. The mortality rates used was 70% of the FJ90-94 Male table.

### Rates of Discontinuance

Best estimate assumptions for the incidence of withdrawal and discontinuance are based on the Group's experience and are reviewed regularly. Rates used for the long term insurance contracts are as follows:

	2012	2011
Whole of Life and Endowment Insurance	15%	14%
Term Insurance	18%	17%
Accident Insurance	14%	14%

### Basis of Calculation of Surrender Values

Surrender values are based on the provisions specified in the policy contracts. There have been no changes to surrender bases during the period (or the prior periods) which have materially affected the valuation result.

### 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. Distributions are split between contract holders and shareholders with the valuation allowing for shareholders to share in distributions at a maximum allowable rate of 20% (31 December 2011: 20%). For business written between 1995 and 1998 the shareholder receives 11% of distributions.

In applying the contract holders' share of profits to provide bonuses, consideration is given to equity between generations of policyholders and equity between the various classes and sizes of contracts in force. 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.

### Reinsurance

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

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

Reinsurance recoveries are recognised as claims recoveries under the statements of comprehensive income. This is netted off against the claim expenses. Reinsurance premiums are recognized as Reinsurance Expenses.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2012

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## **39. Events occurring after balance sheet date**

On 31 January 2013, the company announced that it had made a non-binding conditional offer to acquire the leasing and finance business of Credit Corporation Group for a price of K250 million. Any formal offer by BSP will be conditional upon completion of a successful due diligence, various regulatory approvals in Papua New Guinea, Fiji, Solomon Islands and Vanuatu, shareholder approval and the parties agreeing on the terms of, and entering into agreed transaction documents.

## **Independent Audit Opinion to the members of Bank of South Pacific Limited and subsidiaries**

We have audited the accompanying consolidated financial report of Bank of South Pacific Limited and subsidiaries which comprise the consolidated statement of financial position as at 31 December 2012, the consolidated statement of comprehensive income, consolidated statement of changes in equity and the consolidated statement of cash flow for the year then ended, and a summary of significant accounting policies, other explanatory information and the directors' declaration.

### **Director's Responsibility for the Consolidated Financial Statements**

Directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with the Companies Act 1997 and International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

## **Audit Opinion**

### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Bank of South Pacific Limited and subsidiaries as at 31 December 2012, and of their financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### **Report on Other Legal and Regulatory Requirements**

The financial report of the Bank of South Pacific Limited and subsidiaries is in accordance with the Companies Act 1997 and proper accounting records have been kept. Bank of South Pacific Limited and subsidiaries are in compliance with the Banking and Financial Institutions Act 2000 and other applicable acts and regulations.

During the year ended 31 December 2012 we also provided Bank of South Pacific Limited with tax and consulting services.



**DELOITTE TOUCHE TOHMATSU**



**Paul Barber**

Registered under the Accountants Act 1996

Partner, Chartered Accountants

Port Moresby, 22<sup>nd</sup> day of March 2013.