

Bank of South Pacific Limited and Subsidiaries

Financial Statements

31 December 2016



Contents of Financial Statements

	Page
Directors' Report	1
Statements of Comprehensive Income	3
Statements of Financial Position	4
Statements of Changes in Shareholders' Equity	5
Statements of Cash Flows	6
Notes to the Financial Statements	7
Note 1 Accounting Policies	7
Note 2 Net Interest Income	18
Note 3 Fee and Commission Income	18
Note 4 Other Income	19
Note 5 Operating Expenses	19
Note 6 Income Tax Expense	19
Note 7 Intangible assets	21
Note 8 Investment in Subsidiaries	21
Note 9 Investment in Associates and Joint Ventures	22
Note 10 Cash and Balances with Central Bank	23
Note 11 Treasury and Central Bank Bills	23
Note 12 Amounts Due from Other Banks	24
Note 13 Loans, Advances and Other Receivables from Customers	24
Note 14 Property, Plant and Equipment	26
Note 15 Investment Properties	28
Note 16 Other Financial Assets	28
Note 17 Other Assets	28
Note 18 Amounts Due to Other Bank	28
Note 19 Customer Deposits	28
Note 20 Subordinated Debt Securities	29
Note 21 Other Liabilities	29
Note 22 Other Provisions	29
Note 23 Ordinary Shares	29
Note 24 Retained Earnings and Other Reserves	30
Note 25 Contingent Liabilities and Commitments	31
Note 26 Fiduciary Activities	32
Note 27 Directors and Executive Remuneration	32
Note 28 Reconciliation of Operating Cashflow	34
Note 29 Segment Information	35
Note 30 Related Party Transactions	36
Note 31 Bank Operations, Risks and Strategies in Using Financial Instruments	37
Note 32 Capital Adequacy	37
Note 33 Credit Risk and Asset Quality	38
Note 34 Liquidity Risk	40
Note 35 Operational Risk	41
Note 36 Foreign Exchange Risk	42
Note 37 Interest Rate Risk	43
Note 38 Fair Values of Financial Assets and Liabilities	44
Note 39 Insurance	46
Note 40 Business Combinations	48
Note 41 Events Occurring After Balance Sheet Date	49
Note 42 Remuneration of Auditor	49
Independent Auditor's Report	50

Directors' Report

for the Year Ended 31 December 2016

The Directors take pleasure in presenting the Financial Statements of the Bank of South Pacific Limited and its subsidiaries (Bank and the Group) for the year ended 31 December 2016. 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 also include stock broking, 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 Group are also licensed to operate in the Solomon Islands, Fiji Islands, Cook Islands, Samoa, Tonga and Vanuatu. The registered office is at Douglas Street, Port Moresby.

Review of operations

For the year ended 31 December 2016, Group's profit after tax was K643.451 million (2015: K531.879 million). The Bank's profit after tax was K606.674 million (2015: K505.749 million which included a dividend income of K19.221 million received from BSP Life (Fiji) Limited).

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

The results of the Bank and the Group'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 financial statements. In the opinion of the Directors, no circumstances have arisen, that make adherence to the existing method of valuation of assets or liabilities of the Bank and the Group misleading or inappropriate.

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

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

Dividends

Dividend payments totalling K413.973 million was paid in 2016 (2015: K369.810 million). A detailed breakup of this is provided in Note 23.

Directors and officers

The following were directors of the Bank of South Pacific Limited at 31 December 2016:

Sir K Constantinou, OBE	Mr. R Fleming, CSM	Mr. A Sam
Mr. G Aopi, CBE	Dr. I Temu	Dr. F Lua'iufi
Mr. E B Gangloff	Ms. F Talao	
Mr. G Robb, OAM	Mr. A Mano	

Details of directors' tenure and directors and executives' remuneration during the year are provided in Note 27 of the Notes to the Financial Statements. The CEO Robin Fleming is the only executive director.

The company secretary is Mary Johns.

Independent auditor's report

The financial statements have been audited and should be read in conjunction with the independent auditor's report on page 49. Details of amounts paid to the auditors for audit and other services are shown in Note 42 of the Notes to the Financial Statements.

Directors' Report

for the Year Ended 31 December 2016

Donations and sponsorships

Donations and sponsorship by the Group during the year amounted to K5,789,140 (2015: K9,091,256).

Change in accounting policies

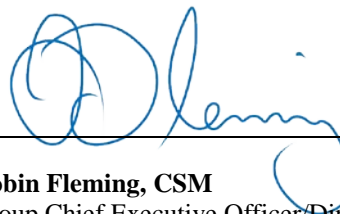
No changes in accounting policies significantly impacted the Group during the year.

For, and on behalf of, the Directors.

Dated and Signed in accordance with a resolution of the Directors in Port Moresby this 1st day of March 2017.



Sir Kostas Constantinou, OBE
Chairman



Robin Fleming, CSM
Group Chief Executive Officer/Director

Statements of Comprehensive Income

for the Year Ended 31 December 2016

<i>All amounts are expressed in K'000</i>	Note	Consolidated		Bank	
		2016	2015	2016	2015
Interest income	2	1,267,911	1,100,866	1,214,671	1,083,281
Interest expense	2	(160,225)	(94,615)	(153,783)	(93,098)
Net interest income		1,107,686	1,006,251	1,060,888	990,183
Fee and commission income	3	362,337	310,468	340,764	301,232
Other income	4	298,078	209,175	277,045	200,425
Net banking operating income		1,768,101	1,525,894	1,678,697	1,491,840
Net insurance premium income		118,418	94,322	-	-
Investment revenue		85,616	93,405	-	-
Increase in policy liabilities	39(b)	(45,036)	(34,984)	-	-
Policy maintenance and investment expenses		(80,395)	(67,488)	-	-
Claims, surrender and maturities		(71,390)	(65,608)	-	-
Share of profits from associates and jointly controlled entities		16,743	1,598	-	-
Net insurance operating income	39(a)	23,956	21,245	-	-
Net operating income before impairment and operating expenses		1,792,057	1,547,139	1,678,697	1,491,840
Impairment on loans and advances	13	(98,622)	(89,905)	(90,460)	(86,657)
Impairment on subsidiary	8	-	-	-	(11,068)
Operating expenses	5	(769,641)	(691,084)	(709,139)	(665,979)
Profit before income tax		923,794	766,150	879,098	728,136
Income tax expense	6	(280,343)	(234,271)	(272,424)	(222,387)
Net profit for the year		643,451	531,879	606,674	505,749
Other comprehensive income					
<i>Items that may be subsequently reclassified to profit or loss</i>					
Translation of financial information of foreign operations to presentation currency	24	42,054	48,839	24,602	31,912
<i>Items that will not be reclassified to profit or loss:</i>					
Recognition of deferred tax on asset revaluation reserve	24	11,816	1,301	11,816	4,592
Net movement in asset revaluation	24	(1,265)	21,450	(1,832)	14,304
Other comprehensive income, net of tax		52,605	71,590	34,586	50,808
Total comprehensive income for the year		696,056	603,469	641,260	556,557
Earnings per share - basic and diluted (toea)	23	137.7	113.7	129.8	108.1

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

Statements of Financial Position

As at 31 December 2016

<i>All amounts are expressed in K'000</i>	Note	Consolidated		Bank	
		2016	2015	2016	2015
ASSETS					
Cash and balances with Central Bank	10	1,656,260	1,202,466	1,410,008	1,010,856
Treasury and Central Bank bills	11	2,933,621	2,503,109	2,918,484	2,501,256
Amounts due from other banks	12	804,233	710,157	691,152	587,277
Statutory deposits with Central Banks	25	1,474,656	1,359,606	1,440,530	1,341,650
Other financial assets	16	2,331,472	2,308,926	2,044,905	2,074,124
Loans, advances and other receivables from customers	13	10,102,909	8,621,514	9,255,080	8,181,227
Assets held for sale	14	-	35,135	-	35,135
Property, plant and equipment	14	683,498	686,325	569,168	597,373
Assets subject to operating lease	14	44,668	52,857	44,668	52,857
Investment in associates and joint ventures	9	125,620	102,439	16,513	14,570
Investment in subsidiaries	8	-	-	318,261	259,869
Intangible assets	7	91,626	110,226	84,727	99,601
Investment properties	15	117,590	101,019	-	-
Tax receivable	6	576	-	3,670	-
Deferred tax assets	6	170,089	147,389	182,625	159,290
Other assets	17	294,985	255,135	247,535	206,558
Total assets		20,831,803	18,196,303	19,227,326	17,121,643
LIABILITIES					
Amounts due to other banks	18	301,291	344,346	327,823	344,877
Customer deposits	19	16,912,349	14,595,374	16,143,696	14,248,296
Subordinated debt securities	20	75,525	75,525	75,525	75,525
Other liabilities	21	1,058,494	969,179	364,434	353,252
Provision for income tax	6	-	39,005	-	36,168
Other provisions	22	169,807	143,698	156,398	132,535
Total liabilities		18,517,466	16,167,127	17,067,876	15,190,653
SHAREHOLDERS EQUITY					
Ordinary shares	23	373,101	374,621	373,101	374,621
Retained earnings	24	1,670,595	1,399,490	1,576,974	1,340,000
Other reserves	24	266,090	255,065	209,375	216,369
Equity attributable to the members of the company		2,309,786	2,029,176	2,159,450	1,930,990
Minority interests		4,551	-	-	-
Total shareholders' equity		2,314,337	2,029,176	2,159,450	1,930,990
Total equity and liabilities		20,831,803	18,196,303	19,227,326	17,121,643

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

Statements of Changes In Shareholders' Equity

for the Year Ended 31 December 2016

<i>All amounts are expressed in K'000</i>	Note	Share capital	Reserves	Retained earnings	Minority Interests	Total
Bank						
Balance as at 1 January 2015		379,297	183,546	1,183,505	-	1,746,348
Net profit		-	-	505,749	-	505,749
Other comprehensive income			50,808			50,808
Total comprehensive income		-	50,808	505,749	-	556,557
2014 final dividend paid	23	-	-	(262,021)	-	(262,021)
2015 interim dividend paid	23	-	-	(105,218)	-	(105,218)
Share buyback	23	(4,676)	-	-	-	(4,676)
Total transactions with owners		(4,676)	-	(367,239)	-	(371,915)
Transfer from Asset Revaluation Reserve	24	-	(22,103)	22,103	-	-
BSP Life policy reserve	24	-	4,118	(4,118)	-	-
Balance at 31 December 2015		374,621	216,369	1,340,000	-	1,930,990
Net profit		-	-	606,674	-	606,674
Other comprehensive income		-	34,586	-	-	34,586
Total comprehensive income		-	34,586	606,674	-	641,260
2015 final dividend paid	23	-	-	(294,448)	-	(294,448)
2016 interim dividend paid	23	-	-	(116,832)	-	(116,832)
Share buyback	23	(1,520)	-	-	-	(1,520)
Total transactions with owners		(1,520)	-	(411,280)	-	(412,800)
Transfer from Asset Revaluation Reserve	24	-	(42,537)	42,537	-	-
BSP Life policy reserve	24	-	957	(957)	-	-
Balance at 31 December 2016		373,101	209,375	1,576,974	-	2,159,450
Group						
Balance as at 1 January 2015		379,297	201,460	1,219,436	-	1,800,193
Net profit		-	-	531,879	-	531,879
Other comprehensive income		-	71,590	-	-	71,590
Total comprehensive income		-	71,590	531,879	-	603,469
2014 final dividend paid	23	-	-	(263,872)	-	(263,872)
2015 interim dividend paid	23	-	-	(105,938)	-	(105,938)
Share buyback	23	(4,676)	-	-	-	(4,676)
Total transactions with owners		(4,676)	-	(369,810)	-	(374,486)
Transfer from Asset Revaluation Reserve	24	-	(22,103)	22,103	-	-
BSP Life policy reserve	24	-	4,118	(4,118)	-	-
Balance at 31 December 2015		374,621	255,065	1,399,490	-	2,029,176
Net profit		-	-	643,451	-	643,451
Other comprehensive income		-	52,605	-	-	52,605
Total comprehensive income		-	52,605	643,451	-	696,056
2015 final dividend paid	23	-	-	(297,141)	-	(297,141)
2016 interim dividend paid	23	-	-	(116,832)	-	(116,832)
Minority interest capital		-	-	-	4,551	4,551
Share buyback	23	(1,520)	-	-	-	(1,520)
Loss attributable to minority interests	24	-	-	47	-	47
Total transactions with owners		(1,520)	-	(413,926)	4,551	(410,895)
Transfer from asset revaluation reserve	24	-	(42,537)	42,537	-	-
BSP Life policy reserve	24	-	957	(957)	-	-
Balance at 31 December 2016		373,101	266,090	1,670,595	4,551	2,314,337

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

Statements of Cash Flows

for the Year Ended 31 December 2016

	Notes	Consolidated		Bank	
		2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>					
CASH FLOW FROM OPERATING ACTIVITIES					
Interest received		1,269,316	1,095,363	1,185,621	1,077,459
Fees and other income		669,187	559,043	581,669	420,288
Interest paid		(161,093)	(73,977)	(155,774)	(76,268)
Amounts paid to suppliers and employees		(629,235)	(536,708)	(569,818)	(433,083)
Operating cash flow before changes in operating assets & liabilities	28	1,148,175	1,043,721	1,041,698	988,396
Increase in loans, advances and other receivables from customers		(1,392,582)	(1,410,690)	(1,130,592)	(1,327,316)
Increase in statutory deposits with the Central Banks		(115,050)	(108,024)	(98,880)	(90,068)
Decrease in bills receivable and other assets		(78,874)	170,312	(48,610)	73,234
Increase in customer deposits		1,960,281	1,081,735	1,895,400	1,010,488
Increase in bills payable and other liabilities		92,305	206,419	20,999	80,903
Net cash flow from operations before income tax		1,614,255	983,473	1,680,015	735,637
Income taxes paid		(338,647)	(282,784)	(330,331)	(282,837)
Net cash flow from operating activities		1,275,608	700,689	1,349,684	452,800
CASH FLOW FROM INVESTING ACTIVITIES					
Increase in government securities		(453,058)	(384,565)	(388,010)	(357,087)
Expenditure on property, plant and equipment		(91,758)	(135,160)	(61,468)	(105,684)
Proceeds from disposal of property, plant and equipment		70,250	63,420	69,982	63,420
Purchase of controlled entities, net of cash acquired	40	162,870	176,524	(38,020)	160,292
Additional funding of subsidiaries		-	-	(20,372)	(16,251)
Net cash flow from investing activities		(311,696)	(279,781)	(437,888)	(255,310)
CASH FLOW FROM FINANCING ACTIVITIES					
Share buyback	23	(1,520)	(4,676)	(1,520)	(4,676)
Non-controlling interests shares		4,551	-	-	-
Dividends paid	23	(413,973)	(369,810)	(411,280)	(367,239)
Net cash flow from financing activities		(410,942)	(374,486)	(412,800)	(371,915)
Net Increase/(decrease) in cash and cash equivalents		552,970	46,422	498,996	(174,425)
Effect of exchange rate movements on cash and cash equivalents		37,955	45,625	21,085	44,601
Cash and cash equivalents at the beginning of the year		1,568,277	1,476,230	1,253,256	1,383,080
Cash and Cash Equivalents at the end of the year		2,159,202	1,568,277	1,773,337	1,253,256

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

1. Accounting Policies

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

A. Basis of Presentation and General Accounting Policies

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

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

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

Standards, amendment and interpretations effective for the year ended 31 December 2016

The following new standards and amendments were applicable for the first time during the accounting period beginning 1 January 2016:

- Amendments to IAS 27 'Separate financial statements' on the equity method. These amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.
- Annual improvements 2014 makes minor changes to IFRS 5, IFRS 7, IAS 19 and IAS 34.
- Amendments to IAS 1 'Presentation of Financial Statements' form a part of the IASB's Disclosure Initiative and clarify guidance in IAS 1 on a number of issues including:
 - Materiality – disclosures specified in IFRS only need to be included in financial statements if they are material to the entity
 - Disaggregation and subtotals – line items specified in IAS 1 may need to be disaggregated where this is relevant to an understanding of the entity's financial position or performance. However, entities should not aggregate or disaggregate information in a manner that obscures useful information. There is also new guidance on the use of subtotals.
 - Notes – confirmation that the notes do not need to be presented in a particular order
 - Other comprehensive income (OCI) arising from investments accounted for under the equity method: the share of OCI arising from equity-accounted investments is grouped based on whether the items will or will not subsequently be reclassified to profit or loss. Each group should then be presented as a single line item in the statement of OCI.
- Amendments to IFRS 10 and IAS 28 on investment entities applying the consolidation exemption. The amendments to IFRS 10 clarify that the exception from preparing Financial Statements is available to intermediate parent entities which are subsidiaries of investment entities. The exception is available when the investment entity parent measures its subsidiaries at fair value. The amendments to IAS 28 allow an entity which is not an investment entity, but has an interest in an associate or joint venture which is an investment entity, a policy choice when applying the equity method of accounting.

The adoption of these amendments did not have any impact on the current period or any prior period and is not likely to affect future periods.

Notes to the Financial Statements

for the Year Ended 31 December 2016

Basis of Presentation and General Accounting Policies (continued)

Standards, amendments and interpretations issued but not yet effective for the year ended 31 December 2016 or adopted early

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the entity's accounting periods beginning on or after 1 January 2017 or later periods, but the entity has not early adopted them:

- Amendments to IAS 7 'Statement of Cash Flows' on disclosure initiative (effective 1 January 2017). These amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities.
- Amendments to IAS 12 'Income Taxes' on recognition of deferred tax assets for unrealised losses (effective 1 January 2017). These amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value.
- Amendments to IFRS 2 'Share based payments' on clarifying how to account for certain types of share-based payment transactions (effective 1 January 2018). This amendment clarifies the measurement basis for cash-settled, share-based payments and the accounting for modifications that change an award from cash-settled to equity-settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly equity-settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share-based payment and pay that amount to the tax authority.
- IFRS 9, 'Financial Instruments' (effective 1 January 2018) replaces the guidance in IAS 39 with a standard that is less complex and principles based. The new standard simplifies the model for classifying and recognising financial instruments and aligns hedge accounting more closely with common risk management practices. Changes in own credit risk in respect of liabilities designated at fair value through profit or loss shall now be presented within OCI; this change can be adopted early without adopting IFRS 9. IFRS 9's new impairment model is a move away from IAS 39's incurred credit loss approach to an expected credit loss model. Earlier recognition of impairment losses is likely to result and for entities with significant lending activities, an overhaul of related systems and processes will be needed.
- IFRS 15 'Revenue from contracts with customers' (effective 1 January 2018) is a converged standard from the IASB and FASB on revenue recognition and replaces IAS 11 and IAS 18. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards. The entity will have to adopt a new 5-step process for the recognition of revenue:
 - identify contracts with customers
 - identify the separate performance obligations
 - determine the transaction price of the contract
 - allocate the transaction price to each of the separate performance obligations, and
 - recognise the revenue as each performance obligation is satisfied.
- Amendments to IFRS 15 (effective 1 January 2018). These amendments comprise clarifications of the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment (gross versus net revenue presentation).
- IFRS 16, 'Leases' (effective 1 January 2019) replaces the guidance in IAS 17 and will have a significant impact on accounting by lessees. The previous distinction under IAS 17 between finance leases and operating leases for lessees has been removed. IFRS 16 now requires a lessee to recognise a lease liability representing future lease payments and a 'right-of-use asset' for virtually all lease contracts. There is an optional exemption for certain short-term leases and leases of low-value assets. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Notes to the Financial Statements

for the Year Ended 31 December 2016

Basis of Presentation and General Accounting Policies (continued)

- Amendments to IFRS 4, 'Insurance contracts' (effective 1 January 2018) regarding implementation of IFRS 9. These amendments introduce two approaches: an overlay approach and a deferral approach. The amended standard will:
 - give all companies that issue insurance contracts the option to recognise in OCI, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts standard is issued; and
 - give companies whose activities are predominantly connected with insurance an optional temporary exemption from applying IFRS 9 until 2021, in which case they will continue to apply IAS 39.
- Amendments to IAS 40, 'Investment property' (effective 1 January 2018) relating to transfers of investment property. These amendments clarify that to transfer to, or from, investment properties there must be a change in use. To conclude if a property has changed use there should be an assessment of whether the property meets the definition. This change must be supported by evidence.
- Annual improvements 2014 – 2016 makes minor changes to IFRS 1, IFRS 12 and IAS 28.
- IFRIC 22, 'Foreign currency transactions and advance consideration' (effective 1 January 2018) addresses foreign currency transactions or parts of transactions where there is consideration that is denominated or priced in a foreign currency. The interpretation provides guidance for when a single payment/receipt is made as well as for situations where multiple payments/receipts are made.

The Group and the Bank have conducted investigations and do not consider that there is any measurement or recognition issues arising from the release of these new pronouncements that will have a significant impact on the reported financial position or financial performance of the Group and the Bank for the year ended 31 December 2016.

IFRS 9 and IFRS 16 may have significant impact on the financial statements of the Group and the Bank when these standards become effective. IFRS 9 will affect the classification, measurement and impairment of financial instruments. IFRS 16 will require the recognition of all leases on the Group and the Bank's Statement of Financial Position.

B. Consolidation

The Financial Statements incorporate the assets and liabilities of all controlled entities of the Group as at 31 December 2016, 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 cost 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.

Notes to the Financial Statements

for the Year Ended 31 December 2016

C. Investment in Associates and Joint Arrangements

Investments in Associates

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

In the Financial Statements, these investments are accounted for under the equity method.

Interests In Joint Arrangements

The Group applies IFRS 11 to all joint ventures. Under IFRS 11 investments in joint arrangements are classified as either joint ventures or joint operations depending on the contractual rights and obligations of each investor.

Joint ventures are accounted for using the equity method in the Financial Statements. Under the equity method of accounting, interests in joint ventures are initially recognised at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses and movements in other comprehensive income. When the Group's share of losses in a joint venture equals or exceeds its interests in the entity (which includes any long-term interests that, in substance, form part of the group's net investment in the joint ventures), the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the joint ventures

Interests in joint ventures classified as held for sale are accounted for under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

D. Revenue

Interest income and expense

Interest income and expense are recognised in the Statement of Comprehensive Income on an accrual basis using the effective interest method. The income arising from the various forms of instalment 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 Statement of Financial Position 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 beneficiaries. They include direct and indirect claims settlement costs and arise from events that have occurred up to the Statement of Financial Position date even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are 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).

Foreign exchange income/(losses)

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

Long term insurance contracts

These contracts insure human life events (for example death, survival, disability or critical illness) over a long duration. Guaranteed benefits paid on occurrence of the specified insurance event are fixed or linked to the level of bonus declared on the policy. 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 in the form of reversionary bonuses.

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

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

Insurance policy liabilities are further detailed in Note 39.

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. Loan origination fees are deferred over the expected term of the financial instrument according to the effective interest method. The effective interest method uses the rate that exactly discounts estimated future payments and receipts through the expected life of the instrument or when appropriate, a shorter period to the net carrying amount of the financial asset.

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. Provision for loan impairment

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

All loans, advances and other receivables from customers are subject to continuous management review. A specific provision for loan impairment is established if there is objective evidence that 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, advances and other receivables from customers. The provisions are determined having regard to the level of risk weighted assets, economic conditions, the general risk profile of the credit portfolio, past loss experience and a range of other criteria. The amount necessary to bring the provisions to their assessed levels, after write-offs, is charged to the Statement of Comprehensive Income.

Notes to the Financial Statements

for the Year Ended 31 December 2016

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 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 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.

J. Property, plant and equipment

Land and buildings are carried at revalued amounts, being its fair value at the date of revaluation less subsequent accumulated depreciation and impairment losses. 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 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 the 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. Buildings under constructions are referred to as work in progress and are accounted for at cost and subsequently reclassified to buildings (premises) upon completion.

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 life, residual value 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	6- 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.

Notes to the Financial Statements

for the Year Ended 31 December 2016

K. Leases

Bank is lessee

All leases entered into by the Group are operating leases. Total payments made are charged to the Statement of Comprehensive Income using the straight line method.

Bank is lessor

Finance leases are included in Loans, Advances and Other Receivables from Customers and are accounted for under the finance method whereby income is recognised using the effective interest method. 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 or revalued amount 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 equivalent

For the purpose of the cash flow statement, cash and cash equivalents comprise notes and coins, and balances due to and from other banks with original maturities of less than three months.

M. Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months, otherwise they are classified as non-current. The Group's financial assets at fair value through profit or loss comprise certain equity securities included under other financial assets in the Statement of Financial Position.

b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Group's loans and receivables comprise 'trade and other receivables' and 'cash and cash equivalents' in the Statement of Financial Position.

c) Held to maturity investments

Held to maturity investments includes non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at the end of each reporting period. Investment securities held to maturity are carried at amortised cost. The Group's held to maturity investments comprise securities issued by Governments and Central Banks of respective countries (Treasury and Central Bank Bills) and certain debt securities included under other financial assets in the Statement of Financial Position.

Recognition and measurement

Regular purchases and sales of financial assets are recognised on the trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the Statement of Comprehensive Income. Financial assets are derecognised when the rights to receive cash flows from the

Notes to the Financial Statements

for the Year Ended 31 December 2016

investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortised cost using the effective interest method.

Gains or losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are presented in the income statement within 'Other banking income' in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognised in the income statement as part of other income when the Group's right to receive payments is established.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the company or the counterparty.

N. Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group 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.

O. 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 Group pays fixed contributions into a separate fund, and there is no recourse to the Group for employees if the fund has insufficient assets to pay employee benefits relating to service up to the balance sheet date.

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 staff members other than non-citizen contract staff for whom there is no legal obligation to do so. The contributions are at the current rate of employees' gross salary. Once the contributions have been paid, the Group has no further payment obligations for post-employment benefits from the date an employee ceases employment with the Group.

Notes to the Financial Statements

for the Year Ended 31 December 2016

P. 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 the reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is accounted for using the balance sheet liability method. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the Statement of Financial Position. 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 the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

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

Current and deferred tax for the period

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

Q. Foreign currency

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

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

Foreign operations

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

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.

S. Asset impairment

At each reporting date, 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 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 cost of disposal 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 Group's control and the Group remains committed to a sale.

U. Fiji Class Shares

Fiji Class Shares issued by BSP Convertible Notes (Fiji) Limited, a subsidiary of the Bank incorporated in Fiji, are classified as equity of the subsidiary.

Notes to the Financial Statements

for the Year Ended 31 December 2016

V. Derivative financial instruments and acceptances

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

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

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

W. Segment reporting

Segments are reported in a manner consistent with the internal reporting provided to the Group's chief operating decision maker.

X. Earnings per share

Earnings per share is determined by dividing the profit or loss attributable to owners of the Bank by the weighted average number of participating shares outstanding during the reporting year.

Y. Comparatives

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

Z. Critical accounting estimates and judgments

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

The areas involving significant estimates of judgments are:

- Estimated impairment of financial and non-financial assets – note 1(g) and 1(s)
- Estimation of current tax payable and current tax expense – note 6
- Estimated goodwill impairment – note 7(a)
- Estimated useful life of computer systems development costs - note 7(b)
- Estimated insurance liability – note 21
- Estimation of fair value of financial assets and liabilities – note 38
- Estimation of fair value of non-financial assets - note 38
- Estimated fair values of assets acquired and liabilities assumed in a business combination – note 40

Estimates and judgments are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

Notes to the Financial Statements

for the Year Ended 31 December 2016

2. Net interest income	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Interest income				
Cash and balances with Central Bank	4,498	9,069	5,935	9,954
Treasury bills	146,692	88,366	146,684	88,366
Central Bank bills	187	8,269	187	8,269
Other financial assets - inscribed stock	191,333	210,270	191,333	210,270
Loans, advances and other receivables from customers	922,046	782,619	867,010	763,984
Other	3,155	2,273	3,522	2,438
	1,267,911	1,100,866	1,214,671	1,083,281
Less:				
Interest expense				
Customer deposits	140,229	73,660	133,757	72,650
Other banks	11,665	12,647	11,695	12,140
Subordinated debt securities	8,331	8,308	8,331	8,308
	160,225	94,615	153,783	93,098
	1,107,686	1,006,251	1,060,888	990,183
3. Fee and commission income				
Fee and commission income				
Product related	205,788	186,258	198,864	184,445
Trade and international related	19,447	14,377	18,867	14,373
Electronic banking related	105,758	87,813	100,219	86,213
Other	32,288	25,483	23,720	19,506
	363,281	313,931	341,670	304,537
Less:				
Fee and commission expenses				
Agencies	384	532	346	374
International Finance Corporation fees	560	2,931	560	2,931
	944	3,463	906	3,305
	362,337	310,468	340,764	301,232

Notes to the Financial Statements

for the Year Ended 31 December 2016

4. Other income	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Foreign exchange related	253,758	178,943	231,436	170,839
Operating lease rentals	10,104	10,104	10,104	10,104
Other	34,216	20,128	35,505	19,482
	298,078	209,175	277,045	200,425

Foreign Exchange related income includes gains and losses from spot and forward contracts and translated foreign currency assets.

5. Operating expenses				
Administration	137,768	126,095	127,119	108,591
Computing	75,205	48,307	63,277	47,307
Depreciation	62,125	70,007	58,299	67,607
Amortisation of computer development	32,508	44,713	30,522	44,224
Non-executive Directors costs	2,798	2,249	1,935	1,713
Non-lending losses	25,661	17,496	24,845	28,328
Fixed asset impairment expenses	12,003	44,666	12,003	44,666
Premises and equipment	84,238	62,857	77,987	60,656
	432,306	416,390	395,987	403,092

Staff costs

Defined contribution plans	13,229	11,463	12,375	11,079
Statutory benefit contributions	10,318	(676)	9,826	(784)
Wages and salaries	255,902	209,189	236,020	199,766
Other staff benefits	57,886	54,718	54,931	52,826
	337,335	274,694	313,152	262,887
	769,641	691,084	709,139	665,979

6. Income tax expense				
Current tax	290,500	260,995	281,352	257,544
Deferred tax	(22,700)	(35,712)	(23,335)	(43,738)
Current year	267,800	225,283	258,017	213,806
Adjustment to prior year estimates	12,543	8,988	14,407	8,581
	280,343	234,271	272,424	222,387
Tax calculated at 30% of profit before tax (2015:30%)	263,729	218,441	263,729	218,441
Tax calculated at respective subsidiary tax rates	11,231	6,510	-	-
Expenses not deductible for tax	6,175	5,175	2,563	2,825
Tax loss not recognised	2,668	2,617	-	-
Deductible expenses not recognised for accounting purposes	(16,003)	(7,460)	(8,275)	(7,460)
Adjustment to prior year estimates	12,543	8,988	14,407	8,581
	280,343	234,271	272,424	222,387

Notes to the Financial Statements

for the Year Ended 31 December 2016

6. Income tax expense (continued)

Represented by:	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Provision for income tax				
At 1 January	(39,005)	(63,022)	(36,168)	(62,738)
Income tax provision	(290,500)	(260,995)	(281,352)	(257,544)
Adjustment to prior year estimates	(8,566)	2,228	(9,141)	1,277
Tax payments made	338,647	282,784	330,331	282,837
At 31 December	576	(39,005)	3,670	(36,168)
Deferred taxes				
Specific allowance for losses on loans, advances and other receivables from customers	34,251	32,603	32,666	32,118
General allowance for losses on loans, advances and other receivables from customers	117,976	95,541	113,807	92,262
Employee related provisions	20,459	17,955	19,213	16,378
Prepaid expenses	(1,126)	(1,396)	(1,204)	(1,396)
Other provisions	16,162	14,028	29,041	25,502
Property, plant and equipment	(39,842)	(32,676)	(30,500)	(31,240)
Unrealised foreign exchange gains	(4,250)	(3,626)	(4,320)	(3,626)
Accruals	26,459	24,960	23,922	29,292
At 31 December	170,089	147,389	182,625	159,290
<i>Represented by:</i>				
Deferred tax asset	229,867	199,444	218,649	195,553
Deferred tax liability	(59,778)	(52,055)	(36,024)	(36,263)
At 31 December	170,089	147,389	182,625	159,290
<i>Deferred taxes movement:</i>				
At 1 January	147,389	111,677	159,290	115,552
Current year movement	22,700	35,712	23,335	43,738
Revaluation recognised in equity	-	4,441	-	4,441
Adjustment to prior year estimates	-	(2,999)	-	(2,999)
Other movements	-	(1,442)	-	(1,442)
At 31 December	170,089	147,389	182,625	159,290

Notes to the Financial Statements

for the Year Ended 31 December 2016

7. Intangible assets

7(a) Goodwill

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
At 1 January	42,374	21,271	35,672	18,267
Net movement	2,933	21,103	5,379	17,405
Gross carrying amount	45,307	42,374	41,051	35,672

Goodwill was tested for impairment as at 31 December 2016 and no impairment has been recognised in the Statement of Comprehensive Income.

7(b) Computer development costs

At 1 January	67,852	89,103	63,929	85,943
Additions	22,580	34,511	21,871	33,257
Disposals	(11,605)	(11,049)	(11,602)	(11,047)
Amortisation expense	(32,508)	(44,713)	(30,522)	(44,224)
At 31 December	46,319	67,852	43,676	63,929
Total intangible assets	91,626	110,226	84,727	99,601

8. Investment in subsidiaries

All amounts are expressed in K'000

Name of Subsidiary	Principal activity	Place of incorporation and operation		Balance of Investment	
		Ownership %		2016	2015
BSP Capital Limited	Share brokerage/Fund Management/Capital Raising	PNG	100%	5,500	2,000
BSP Life Limited	Life Insurance	Fiji	100%	87,599	87,599
BSP Convertible Notes Limited	Capital Raising	Fiji	100%	371	371
BSP Finance Limited	Credit Institution	PNG	100%	44,449	27,958
Bank of South Pacific Tonga Ltd	Bank	Tonga	100%	71,610	71,610
Bank South Pacific (Samoa) Ltd	Bank	Samoa	98.7%	70,712	70,331
Bank South Pacific Vanuatu Ltd	Bank	Vanuatu	100%	38,020	-
At 31 December				318,261	259,869

During the year the Bank acquired one subsidiary as part of its acquisition of interests in regional banks (refer to note 40). Investment in subsidiaries are stated at cost, less impairment.

Notes to the Financial Statements

for the Year Ended 31 December 2016

Provision for impairment of the Investment in BSP Capital Limited

In the prior year the directors determined that the investment in BSP Capital Limited had been materially impaired as the carrying amount of the investment was greater than its recoverable value. As of the reporting date that year, the investment amount is written down to its net book value.

Represented by:

<i>All amounts are expressed in K'000</i>	2016	2015
Opening Balance	2,000	8,959
Additional capital	3,500	4,109
Provision for Impairment	-	(11,068)
At 31 December	5,500	2,000

9. Investment in Associates and Joint Ventures

Entity	Joint Venture/ Associate	Principal activity	Place of incorporation and operation	Proportion of ownership and voting power held	
				2016	2015
Suva Central Ltd	Joint Venture	Property rental	Fiji	50%*	50%*
Richmond Ltd	Joint Venture	Hotel operation Freight	Fiji	61.3%** ,50%***	61.3%** ,50%***
Williams and Gosling Ltd	Associate	forwarding	Fiji	27.7%*	27.7%*

The investments above are accounted for using the equity method in the Financial Statements.

Both ownership and voting power held, **ownership, *voting power held.*

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Associates				
Investment in associate - equity	8,820	8,085	-	-
Translation movement	442	660	-	-
Share of profit for the year	3,597	75	-	-
Net investment at 31 December	12,859	8,820	-	-
Summarised financial information of associate:				
Total assets	46,131	43,176	-	-
Total liabilities	(9,168)	(8,882)	-	-
Net assets	36,963	34,294	-	-
Share of Profits	1,719	1,710	-	-
Group Adjustment	1,878	(1,635)	-	-
Share of profit in Group	3,597	75	-	-

Notes to the Financial Statements

for the Year Ended 31 December 2016

9. Investment in Associates and Joint Ventures (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Joint ventures				
Investment in joint ventures	93,620	84,985	14,570	13,353
Movement	4,804	6,984	752	1,090
Share of profit for the year	14,338	1,650	1,191	127
Net investment at 31 December	112,762	93,619	16,513	14,570
Summarised financial information of joint ventures:				
Total assets	180,793	159,854	62,959	56,017
Total liabilities	(57,663)	(59,375)	(29,933)	(26,878)
Net assets	123,130	100,479	33,026	29,139
Share of Profits	6,574	4,859	1,191	127
Group Adjustment	7,764	(3,209)	-	-
Share of profit in Group	14,338	1,650	1,191	127
Associates and Joint Ventures				
Share of associate's net assets - equity	12,859	8,820	-	-
Shares held in jointly owned entity - at cost less impairment	112,761	93,619	16,513	14,570
Total investments in associates and joint ventures	125,620	102,439	16,513	14,570

10. Cash and balances with Central Bank

Notes, coins and cash at bank	483,966	468,712	445,503	403,269
Balances with Central Bank other than statutory deposit	1,172,294	733,754	964,505	607,587
Total cash and balances with Central Bank	1,656,260	1,202,466	1,410,008	1,010,856

11. Treasury and Central Bank bills

Treasury and Central Bank bills – face value	3,000,888	2,541,571	2,985,751	2,539,719
Discount for interest receivable	(67,267)	(38,462)	(67,267)	(38,463)
At 31 December	2,933,621	2,503,109	2,918,484	2,501,256

Treasury and Central Bank bills are debt securities issued by Central Banks. These bills are classified as assets held for trading and carried at fair value by the Insurance business and as assets held to maturity and carried at amortised cost by the Banking businesses.

Notes to the Financial Statements

for the Year Ended 31 December 2016

	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
12. Amounts due from other banks				
Items in the course of collection	29,779	18,259	29,779	18,260
Placements with other banks	774,453	691,898	661,373	569,017
At 31 December	804,233	710,157	691,152	587,277

The Group undertakes thorough compliance and due diligence reviews before entering into any correspondent banking relationships.

13. Loans, advances and other receivables from customers

Overdrafts	731,500	583,436	692,256	557,746
Lease financing	198,457	245,153	175,445	230,487
Term loans	7,976,794	7,059,098	7,458,125	6,710,903
Mortgages	1,672,965	1,137,938	1,417,495	1,110,619
Policy loans	46,854	42,761	-	-
Gross loans, advance and other receivables due from customers net of reserved interest	10,626,570	9,068,386	9,743,321	8,609,755
Less allowance for losses on loans, advances and other receivables from customers	(523,661)	(446,872)	(488,241)	(428,528)
At 31 December	10,102,909	8,621,514	9,255,080	8,181,227

The spread of the loans are detailed in the maturity analysis table on Note 34. The loans are well-diversified across various sectors and are further analysed on Note 33.

Lease financing

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

13. Loans, advances and other receivables from customers (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Gross investment in finance lease receivable				
Not later than 1 year	38,130	56,733	35,604	49,816
Later than 1 year and not later than 5 years	181,996	215,911	156,783	201,049
	220,126	272,644	192,387	250,865
Unearned future finance income				
Not later than 1 year	(1,646)	(4,963)	(1,441)	(1,803)
Later than 1 year and not later than 5 years	(20,023)	(22,528)	(15,501)	(18,575)
	(21,669)	(27,491)	(16,942)	(20,378)
Present value of minimum lease payments receivable	198,457	245,153	175,445	230,487
Present value of minimum lease payments receivable is analysed as follows:				
Not later than 1 year	36,484	51,770	34,163	48,013
Later than 1 year and not later than 5 years	161,973	193,383	141,282	182,474
At 31 December	198,457	245,153	175,445	230,487
Provision for impairment				
Movement in allowance for losses on loans, advances and other receivables from customers:				
Balance at 1 January	446,872	328,037	428,528	327,087
Net new and increased provisioning	75,406	74,410	70,096	71,201
Loans written off against provisions / (Write back of provisions no longer required)	1,383	44,425	(10,383)	30,240
At 31 December	523,661	446,872	488,241	428,528
Provision for impairment is represented by				
Collective provision	398,988	329,641	379,355	321,468
Individually assessed or specific provision	124,673	117,231	108,886	107,060
At 31 December	523,661	446,872	488,241	428,528
Loan impairment expense				
Net collective provision funding	60,786	51,406	58,491	48,656
Net new and increased individually assessed provisioning	14,620	23,004	11,605	22,545
Total new and increased provisioning	75,406	74,410	70,096	71,201
Recoveries during the year	(49,721)	(60,155)	(49,104)	(59,713)
Net write back/(write off)	72,937	75,650	69,468	75,169
At 31 December	98,622	89,905	90,460	86,657

Notes to the Financial Statements

for the Year Ended 31 December 2016

14. Property, plant and equipment

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Carrying value				
Capital Work in Progress	157,713	158,621	144,975	151,589
Premises	522,393	578,832	475,696	527,023
Accumulated depreciation	(119,927)	(109,247)	(112,856)	(104,351)
	402,466	469,585	362,840	422,672
Equipment	335,088	281,633	227,004	209,931
Accumulated depreciation	(211,769)	(188,379)	(165,651)	(151,684)
	123,319	93,254	61,353	58,247
At 31 December	683,498	721,460	569,168	632,508
Assets held for sale (premises)	-	(35,135)	-	(35,135)
Net assets at 31 December	683,498	686,325	569,168	597,373

Reconciliation is as follows:

Capital Work in Progress

At 1 January	158,621	180,694	151,589	176,719
Additions	51,932	127,472	45,847	112,205
Transfers	(52,840)	(149,545)	(52,461)	(137,335)
At 31 December	157,713	158,621	144,975	151,589

Premises

At 1 January	469,585	453,677	422,672	436,957
Additions	20,723	77,426	15,800	66,934
Disposals	(78,279)	(41,383)	(57,144)	(41,383)
Revaluation gains/(losses)	14,915	7,400	4,249	(13,506)
Depreciation expense	(24,478)	(27,535)	(22,737)	(26,330)
At 31 December	402,466	469,585	362,840	422,672

Equipment

At 1 January	93,254	92,994	58,247	81,058
Additions	66,312	50,174	32,014	21,672
Disposals	(1,752)	(10,928)	(1,535)	(10,928)
Depreciation expense	(34,495)	(38,986)	(27,373)	(33,555)
At 31 December	123,319	93,254	61,353	58,247

Notes to the Financial Statements

for the Year Ended 31 December 2016

14. Property, plant and equipment (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Assets subject to operating lease				
Carrying value				
Aircraft	130,122	130,122	130,122	130,122
Accumulated depreciation	(85,454)	(77,265)	(85,454)	(77,265)
At 31 December	44,668	52,857	44,668	52,857

Reconciliation of carrying value of aircraft is set out below:

Aircraft

At 1 January	52,857	53,783	52,857	53,783
Depreciation	(8,189)	(7,722)	(8,189)	(7,722)
Revaluation net increase	-	6,796	-	6,796
At 31 December	44,668	52,857	44,668	52,857

Future minimum lease receipts

Not later than 1 year	5,219	10,104	5,219	10,104
Later than 1 year and not later than 5 years	-	5,219	-	5,219
At 31 December	5,219	15,323	5,219	15,323

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

Freehold land	18,911	25,987	18,433	25,987
Buildings	122,706	132,727	118,655	128,935
Aircraft	18,070	21,834	18,070	21,834
At 31 December	159,687	180,548	155,158	176,756

Freehold land and buildings carried at fair value

Independent valuations of the Bank's land and buildings were performed by Countrywide Realty Limited and The Professional Valuers of PNG Limited to determine the fair value of the land and buildings. The valuations, which conform to International Valuation Standards, were determined by reference to capitalization of the notional income stream approach on the Market Value basis. The recent valuation was dated 31 December 2014.

Assets subject to operating lease – aircraft

An independent valuation of the Bank's aircrafts was performed by Ascend Advisory 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 was 31 March 2014 and was extrapolated to 31 December 2015 based on expected fair values per the aircraft lease contracts.

Notes to the Financial Statements

for the Year Ended 31 December 2016

15. Investment properties

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Opening net book value	101,019	70,684	-	-
Additions	4,127	10,325	-	-
Translation movement	5,250	5,736	-	-
Gain on revaluation	7,194	14,274	-	-
At 31 December	117,590	101,019	-	-

16. Other financial assets

Securities – held to-maturity:

Inscribed stock – issued by Central Bank	2,218,037	2,227,847	2,044,905	2,074,124
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Financial assets carried at fair value through profit and loss:

Equity securities	113,435	81,079	-	-
At 31 December	2,331,472	2,308,926	2,044,905	2,074,124

17. Other assets

Funds in transit and other assets	150,018	115,258	145,353	107,147
Accrued interest income	82,409	83,814	74,093	78,763
Intercompany account	-	-	12,344	4,614
Outstanding premiums	35,902	30,831	-	-
Inventory	7,698	6,896	-	-
Prepayments	16,269	15,311	14,999	14,706
Accounts receivable	2,689	3,025	746	1,328
At 31 December	294,985	255,135	247,535	206,558

18. Amounts due to other banks

Vostro account balances	24,773	39,185	50,038	38,789
Other borrowings	276,518	305,161	277,785	306,088
At 31 December	301,291	344,346	327,823	344,877

19. Customer deposits

On demand and short term deposits	12,832,771	11,589,377	12,272,022	11,390,548
Term deposits	4,079,578	3,005,997	3,871,674	2,857,748
At 31 December	16,912,349	14,595,374	16,143,696	14,248,296

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 34. The deposits are diversified across industries and region.

Notes to the Financial Statements

for the Year Ended 31 December 2016

20. Subordinated debt securities

At 31 December, there is 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 since issue.

21. Other liabilities

<i>All amounts are expressed in K'000</i>	<i>Note</i>	Consolidated		Bank	
		2016	2015	2016	2015
Creditors and accruals		104,679	115,785	82,987	95,900
Items in transit and all other liabilities		293,870	269,958	281,447	257,352
Policy liabilities	39(b)	640,043	563,441	-	-
Premiums received in advance		5,295	5,969	-	-
Outstanding claims		13,211	12,462	-	-
Claims incurred but not reported (IBNR)		1,396	1,564	-	-
At 31 December		1,058,494	969,179	364,434	353,252

22. Other provisions

Staff related	76,684	62,205	65,206	55,274
Provision for non-lending loss	52,163	47,762	51,944	47,743
Provisions – other	40,960	33,731	39,248	29,518
	169,807	143,698	156,398	132,535
Staff related provisions:				
At 1 January	62,205	67,665	55,274	62,547
Provisions charge	39,986	34,969	31,165	30,535
Payouts	(25,507)	(40,429)	(21,233)	(37,808)
At 31 December	76,684	62,205	65,206	55,274

23. Ordinary shares

<i>Number of shares in '000s, Book value in K'000</i>	Number of shares	Book value
At 31 December 2014/1 January 2015	468,137	379,297
Share buyback	(612)	(4,676)
At 31 December 2015 / 1 January 2016	467,525	374,621
Share buyback	(196)	(1,520)
At 31 December 2016	467,329	373,101

In May 2014, the Directors agreed to introduce a share-buyback scheme of up to K15 million. The share-buyback commenced in July 2014 and was extended to such time when the allocated K15 million buyback was utilised, or if the Board wishes, anytime before that.

Notes to the Financial Statements

for the Year Ended 31 December 2016

23. Ordinary shares (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Earnings per ordinary share				
Net profit attributable to shareholders (K'000)	643,451	531,879	606,674	505,749
Weighted average number of ordinary shares in use ('000)	467,427	467,831	467,427	467,831
Basic and diluted earnings per share (expressed in toea)	137.7	113.7	129.8	108.1

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

Dividends paid on ordinary shares

Interim ordinary dividend (2016:25 toea; 2015:22.5 toea)	116,832	105,938	116,832	105,218
Final ordinary dividend (2015: 63 toea; 2014: 56 toea)	297,141	263,872	294,448	262,021
	413,973	369,810	411,280	367,239

24. Retained earnings and other reserves

Retained earnings

At 1 January	1,399,490	1,219,436	1,340,000	1,183,505
Net profit for the year	643,451	531,879	606,674	505,749
Dividends paid	(413,973)	(369,810)	(411,280)	(367,239)
Disposal of assets – Asset revaluation	42,537	22,103	42,537	22,103
BSP Life policy reserve	(957)	(4,118)	(957)	(4,118)
Loss in minority interest	47	-	-	-
At 31 December	1,670,595	1,399,490	1,576,974	1,340,000

Other reserves comprise

Revaluation reserve	134,892	166,878	130,470	163,023
Capital reserve	635	635	635	635
Equity component of Fiji Class Shares	21,578	21,578	-	-
General reserve	32,005	31,048	32,005	31,048
Exchange reserve	76,980	34,926	46,265	21,663
	266,090	255,065	209,375	216,369

Movement in reserves for the year:

Revaluation reserve

At 1 January	166,878	166,230	163,023	166,230
Asset revaluation increment	(1,265)	21,450	(1,832)	14,304
Transfer assets revaluation reserve to retained earnings	(42,537)	(22,103)	(42,537)	(22,103)
Deferred tax on disposal of properties	11,816	6,631	11,816	6,631
Deferred tax on asset revaluation – prior year	-	(5,330)	-	(2,039)
At 31 December	134,892	166,878	130,470	163,023

Notes to the Financial Statements

for the Year Ended 31 December 2016

24. Retained earnings and other reserves (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2016	2015	2016	2015
Capital reserve				
At 1 January	635	635	635	635
At 31 December	635	635	635	635
General reserve				
At 1 January	31,048	26,930	31,048	26,930
BSP Life policy reserve	957	4,118	957	4,118
At 31 December	32,005	31,048	32,005	31,048
Exchange reserve				
At 1 January	34,926	(13,913)	21,663	(10,249)
Movement during the year	42,054	48,839	24,602	31,912
At 31 December	76,980	34,926	46,265	21,663

Equity component of convertible notes

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

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

- (i) The right to receive dividend equal to the amount of dividend to be paid on BSP Ordinary Share.
- (ii) The same voting rights as a BSP Ordinary Share and effected through a special voting share held by the Chairman of BSP.
- (iii) The Fiji Class Share may be exchanged on a one for one basis into BSP Ordinary Shares at a subsequent date and at the option of BSP on the occurrence of certain prescribed events.

25. Contingent liabilities and commitments

Off balance sheet financial instruments	Consolidated		Bank	
	2016	2015	2016	2015
Standby letters of credit	29,230	31,164	29,230	31,164
Guarantees and indemnities issued	346,729	304,086	334,873	299,857
Trade letters of credit	92,540	46,139	85,897	45,255
Commitments to extend credit	1,195,621	1,224,744	1,163,392	1,223,746
	1,664,120	1,606,133	1,613,392	1,600,022

Legal Proceedings

A number of legal proceedings against the Group were outstanding as at 31 December 2016. Based on information available at 31 December 2016, the Group estimates a contingent liability of K17.9 million (2015: K8.9 million) in respect of these proceedings.

Notes to the Financial Statements

for the Year Ended 31 December 2016

25. Contingent liabilities and commitments (continued)

Statutory deposits with Central Banks	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Cash reserve requirement: requisite reserve requirements of respective countries	1,474,656	1,359,606	1,440,530	1,341,650
Commitments for capital expenditure				
Amounts with firm commitments, and not reflected in the accounts	28,753	29,505	19,899	20,631
Operating lease commitments - predominantly premises				
Not later than 1 year	52,259	22,466	49,776	22,466
Later than 1 year and not later than 5 years	60,287	36,421	56,480	36,421
Later than 5 years	26,082	16,797	25,418	16,797
	138,628	75,684	131,674	75,684

26. 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 Financial Statements.

27. Directors and executive remuneration

Directors remuneration

Directors of the company received remuneration including benefits during 2016 as detailed below:

Name of Director	Meetings attended / total held	Appointed/ (Resigned)	Total remuneration	
			2016	2015
Sir K. Constantinou, OBE	8/8	-	347,393	293,105
T. E. Fox, OBE, BEc	3/4	(21/06/16)	182,818	251,351
Dr. I. Temu, PhD, MEc	7/8	-	130,511	133,966
Sir N. Bogan, KBE, LLB	5/7	(11/11/16)	135,546	139,000
R. Fleming, CSM, MBA, MMGT	8/8	-	-	-
G. Aopi, CBE, MBA	7/8	-	140,434	147,872
G. Robb, OAM, BA, MBA	8/8	-	373,776	376,039
F. Talao, LLM, MPHIL	8/8	-	190,511	137,950
E. B Gangloff, CPA, GAICO	8/8	-	135,546	142,119
A. Mano, BEc, MSc	7/8	-	117,141	122,855
A Sam	5/5	13/07/16	60,268	-
Dr. F Lua'iufi	-	21/12/16	-	-
			1,813,944	1,744,257

Notes to the Financial Statements

for the Year Ended 31 December 2016

27. Directors and executive remuneration (continued)

Non-executive Board Members of the Board - Constantinou, Fox and Robb received an allowance of K60,000 as Directors of BSP Capital Ltd which forms part of the Group.

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

Executive remuneration

The 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	2016 No.	2015 No.	Remuneration K'000	2016 No.	2015 No.	Remuneration K'000	2016 No.	2015 No.
100 – 110	30	36	420 - 430	3	2	780 - 790	1	-
110 – 120	27	29	430 – 440	1	-	790 - 800	3	-
120 - 130	28	21	440 – 450	1	2	800 -810	-	2
130 - 140	24	17	450 – 460	-	1	820 – 830	2	2
140 - 150	16	17	460 – 470	3	4	830 – 840	1	-
150 - 160	16	12	480 – 490	1	-	850 – 860	-	1
160 – 170	15	7	490 – 500	2	-	860 – 870	1	-
170 – 180	9	13	500 – 510	2	-	880 – 890	1	1
180 – 190	11	9	510 – 520	1	1	890 – 900	1	-
190 – 200	9	3	520 – 530	2	2	910 – 920	1	1
200 – 210	7	3	530 – 540	1	-	970 - 980	2	-
210 – 220	4	3	540 – 550	1	2	980 - 990	-	1
220 – 230	5	4	560 – 570	1	5	1000 - 1010	2	-
230 – 240	2	2	570 - 580	-	1	1010 - 1020	1	-
240 – 250	3	2	580 - 590	1	-	1040 - 1050	1	-
250 – 260	5	5	590 - 600	2	3	1050 - 1060	1	-
260 – 270	1	4	600 – 610	1	1	1090 - 1100	-	1
270 – 280	5	8	610 - 620	-	3	1100 – 1100	-	1
280 – 290	4	8	630 – 640	-	2	1170 - 1180	-	1
290 – 300	3	3	640 – 650	1	1	1180 - 1190	1	-
300 - 310	11	3	650 – 660	3	2	1220 - 1230	2	-
310 – 320	5	3	660 – 670	2	2	1280-1290	3	-
320 – 330	2	4	680 - 690	-	3	1370 - 1380	1	-
330 – 340	3	3	690 - 700	3	3	1530 - 1540	1	-
340 – 350	3	3	700 - 710	1	2	1630 - 1640	-	2
350 – 360	3	1	710 - 720	-	2	1660 - 1670	-	1
360 – 370	4	5	720 - 730	2	2	1700 - 1710	1	-
370 – 380	2	-	730 - 740	1	1	1730 - 1740	-	1
380 - 390	5	3	740 – 750	-	-	1840 - 1850	-	-
390 - 400	3	0	750 – 760	1	-	1880 - 1890	1	-
410 - 410	2	1	760 – 770	5	-	3560 - 3570	-	1
410 - 420	4	-	770 - 780	3	1	4510 - 4520	1	-
Total							345	296

Notes to the Financial Statements

for the Year Ended 31 December 2016

27. Directors and executive remuneration (continued)

The specified executives during the year were:

Robin Fleming, CSM	Robert Loggia	Paul Thornton	Hari Rabura	Richard Borysiewicz
Johnson Kalo	Peter Beswick	Rohan George	Giau Duruba	
Aho Baliki, OBE	Haroon Ali	Edward Ruha	Christophe Michaud	

Specified executives' remuneration in aggregate (K'000)

Year	Primary		Non-monetary	Super	Post-employment Prescribed		Equity options	Other benefits	Total
	Salary	Bonus			benefits	Other			
2016	14,595	3,274	272	249	204		960	413	19,967
2015	11,478	2,443	397	222	-	-	-	375	14,915

28 Reconciliation of operating cash flow

	Consolidated		Bank	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Reconciliation of operating profit after tax to operating cash flow before changes in operating assets				
Operating profit after tax	643,451	531,879	606,674	505,749
Add: Tax Expense	280,343	234,271	272,424	222,387
Operating profit before income tax	923,794	766,150	879,098	728,136
Major non cash amounts				
Depreciation	66,401	74,243	58,299	67,607
Amortisation of deferred acquisition and computer development costs	32,508	44,713	30,522	44,224
Net profit on sale of fixed assets	(15,184)	(2,621)	(15,145)	(2,621)
Movement in forex income accrual	42,037	45,625	24,602	44,601
Impairment on loans and advances	98,622	89,905	90,460	86,657
Movement in payroll provisions	39,986	34,969	31,165	30,535
Impairment of subsidiary	-	-	-	11,068
Impairment of fixed assets	12,003	44,666	12,003	44,666
Net effect of other accruals	(51,992)	(53,929)	(69,306)	(66,477)
Operating cash flow before changes in operating assets & liabilities	1,148,175	1,043,721	1,041,698	988,396

Cash and cash equivalents

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

Cash and balances with Central Banks (note 10)	1,656,260	1,202,466	1,410,008	1,010,856
Amounts due from other banks (note 12)	804,233	710,157	691,152	587,277
Amounts due to other banks (note 18)	(301,291)	(344,346)	(327,823)	(344,877)
	2,159,202	1,568,277	1,773,337	1,253,256

Notes to the Financial Statements

for the Year Ended 31 December 2016

29 Segment information

The Bank and the Group comprise various segments, these being the provision of banking services and products, stock broking and insurance services and asset financing. 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 services in PNG, Banking Services in other jurisdictions outside PNG, insurance operations, stock broking, fund management and asset financing activities. The Bank and Group's business segments operate in Papua New Guinea, Fiji, Solomon Islands, Cook Islands, Tonga, Samoa and Vanuatu. Inter segment adjustments reflect elimination entries in respect of inter segment income and expense allocations included funds transfer pricing.

Consolidated

All amounts are expressed in K'000

	PNG Bank	Non PNG Bank	Non Bank Entities	Adjust Inter Segments	Total
<i>Analysis by segments</i>					
Year ended 31 December 2016					
Net interest income	913,532	179,807	14,347	-	1,107,686
Other income	470,708	185,400	11,753	(7,446)	660,415
Net insurance income	-	-	23,956	-	23,956
Total operating income	1,384,240	365,207	50,056	(7,446)	1,792,057
Operating expenses	(556,709)	(193,365)	(22,757)	3,190	(769,641)
Impairment expenses	(68,947)	(24,642)	(5,033)	-	(98,622)
Profit before income tax	758,584	147,200	22,266	(4,256)	923,794
Income tax	(241,352)	(37,830)	(1,161)	-	(280,343)
Net profit after income tax	517,232	109,370	21,105	(4,256)	643,451
Year ended 31 December 2015					
Net interest income	887,970	112,624	5,657	-	1,006,251
Other income	395,067	119,780	7,468	(2,672)	519,643
Net insurance income	-	-	21,245	-	21,245
Total operating income	1,283,037	232,404	34,370	(2,672)	1,547,139
Operating expenses	(560,381)	(128,324)	(15,102)	12,723	(691,084)
Impairment expenses	(73,110)	(14,194)	(2,601)	-	(89,905)
Profit before income tax	649,546	89,886	16,667	10,051	766,150
Income tax	(202,005)	(23,063)	(9,203)	-	(234,271)
Net profit after income tax	447,541	66,823	7,464	10,051	531,879

Notes to the Financial Statements

for the Year Ended 31 December 2016

30. Related party transactions

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

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

A number of banking transactions are entered into with these related parties in the normal course of business, and include loans, deposits, property rentals, share transfers and foreign currency transactions. These transactions are carried out on commercial terms and market rates. For the year ended 31 December 2016, balances and transactions of accounts for Directors, including companies in which directorships were held by BSP directors, were as follows:

<i>All amounts are expressed in K'000</i>	Consolidated	
	2016	2015
Customer Deposits		
Opening balances	102,940	142,812
Net movement	(37,437)	(39,872)
Closing balance	65,503	102,940
Interest paid	54	1,967
Loans, advances and other receivables from customers		
Opening balances	618,985	599,994
Loans issued	241,746	73,272
Interest	24,387	43,000
Charges	4,228	6,656
Loan repayments	(215,672)	(103,937)
Closing balance	673,674	618,985

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 2016, staff account balances were as follows:

<i>All amounts are expressed in K'000</i>	2016	2015
Housing loans	116,936	87,090
Other loans	42,794	34,929
	159,730	122,019
Cheque accounts	7,997	8,920
Foreign currency accounts	-	1
Savings accounts	10,082	11,399
	18,079	20,320

Notes to the Financial Statements

for the Year Ended 31 December 2016

31. 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 Group's primary financial intermediary role in the financial markets, including the use of financial instruments including derivatives. These risks (risk of an advance event in the financial markets that may result in loss of earnings) include liquidity risk, foreign exchange risk, interest rate risk and credit risk.

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

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

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

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

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

32. Capital adequacy

The Group is required to comply with various prudential standards issued by the Bank of Papua New Guinea (BPNG), the official authority for the prudential supervision of banks and similar financial institutions in Papua New Guinea. Additionally, subsidiaries and branches in Fiji, Solomon Islands, Cooks Islands, Samoa, Tonga and Vanuatu are required to adhere to prudential standards issued by the Reserve Bank of Fiji (RBF), Central Bank of Solomon Islands (CBSI), The Financial Supervisory Commission (FSC), Central Bank of Samoa (CBS), National Reserve Bank of Tonga (NRBT) and Reserve Bank of Vanuatu respectively. One of the most critical prudential standards is the capital adequacy requirement. All banks are required to maintain at least the minimum acceptable measure of capital to risk-weighted assets to absorb potential losses. The BPNG follows the prudential guidelines set by the Bank of International Settlements under the terms of the Basel Accord. The BPNG revised prudential standard 1/2003, Capital Adequacy, prescribes ranges of overall capital ratios to measure whether a bank is under, adequately, or well capitalised, and also applies the leverage capital ratio. The Group complies with the prevailing prudential requirements for total capital and leverage capital. As at 31 December 2016, the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for a 'well-capitalised' bank. The minimum capital adequacy requirements set out under the standard are: Tier 1 8%, total risk based capital ratio 12% and the leverage ratio 6%.

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

32. Capital adequacy (continued)

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 Group's capital adequacy level is as follows:

	Balance sheet / notional amount		Risk-weighted amount	
	2016	2015	2016	2015
<i>All amounts are expressed in K'000</i>				
Balance sheet assets (net of provisions)				
Currency	3,130,916	2,562,072	-	-
Loans, advances and other receivables from customers	10,102,909	8,621,514	7,851,477	6,693,220
Investments and short term securities	5,265,093	4,812,035	113,440	-
All other assets	2,332,885	2,200,682	1,437,945	1,415,736
Off-balance sheet items	1,665,374	1,606,133	279,385	271,380
Total	22,497,177	19,802,436	9,682,247	8,380,336

Capital Ratios	Capital (K'000)		Capital Adequacy Ratio (%)	
	2016	2015	2016	2015
a) Tier 1 capital	1,916,502	1,603,825	19.8%	19.0%
Tier 1 + Tier 2 capital	2,233,493	1,952,807	23.1%	23.1%
b) Leverage Capital Ratio			9.3%	8.9%

33. Credit risk and asset quality

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

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

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

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 2016, the 25 largest exposures totaled K5.4 billion, accounting for over 55% of the Bank and 51% of the Group's total loan portfolio (2015: K4.6 billion, accounting for over 53% and 50% respectively).

Notes to the Financial Statements

for the Year Ended 31 December 2016

33. Credit risk and asset quality (continued)

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

An analysis by credit quality of loans outstanding at 31 December 2016 is as follows:

Consolidated	Overdrafts	Term loans	Mortgages	Lease financing	Policy loans	Total
<i>Neither past due nor impaired</i>	677,535	7,243,317	1,510,930	98,290	46,854	9,576,926
<i>Past due but not impaired</i>						
- Less than 30 days	37,403	227,706	76,080	58,020	-	399,209
- 30 to 90 days	5,574	443,095	37,116	8,146	-	493,931
- 91 to 360 days	1,332	7,773	2,988	3,868	-	15,961
- More than 360 days	368	0	40	0	-	408
	44,677	678,574	116,224	70,034	-	909,509
<i>Individually impaired loans</i>						
- Less than 30 days	1,838	480	1,112	16,270	-	19,700
- 30 to 90 days	0	6,920	1,450	2,567	-	10,937
- 91 to 360 days	30	5,090	10,239	2,772	-	18,131
- More than 360 days	7,420	42,413	33,010	8,524	-	91,367
	9,288	54,903	45,811	30,133	-	140,135
Total gross loans, advances and other receivables from customers	731,500	7,976,794	1,672,965	198,457	46,854	10,626,570
Less impairment provisions	-	-	-	-	-	(523,661)
Net Loans and Advances	731,500	7,976,794	1,672,965	198,457	46,854	10,102,909

Credit related commitments

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

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

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

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

33. Credit risk and asset quality (continued)

Economic sector risk concentrations

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

All amounts are expressed in K'000

Consolidated				
As at 31 December	2016	%	2015	%
Commerce, finance and other business	5,725,076	57	5,136,578	60
Private households	2,001,460	20	1,669,618	19
Government and public authorities	331,130	3	126,141	1
Agriculture	240,974	2	405,766	5
Transport and communication	925,674	9	582,835	7
Manufacturing	202,423	2	244,371	3
Construction	676,172	7	456,205	5
Net loan portfolio balance	10,102,909	100	8,621,514	100

Ownership risk concentrations

Ownership risk concentrations within the customer loan portfolio are as follows:

All amounts are expressed in K'000

Consolidated				
As at 31 December	2016	%	2015	%
Corporate / Commercial	5,305,676	53	4,625,570	54
Government	2,252,365	22	2,110,014	24
Retail	2,544,868	25	1,885,930	22
Net loan portfolio balance	10,102,909	100	8,621,514	100

34. Liquidity risk

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

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

Short-term mismatch of asset and liability maturity at 31 December 2016

The maturity profile of material Assets and Liabilities as at 31 December 2016 is shown in the following schedule. The mismatching of maturity of assets and liabilities indicates an apparent negative net "current" asset position. However, as stated in the preceding paragraph, mismatched positions are established and managed to achieve profit opportunities that arise from them, particularly in a normal yield curve environment. Accordingly, this mismatched maturity position is considered manageable by the Group, and does not impair the ability of the Group to meet its financial obligations as they fall due. The Directors are also of the view that 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 Cash Reserve Requirement ("CRR") set by the regulatory authorities of the jurisdictions that the Bank operates in. The CRR specifies that a bank must hold an amount equal to a percentage of its total customer deposits in the form of cash in an account maintained by the respective Central Bank. The Bank complies with this daily requirement on an ongoing basis. The balance of the CRR account is shown in Note 10, Cash and Balances with Central Bank, and Note 28, Cash and Cash Equivalents.

Notes to the Financial Statements

for the Year Ended 31 December 2016

34. Liquidity risk (continued)

Maturity of assets and liabilities

All amounts are expressed in K'000

Consolidated As at 31 December 2016	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and balances with Central Bank	3,130,916	-	-	-	-	3,130,916
Treasury and Central Bank bills	281,398	853,071	1,868,998	9,400	-	3,012,867
Amounts due from other banks	802,837	-	-	1,396	-	804,233
Loans, advances and other receivables from customers	1,254,576	510,790	1,838,148	4,637,096	4,685,542	12,926,152
Other financial assets	184,447	321,154	214,945	1,763,330	720,983	3,204,859
Total assets	5,654,174	1,685,015	3,922,091	6,411,222	5,406,525	23,079,027
Liabilities						
Amounts due to other banks	281,675	19,616	-	-	-	301,291
Customer Deposits	12,383,938	1,521,797	1,329,468	263,878	1,573,965	17,073,046
Other liabilities	1,045,556	1,095	4,527	7,316	75,525	1,134,019
Other provisions	169,807	-	-	-	-	169,807
Total liabilities	13,880,976	1,542,508	1,333,995	271,194	1,649,490	18,678,163
Net liquidity gap	(8,266,802)	142,507	2,588,096	6,140,028	3,757,035	4,400,864
As at 31 December 2015	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Total assets	4,986,519	1,351,025	3,047,207	6,248,526	4,812,054	20,445,331
Total liabilities	12,614,639	565,759	1,594,016	186,711	1,358,855	16,319,980
Net liquidity gap	(7,628,120)	785,266	1,453,191	6,061,815	3,453,199	4,125,351

35. Operational risk

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

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

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

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

Notes to the Financial Statements

for the Year Ended 31 December 2016

36. Foreign exchange risk

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

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

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

All amounts are expressed in K'000

Consolidated						
As at 31 December 2016	PGK	FJD	SBD	USD	Other	Total
Assets						
Cash and balances with Central Bank	1,906,100	469,600	461,809	9,237	284,170	3,130,916
Treasury and Central Bank bills	2,705,620	7,571	205,294	-	15,136	2,933,621
Amounts due from other banks	94,931	96,335	24,068	180,380	408,519	804,233
Loans, advances and other receivables from customers	6,291,284	2,167,912	344,052	486,375	813,286	10,102,909
Other financial assets	2,044,905	286,567	-	-	-	2,331,472
Other assets	909,389	489,411	60,509	5,487	63,856	1,528,652
Total assets	13,952,229	3,517,396	1,095,732	681,479	1,584,967	20,831,803
Liabilities						
Amounts due to other banks	(3,106)	(7,152)	(1,889)	(266,816)	(22,328)	(301,291)
Customer Deposits	(11,801,027)	(2,425,255)	(841,747)	(439,296)	(1,405,024)	(16,912,349)
Other liabilities	(450,773)	(761,224)	(49,973)	(10,184)	(31,672)	(1,303,826)
Total liabilities	(12,254,906)	(3,193,631)	(893,609)	(716,296)	(1,459,024)	(18,517,466)
Net on-balance sheet position	1,697,323	323,765	202,123	(34,817)	125,943	2,314,337
Off-balance sheet net notional position	(18,957)	-	-	(122,730)	127,138	(14,549)
Credit commitments	1,308,204	307,432	6,588	-	41,896	1,664,120
31 December 2015						
Total Assets	13,098,056	2,633,175	659,841	302,168	1,503,063	18,196,303
Total Liabilities	(11,756,719)	(2,208,852)	(774,386)	(475,610)	(951,560)	(16,167,127)
Net on-balance sheet position	1,341,337	424,323	(114,545)	(173,442)	551,503	2,029,176
Off-balance sheet net notional position	(45)	-	-	(1,562)	6,159	4,552
Credit commitments	1,259,124	338,854	4,352	-	3,802	1,606,132

Notes to the Financial Statements

for the Year Ended 31 December 2016

36. Foreign exchange risk (continued)

All amounts are expressed in K'000

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

	At 31 December 2016		At 31 December 2015	
	Impact on profit or loss	Impact on equity	Impact on profit or loss	Impact on equity
USD strengthening by 1% (2015 – 1%)	1,408	1,408	1,372	1,372
USD dollar weakening by 1% (2015 – 1%)	(1,380)	(1,380)	(1,345)	(1,345)
AUD strengthening by 1% (2015 – 1%)	-	-	7	7
AUD dollar weakening by 1% (2015 – 1%)	-	-	(7)	(7)

37. Interest rate risk

Interest rate risk in the balance sheet arises from the potential for a change in interest rate to have an adverse effect on the revenue earnings in the current reporting period and future years. As interest rates and yield curves change over time the Group may be exposed to a loss in earnings due to the effects of interest rates on the structure of the balance sheet. Sensitivity to interest rates arises from mismatches in the re-pricing dates, cash flows and other characteristics of the assets and their corresponding liability funding. These mismatches are actively managed as part of the overall interest rate risk management process governed by the Assets and Liabilities Committee (ALCO), which meets regularly to review the effects of fluctuations in the prevailing levels of market interest rates on the financial position and cash flows of the Group. The objective of interest rate risk control is to minimise these fluctuations in value and net interest income over time, providing secure and stable sustainable net interest earnings in the long term. The table below illustrates the interest sensitivity of assets and liabilities at the balance date.

Given the profile of assets and liabilities as at 31 December 2016 and prevailing rates of interest, a 1% increase in markets rates will result in a K38.6 million increase in net interest income, whilst a 1% decrease in rates will result in a K48.9 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

Consolidated As at 31 December 2016	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing
Assets						
Cash and Central Bank assets	-	-	-	-	-	1,656,260
Treasury and Central Bank bills	267,696	826,806	1,829,719	9,400	-	-
Amounts due from other banks	313,687	1,196	0	9,281	-	480,069
Statutory deposits - Central Bank	-	-	-	-	-	1,474,656
Loans, advances and other receivables from customers	8,775,060	155,994	651,630	385,975	134,250	-
Investments	294,354	291,914	128,461	1,238,363	504,000	-
Other assets	44,545	-	-	-	-	1,358,487
Total assets	9,695,342	1,275,910	2,609,810	1,643,019	638,250	4,969,472
Liabilities						
Amounts due to other banks	234,119	19,616	-	-	-	47,556
Customer deposits	7,542,495	1,512,379	1,285,789	194,552	39	6,377,095
Other liabilities	-	-	-	-	75,525	1,058,494
Other provisions	-	-	-	-	-	169,807
Total liabilities	7,776,614	1,531,995	1,285,789	194,552	75,564	7,652,952
Interest sensitivity gap	1,918,728	(256,085)	1,324,021	1,448,467	562,686	(2,683,480)

Notes to the Financial Statements

for the Year Ended 31 December 2016

37. Interest rate risk (continued)

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

As at 31 December 2015	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing
Assets						
Cash and Central Bank assets	-	-	-	-	-	1,202,466
Treasury and Central Bank Bills	441,264	157,000	175,395	1,087,400	642,050	-
Amounts due from other banks	630,079	27,731	52,347	-	-	-
Statutory deposits - Central Bank	-	-	-	-	-	1,359,606
Loans, advances and other receivables from customers	7,512,150	150,807	535,575	294,081	128,901	-
Investments	1,657	157,000	160,518	1,251,744	840,446	-
Other assets	219,023	-	-	-	-	1,169,063
Total assets	8,804,173	492,538	923,835	2,633,225	1,611,397	3,731,135
Liabilities						
Amounts due to other banks	270,943	32,749	36,559	-	-	4,095
Customer deposits	6,847,265	536,520	1,501,362	167,803	154,177	5,388,247
Other liabilities	103,068	-	-	-	75,525	866,111
Other Provisions	-	-	-	-	-	182,703
Total liabilities	7,221,276	569,269	1,537,921	167,803	229,702	6,441,156
Interest sensitivity gap	1,582,897	(76,731)	(614,086)	2,465,422	1,381,695	(2,710,021)

38. Fair values of financial assets and liabilities

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

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

The different levels have been defined as follows:

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

Consolidated

All amounts are expressed in K'000

2016	Level 1	Level 2	Level 3	Total
Financials assets				
Equity securities	-	111,612	1,823	113,435
Non-financial assets				
Property, plant and equipment	-	-	683,498	683,498
Total	-	111,612	685,321	796,933
Financials liabilities				
Policy liabilities	-	-	640,043	640,043

Notes to the Financial Statements

for the Year Ended 31 December 2016

38. Fair values of financial assets and liabilities (continued)

2015	Level 1	Level 2	Level 3	Total
<i>Financials assets</i>				
Equity securities	-	79,544	1,535	81,079
<i>Non-financial assets</i>				
<i>Assets held for sale</i>				
Property, plant and equipment	-	-	35,135	35,135
	-	-	686,325	686,325
Total	-	79,544	722,995	802,539
<i>Financial liabilities</i>				
Policy liabilities	-	-	563,441	563,441

There were no changes in valuation technique for Level 3 recurring fair value measurements during the year ended 31 December 2016. Property, plant and equipment and assets held for sale represents commercial land and buildings owned by the Group based on valuations provided by independent valuers. The valuation is based on the capitalisation method with an assessment of the property based on its potential earning capacity. Disposal cost for properties classified as held for sale is not expected to be material.

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

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

Forward exchange contracts outstanding at 31 December 2016 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 2016	USD	AUD	EURO	GBP	JPY	Other	Total
Selling FCY	(55,034)	(1,410)	-	(1,700)	(360,607)	(1,094)	-
Kina	(38,981)	-	-	(4,796)	-	-	(43,777)
Buying FCY	16,374	60,315	-	1,197	37,100	1,914	-
Kina	16,420	-	-	-	8,400	-	24,820
As at 31 December 2015	USD	AUD	EURO	GBP	JPY	Other	Total
Selling FCY	(9,979)	-	(200)	(4,050)	(11,000)	(2,681)	-
Kina	(45)	-	-	-	-	-	(45)
Buying FCY	9,459	12,780	-	-	3,000	820	-
Kina	-	-	-	-	-	-	-

Notes to the Financial Statements

for the Year Ended 31 December 2016

39 Insurance

(a) Net insurance operating income

<i>All amounts are expressed in K'000</i>	Consolidation		Bank	
	2016	2015	2016	2015
Net insurance income	23,956	21,245	-	-

Presentation of insurance business results in the Statement of Comprehensive Income has been regrouped to more accurately reflect the insurance business contribution to shareholder profits. Comparative figures have been adjusted to conform to changes in presentation in the current year.

(b) Policy liabilities

Key assumptions used in determining this liability are as follows:

Discount rates

For contracts in Statutory Fund 1 which have a Discretionary Participating Feature (DPF), the discount rate used is linked to the assets which back those contracts. For 31st December 2016 this was 6.24% per annum (31st December 2015: 5.04% per annum), based on current 10 year government bond yields and expected earnings from the investment portfolio. For contracts without DPF and Accident Business, a rate of 5.16% per annum was used at 31st December 2016 (31st December 2015: 4.16% per annum). These rates were based on the 10 year government bond rate as published by the Reserve Bank of Fiji.

Investment and maintenance expenses

Future maintenance and investment expenses are based on the budgeted expenses. Future inflation has been assumed to be 3.5% per annum (31st December 2015: 3.5% per annum) for determining future expenses.

Taxation

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

Mortality and morbidity

Projected future rates of mortality for insured lives are based on the Fiji Mortality Statistics table FJ90-94 Male. These are then adjusted for the Group's own experience. The mortality rates used was 70% of the FJ90-94 Male table for participating business in Statutory Fund 1.

Rates of discontinuance

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

	2016	2015
Whole of Life and Endowment Insurance	15%	15%
Term Insurance	18%	18%
Accident Insurance	14%	14%

Notes to the Financial Statements

for the Year Ended 31 December 2016

39 Insurance (continued)

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. Profits from these policies are split between contract holders and shareholders in accordance with the policy conditions which allow for shareholders to share in allocations at a maximum rate of 20%. For business written between 1995 and 1998 the shareholder receives 11% of profits.

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

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

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

<i>All amounts are expressed in K'000</i>	2016	2015
<u>Policy Liabilities</u>		
Opening balance	563,441	473,753
Translation movement	24,541	40,319
Increase in policy liabilities	45,036	34,984
Increase in policy liabilities on revaluation of land	7,025	14,385
Total policy liabilities	640,043	563,441

Notes to the Financial Statements

for the Year Ended 31 December 2016

40. Business combinations

(a) Summary of acquisition

During the year the Bank acquired the operations of Westpac Banking Vanuatu Branch :

<u>Acquisition date</u>	<u>Entity</u>	<u>% acquired</u>
		2016
1 July 2016	Westpac Banking Corporation Vanuatu Branch	100

<u>Acquisition account</u>	<u>K'000</u>
Cash	96,205
Due from other financial institution and regulatory deposits	104,685
Loans and advances	187,435
Other assets and intergroup balances	708
Property, plant and equipment	5,995
Deposits	(356,694)
Due to other financial institutions	355
Provisions and other liabilities	(11,142)
Net identifiable assets acquired	27,547
Add: goodwill	(2,827)
Net assets acquired for cash consideration	24,720

(1) Acquired loans and advances

The fair value of acquired loans and advances is K187.435m. The gross contractual amount for loans and advances due is K199.640m of which K12.205m is expected to be uncollectible.

(2) Profit Contribution of acquired business

The acquired businesses contributed revenue of K7.49m and net profit of K1.49m to the Group for the period from 1 July 2016 to 31 December 2016. If the acquisition had occurred on 1 January 2016, consolidated pro-forma revenue and profit for the year ended 31 December 2016 would have been K14.9m and K2.9m respectively.

The acquisition was effected by Bank of South Pacific Vanuatu Limited, a company incorporated in 2016, acquiring the assets and business.

Notes to the Financial Statements

for the Year Ended 31 December 2016

40. Business combinations (continued)

(3) Purchase consideration – cash outflow

<i>Outflow of cash to acquire subsidiary, net of cash acquired</i>	K'000s
Cash consideration	24,720
Additional capital injection	13,300
Less: cash balances acquired	<u>(200,890)</u>
Net inflow of cash – investing activities	<u>(162,870)</u>

(b) Other acquisition related transactions during the year

During the year, the following transactions were recorded relating to entities acquired in 2016, increasing recorded goodwill for the respective entities:

	K'000s
Acquisition of minority shareholding in Bank South Pacific Samoa Limited	380
Adjustment to acquired net assets from Westpac Banking Corporation Solomon Island Branch resulting in a write-off of tax receivable balance	2,128
Adjustment to acquired net assets from Westpac Banking Corporation Cook Islands Branch resulting in a write-off of tax receivable balance	<u>3,252</u>
Total increase in goodwill from prior year transactions	<u>5,760</u>

41. Events occurring after balance sheet date

On February 27, 2017, the Bank signed an Agreement with Oracle Corporation Australia Pty Limited (“Oracle”) to procure licences for a new banking software. The new software will initially be implemented in the Banks Papua New Guinea business and expected to be completed by 2018, following which it will be rolled out to the Banks banking businesses in all other jurisdictions by 2020.

42. Remuneration of auditor

All amounts are expressed in K'000	Consolidated		Bank	
	2016	2015	2016	2015
Financial statement audits	2,762	2,372	2,081	1,934
Other services	<u>999</u>	<u>997</u>	<u>947</u>	<u>900</u>
	<u>3,761</u>	<u>3,369</u>	<u>3,028</u>	<u>2,834</u>

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



Independent auditor's report

To the shareholders of Bank of South Pacific Limited

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

Our opinion

We have audited the financial statements of Bank of South Pacific Limited (the Bank), which comprise the statements of financial position as at 31 December 2016, and the statements of comprehensive income, statements of changes in shareholders' equity and statements of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Bank and the Group. The Group comprises the Bank and the entities it controlled at 31 December 2016 or from time to time during the financial year.

In our opinion the accompanying financial statements:

- comply with International Financial Reporting Standards and other generally accepted accounting practice in Papua New Guinea; and
- give a true and fair view of the financial position of the Bank and the Group as at 31 December 2016, and their financial performance and cash flows for the year then ended.

Basis for opinion

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

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

Independence

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

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

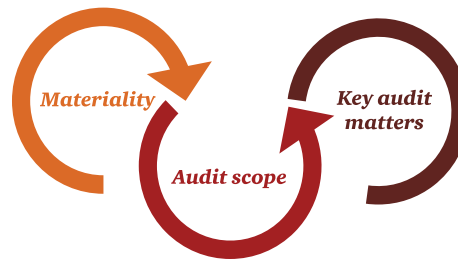
Our audit approach

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

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

PricewaterhouseCoopers

PwC Haus, Level 6, Harbour City, Konedobu, PO Box 484, PORT MORESBY, PAPUA NEW GUINEA
T: (675) 321 1500 / (675) 305 3100, F: (675) 321 1428, www.pwc.com.pg



Materiality	Audit scope	Key audit matters
<ul style="list-style-type: none"> • For the purpose of our audit of the Group we used overall group materiality of K43.81 million which represents approximately 5% of the Group's profit before taxes. • We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the financial statements as a whole. • We chose Group profit before taxes as, in our view, it is the metric against which the performance of the Group is most commonly measured and is a generally accepted benchmark. • We selected 5% based on our professional judgement noting that it is also within the range of commonly acceptable related thresholds. 	<ul style="list-style-type: none"> • We (PwC Papua New Guinea) conducted the audit over all of the Group's operations in Papua New Guinea, which are the most significant to the Group, and directed the scope of the audit of other subsidiaries included in the Group financial statements sufficient to express an opinion on the financial statements as a whole. • For the Group's activities in Fiji, Samoa, Tonga, Cook Islands, Solomon Islands and Vanuatu the audit work was performed by other PwC network firms or other firms operating under our instructions. In addition we visit significant overseas operations and this year we met with management and the local audit team in Fiji. • Our audit focused on where the directors made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events. 	<ul style="list-style-type: none"> • Amongst other relevant topics, we communicated the following key audit matters to the Board Audit Committee: <ul style="list-style-type: none"> • Loan loss provisioning • IT systems and controls • These matters are further described in the <i>Key audit matters</i> section of our report.

Key audit matters

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

Key audit matter	How our audit addressed the key matter
<p>Loan loss provisioning amounting to K523.661m - Refer to Note 13</p> <p>Our audit focused on this area, owing to the significance of loans and advances to the financial statements, the prevailing economic environments in the markets in which the group operates, particularly PNG, and the subjectivity and management judgements involved in determining whether loans within the portfolio are impaired, and the amount of impairment loss that should be recognised in the current period.</p> <p>In making an assessment of loans that are impaired and determining the impairment provision required, the Group generally takes a portfolio approach, except in the case where a specific provision is required based on an assessment of individual exposures. In either case, the application of the Group's policy is inherently judgmental.</p> <p>For the individual assessment or specific provision, loans (excluding retail personal loans) are reviewed for impairment indicators, using various event thresholds, such as repayment performance. Where an impairment indicator exists, the amount of the expected future cash flows related to the loan is estimated, together with the expected realisable value of collateral held.</p> <p>All other loans are collectively assessed on a portfolio basis. For this assessment impairment models are used which aim to build in the impact of credit conditions and default risk for determining the provision. The inputs to these models also include judgmental overlays which aim to take into account emerging trends or particular situations which are not captured by the models, such as sectoral weaknesses in particular markets. This assessment involves various judgements, for example how loans are categorised for credit risk purposes and the probability of default associated with each risk grade.</p>	<p>The procedures we performed to support our audit conclusions, included:</p> <ul style="list-style-type: none"> Assessing the design and testing the operating effectiveness of the controls over loan impairment provisioning processes. The key controls over this process includes the role of the Credit Committee in ensuring governance and monitoring of the credit function, appropriate identification of emerging credit risks, including stress testing, and its impact on key inputs to the loan provisioning process, identification and management of material exposures and the establishment of impairment models to capture losses. This assessment and testing gave us sufficient evidence to be able to rely on these processes and controls for our audit. For individually assessed provisions, applying sampling procedures for testing the operating effectiveness of controls over the Credit Inspection Unit's customer loan file reviews, testing the completeness of the credit watch list and delinquencies, assessing the Group's estimates of specific provisions, and re-performing the calculations for accuracy. The outcomes of this testing were satisfactory. For collectively assessed provisions, critically examining the model methodology for consistency and appropriateness, evaluating the probability of default factors used for appropriateness, testing the accuracy of data, such as risk grades used in the models and re-performance of model calculations. This combination of evaluation and testing gave us sufficient evidence to rely on the model's design for our audit. For judgmental overlays to model calculations, we considered the potential for impairment to be affected by events not captured in the models. This included making our own independent assessment of the credit environment and evaluated the impact of the Group's stress testing of loans on the credit watch list. The judgements made by the Group and the matters considered were consistent with our understanding.

Key audit matter	How our audit addressed the key matter
<p><i>IT systems and controls</i></p> <p>We focused on this area because the Group is heavily dependent on complex IT systems for the processing of significant volumes of transactions and for financial accounting and reporting purposes. For example, these systems are also critical to capturing various data that are used to produce reports which management use to make decisions, monitor and control the business and for financial reporting purposes.</p> <p>Our audit approach relies on reports that are generated from these critical IT systems, and therefore the operating effectiveness of automated controls as well as IT dependent manual controls is important to enable that reliance.</p> <p>In particular, our audit focused on access rights, because they aim to ensure that changes to applications are authorised and made appropriately. Ensuring staff have appropriate access to IT systems, and that access is monitored, are key controls in mitigating the potential for fraud and error as a result of a change to an application or underlying data.</p>	<p>The procedures we performed to support our audit conclusions, included:</p> <p>We assessed and tested the design and operating effectiveness of the controls over the continued integrity of the IT systems that are relevant to financial reporting and upon which we relied for the purpose of our audit.</p> <p>We examined the framework of governance over the Group's IT organisation, the controls over program changes and development, access to programs and data and IT operations, including compensating controls where required. We also carried out procedures over certain aspects of security of the Group's IT systems including access management and segregation of duties.</p> <p>The combination of the tests of controls and direct tests we performed gave us sufficient evidence to enable us to rely on the continued and proper operation of the Group's IT systems for the purposes of our audit.</p>

Information other than the financial statements and auditor's report

The directors are responsible for the annual report which includes other information. Our opinion on the financial statements does not cover the other information included in the annual report and we do not, and will not, express any form of assurance conclusion on the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard, except that not all other information was available to us at the date of our signing.

Responsibilities of the directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements of the Group. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Report on other legal and regulatory requirements

The Companies Act 1997 requires that in carrying out our audit we consider and report on the following matters. We confirm in relation to our audit of the financial statements for the year ended 31 December 2016:

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

Who we report to

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



PricewaterhouseCoopers



Jonathan Seeto
Partner

Registered under the Accountants Act 1996

Port Moresby
1 March 2017