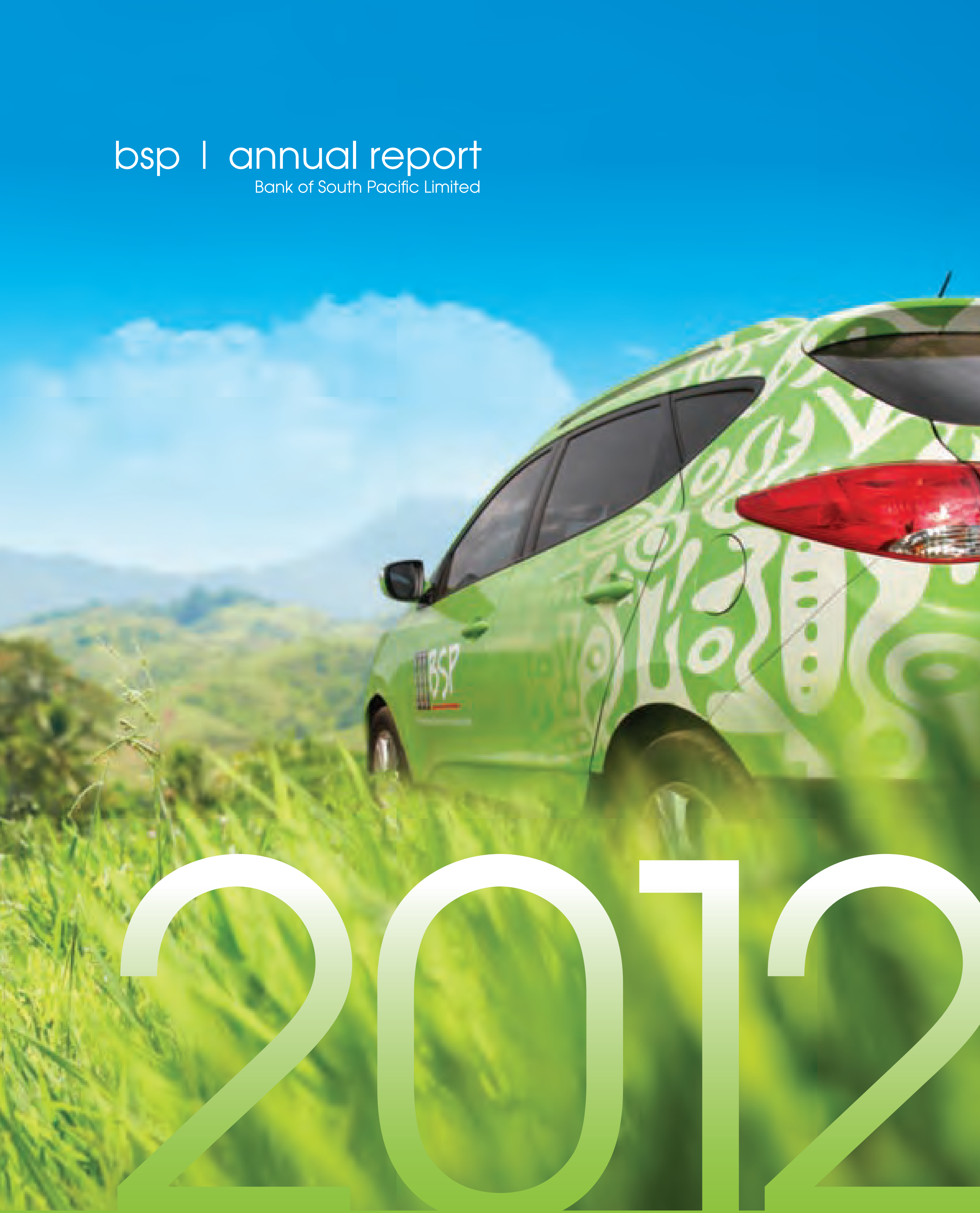
bsp | annual report

Bank of South Pacific Limited



2012

BSP

Our Vision

To be the leading bank in the South Pacific

The key features of BSP's strategy:

- A focus on sales and services
- Operational excellence
- High performing teams
- Profitable growth

Contents

PORT MORESBY 2015
XV PACIFIC GAMES
PAPUA NEW GUINEA

global winners

BSP - Global Leader in Mobile Banking Solutions, was awarded "Best Bank - Led Mobile Money Programme" in the world, in the Connected World Forum Awards, Dubai, November 2012, sponsored by MasterCard Worldwide.

BSP was recognised for making banking secure, safe and easy for rural people & encouraging a saving culture through Mobile Banking.

Our Bank Locations

BSP - Fiji

BSP - Solomon Islands

Chairman's Report

Kostas Constantinou, OBE
Chairman

The Key Issues

While 2012 has been a year in which we have noted a slowing down of the pace of economic growth, this has not proven to have been exceptionally problematic for Australasian and Pacific economies, as it has been for other parts of the world.

2012 was also a time for reassessing political aspirations for many nations around the world. The 2012 national elections in Papua New Guinea (PNG) coincided with American voters going to the polls, and the Chinese bureaucracy also electing their new leaders.

In PNG, the LNG construction phase reached its peak, and the construction workforce numbers moderated. Agricultural and mineral exports and tourism remained core to the Pacific economies' performance. High liquidity, slowing credit growth, low interest rate levels, a competitive foreign exchange market, and financial inclusion all featured in PNG, Fiji, and the Solomon Islands. A new competitor-Bred Bank—was granted entry into the Fiji market.

The Financials

BSP's vital financial statistics in 2012 include a profit of K408 million, and assets of over K13 billion.

The growth in profit is in line with average GDP growth in BSP's markets, and exceeds inflation.

Asset growth is fuelled by solid liquidity conditions in all markets.

The numbers reflect continued strong commitment by BSP and its people to keep improving personal performance, advancing financial services to customers, and delivering market competitive returns to shareholders.

Sustained Economic Growth for the South Pacific Region

The global economy slowed during 2012 but growth in Asia was still at strong levels, and this pulled Australasia along with it. Locally, PNG, Solomon Islands and Fiji economies have been stable, despite politically challenging conditions.

PNG elections influenced market activity, but momentum for large scale projects was unaffected. Relationships with larger Pacific partners have been critical for the Solomon Islands economy. Tourism is solid in Fiji, and the continued rebuilding of the sugar industry has also contributed to economic stability. In addition, the mining industry is expected to develop in the medium term.

Major Project Milestones

BSP's critical capital projects are all aimed at operational capabilities to support transactional activity, with processes, products and channels to achieve customer growth.

In 2012, some major project milestones were achieved in the areas of:

- **Customer growth**
  The number of accounts in PNG reached 1.274 million. Across all countries, the total number of accounts is 1.550 million; transaction volumes have increased significantly in 2012.

- **Channel volume growth**
  All electronic channels have experienced strong transaction volume growth. The ATM and EFTPoS fleets have experienced continued growth with a total of 388 ATMs and 10,013 EFTPoS devices in operation at the end of 2012.

BSP has physically taken service delivery to remote locations, using tablets, mobile phones and mobile telecommunications technology supported by Digicel.

- **Electronic and branch highlights**
  23 new rural branches were opened in PNG in 2012; a container branch at Arawa in the AROB also commenced operation. BSP First, Premium and Express counter services were introduced in selected locations in PNG, Fiji and the Solomon Islands.

Profit

Group Profit grew 14 percent to K407.7 million, the banking operations generating the bulk of this.

Net interest income grew 14 percent from 2011.

Non-interest income exceeded target expectations, indicating growing income resilience. Operating expenses rose 13 percent from 2011, reflecting the continued investments being made to improve operational capabilities.

Net Loan provisioning was higher in 2012, due to an increase in general provisions to counter evidence of stress in the market as the LNG investment cycle began to retreat from its mid-2012 peak.

Balance Sheet

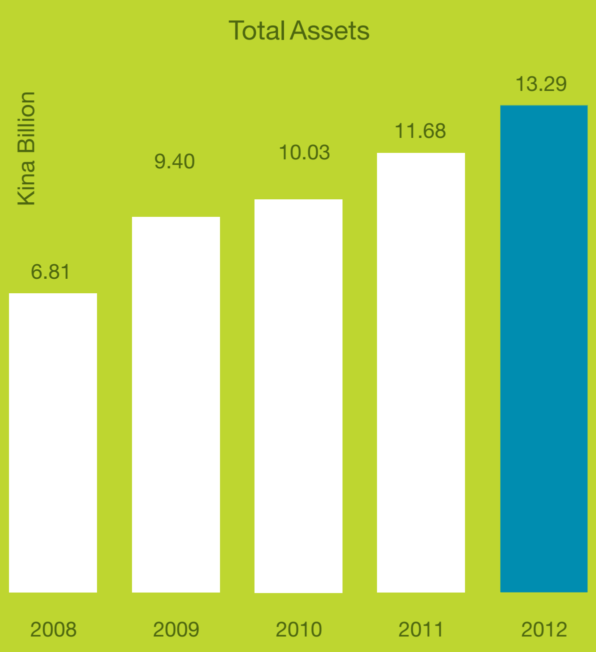
At the end of 2012, the Group's assets were K13.3 billion. Since 2010, the compound annual growth rate for assets has been a solid 10 percent. PNG's balance sheet makes up 84 percent of the Group, and Fiji 13 percent.

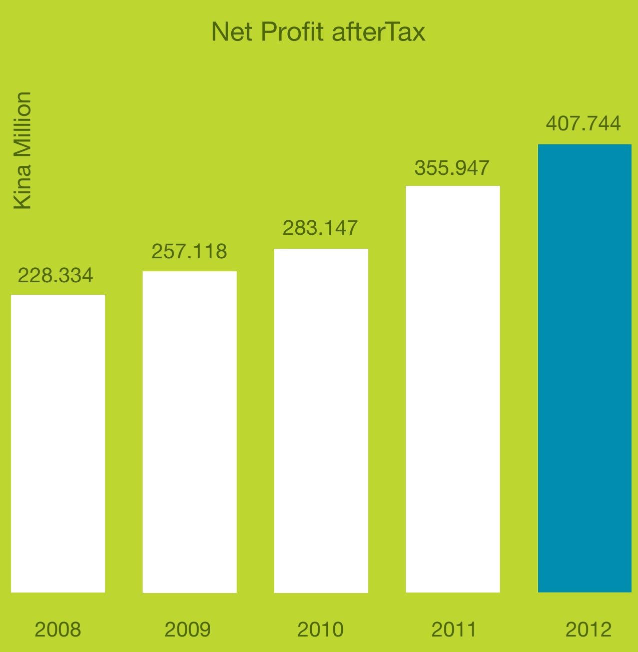
Overall, balance sheet growth has been within the range that can be adequately supported by the Group's regulatory capital.

BSP enjoys sufficient levels of regulatory capital overall, but there are sub-limits such as for large exposures and related parties, where limits are being tested by recent credit growth.

Business Conditions

The Pacific markets demonstrated good growth in 2012, but conditions under which businesses have to operate still present challenges. Conditions in the Pacific in 2012 have been characterised by: sporadic bouts of mild political volatility; bureaucratic regulatory regimes; national infrastructure and other social systems requiring re-investment and modernisation; large enclave type resource projects that dominate GDP componentry supplemented by agriculture and tourism; and the occasional major weather or geological event.





Chairman's Report

Market Shares, Customers and Channels

BSP maintains its leading position in bringing banking services to the People of PNG, Fiji and the Solomon Islands.

BSP's overall market share for deposits across the three countries, is 47 percent and for loans, it is 40 percent. By value, BSP has almost 49 percent of 'household' deposits in PNG and just under 60 percent of personal loans.

By the end of 2012, the number of depositor accounts in the Bank, across all countries, exceeded 1.5 million. This customer base is amplified by the largest aggregate fleet of ATMs and EFTPoS devices in the three countries.

Capital and Dividends

The Bank's regulatory overall capital adequacy position is quite strong. However, even with this allowance, the propensity for high concentrations of good credit risk in Pacific markets causes BSP to be at the frontier of its regulatory limits. Common directorships, due to limited numbers of good company directors places technical stress on capital limits.

The dividend policy to pay out 75 percent of profits continues, with which a competitive dividend yield is being achieved.

Operational Initiatives

The strategy of BSP involves setting challenging outcomes. To achieve these objectives, some strategic initiatives need to be implemented by the business, typically in a project format.

In 2012, this work has resulted in product and operational advancements such as USSD mobile banking, real time fee reporting, PIN changes at ATM, cheque scanners for processing & fraud detection, and BSP Rural branches and agencies.

This work is both strategic and operational, and improvements should be expected to continue in the coming years.

People and Community

Once again, staff at BSP contributed a large part of their lives this year to BSP the organisation. This, in turn, has enabled BSP to contribute to the lives of the people in the communities it serves. A unique part of working for BSP is that people are guaranteed an opportunity to contribute directly to the communities in which they work, through the various community projects, sponsorships and supporting donations that BSP undertakes. BSP certainly has an admirable group of people working for it. People speak of the uncomfortable truth that opening the doors to the BSP branch practically brought one face-to-face with the community. Today, I would have to say it is becoming the enviable truth, as BSP extends its services to communities that have not seen a bank before.

The Board and management of BSP have worked diligently to combine responsible stewardship with a measured commercial approach. They hold the firm belief that a financial organisation can make a significant difference in people's lives.

At board level, the mix of skills and perspective is changing to reflect the way BSP is developing into a modern bank within the Pacific region. In 2012, Mr Geoff Robb, OAM, a commercial banker with global credentials, and Ms Freda Talao, one of Papua New Guinea's leading women in the legal profession, joined the Board.

Mr Arthur Sam, the PNG Institute of Directors 2012 Young Director of the Year Awardee, also joined the Board Audit, Risk and Compliance Committee as a professional member. I acknowledge their contribution, and also that of my other colleagues on the Board of BSP.

I congratulate the management and staff on their efforts in producing another record year of results at BSP.

For customers, I am confident that we will continue to improve your BSP experience.

I am very pleased to commend the performance of the BSP Group during 2012 to its stakeholders.

Kostas Constantinou, OBE
Chairman

A Brief History of BSP

1957
The Bank commenced operations on 1 May 1957 in Port Moresby as a branch of the National Bank of Australasia Limited.

1974
Operations were later expanded to several centres. On 17 May 1974 the company was incorporated as Bank of South Pacific Limited, a wholly owned subsidiary of the Australian parent, with a paid-up capital of K2.00 million.

1980
In April 1980 and August 1981, a total of 300,000 ordinary fully paid shares of K1.00 were issued to the public in Papua New Guinea, thus increasing the paid-up capital to 2,300,000 fully paid K1.00 shares.

1993
On 24 August 1993, the nationally owned company, National Investment Holdings Limited (NIHL) acquired the 87 percent shareholding held by National Australia Bank. On 25 October 1993, 100 percent ownership of the Bank was achieved by NIHL, which later changed its name to BSP Holdings Limited.

1995
In December 1995, BSP Holdings Limited successfully raised capital of K2.70 million by way of a Convertible Note Issue. The holding company took up an additional 2,700,000 fully paid shares of K1.00 in Bank of South Pacific Limited, increasing the issued capital to K5,000,000.

1998
In October 1998, BSP Holdings Limited raised K12.90 million through a Rights Issue of shares at K3.00. During December 1998 BSP Holdings Limited went into voluntary liquidation. As a result, its shareholders now hold shares in Bank of South Pacific Limited.

2001
In 2001 the Privatisation Commission, on behalf of the Government of Papua New Guinea, offered a 51 percent interest in the Papua New Guinea Banking Corporation (PNGBC) for sale through a competitive trade sale process. The company participated in this process by lodging a bid whereby it proposed to effect the acquisition of PNGBC through an amalgamation under the Companies Act rather than through a sale and purchase.

2002
Following an appraisal of all bids lodged in relation to the acquisition of PNGBC, the Commission agreed to accept the company's bid. The company, the commission and the PNGBC executed the amalgamation deed in December 2001 which provided for the implementation of the amalgamation. The amalgamation was completed on 9 April 2002.

2003
The company's shares were listed on the Port Moresby Stock Exchange on 27 August 2003.

2004
In 2004, the company returned a profit after tax of K86.65 million up from the K39.98 million result in 2003. As at 31 December 2004, shareholders' equity reached K255.63 million. During 2004, the Bank acquired the Niue Branch operations of Westpac Banking Corporation.

2005
In November 2005, Standard & Poors (S&P) issued an inaugural credit rating for BSP. The rating was B+ Stable, consistent with the S&P sovereign rating for Papua New Guinea.

2005 saw continued strong financial performance and balance sheet growth. Profit after tax increased to K99.22 million. Total assets increased to K2.95 billion and shareholders' equity grew to K308.30 million. Market capitalisation reached K1.40 billion. During this year, Capital Stockbrokers Limited was acquired and renamed BSP Capital Limited.

2006

Strong balance sheet growth with total assets reaching K4.33 billion and a 12.50 percent increase in after tax profit to K111.62 million continued the strong growth and financial performance during 2006.

On 18 December 2006, a BSP branch was established in Suva, Fiji following the acquisition of the Habib Bank Ltd interests in Fiji.

2007

The acquisition of the National Bank of Solomon Islands Ltd was completed during April 2007. Now rebadged as a branch of BSP, it has the largest branch network in the Solomon Islands.

Outstanding performance continued during 2007. Total assets increased to K5.80 billion, after tax profit increased by 71 percent to K191.07 million and market capitalisation to K3.28 billion. Expense to income ratio reduced to 39.40 percent.

2008

Performance was strong for the year despite the broader effects of downturn in the global economy beginning to impact the PNG economy in the last half of the year. After tax profit continued to grow, with an increase of 19 percent during the previous year, despite the BSP Capital CDO provisioning of K50 million. Strong balance sheet growth continued despite these effects with total assets increasing by 17 percent to K6.8 billion and capitalisation increasing by 33 percent to K4.3 billion.

2009

BSP posted sound results as the global economic downturn continued, increasing after tax results by 13 percent. BSP acquired the National Bank of Fiji and Colonial Fiji Life Insurance Limited from Commonwealth Bank of Australia, contributing K1.2 billion to assets growth of K2.6 billion.

2010

Solid results achieved as the global economy starts a slow recovery from the Global Financial Crisis, positively impacting PNG's resource-based economy. BSP's group profit increases 10 percent to K283.1 million, and assets reach K10.0 billion; IFC makes significant equity investment for 10 percent shareholding in BSP.

2011

Strong performance for the year with a profit of K355.9 million being a 26 percent increase on 2010's results. Achieved balance sheet and profitability milestones in exceeding K11 billion in assets and K1 billion in revenue. New branches opened in Vision City, Port Moresby and flagship BSP First at Ravalien Haus, Port Moresby. Share buyback K40 million approved.

2012

Profits increased over 14 percent to K407.7 million, and assets also grew 14 percent to K13.3 billion. More than 10,000 BSP EFTPoS machines were operating across all markets. Over 70 million transactions were processed through all electronic and mobile phone channels; BSP's account opening process employing a tablet computer and instant card issuance, won the award for the world's Best Bank Led Mobile Money Program at the 2012 Connected World Global Awards. Appointed as official sponsor of 2015 Pacific Games.

BSP Rural, in action at Ginigolo opening accounts using tablet technology.

Board Of Directors

Kostas Constantinou, OBE
Chairman

Director since April 2009
Appointed Chairman February 2011

Kostas Constantinou is a prominent business figure in Papua New Guinea, holding a number of high level public sector and private sector appointments. He is a Chairman of various companies, including Airways Hotel & Apartment, Lamana Hotel Limited, Lamana Development Limited, Hebou Constructions and Alotau International Hotel. He is a Director of Heritage Park Hotel in Honiara, Gazelle International Hotel in Kokopo and Grand Pacific Hotel, Fiji. Kostas is a Director of two other listed companies: Oil Search Limited and Airlines PNG Limited. He is Deputy President of Employers Federation of Papua New Guinea, Honorary Consul for Greece in Papua New Guinea and Trade Commissioner of Solomon Islands to Papua New Guinea.

Ian B Clyne
Group Chief Executive Officer

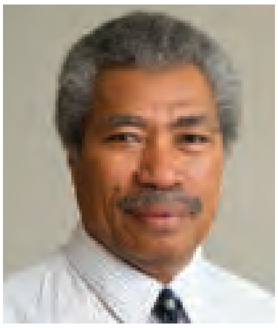
Director since December 2008.

Ian Clyne was appointed as Group Chief Executive Officer by the Board of Bank of South Pacific Limited on 17 October 2008. He has had a distinguished career in banking and finance; his most recent appointment was Executive Vice President and Managing Director, ING Bank Slaski Group, Poland. During his career, Mr Clyne, a Bachelor of Business graduate from the Curtin University, Perth, Western Australia, has held senior banking appointments with Indosuez Bank, ING Barings and Lippo Bank in Australia, PNG, Pakistan, Hong Kong/China, France, UK, Singapore, Indonesia, Italy, and Poland. Prior to embarking on an international banking career, Mr Clyne worked in Papua New Guinea with Nambawan Finance Limited and Indoniu Finance (1980 - 1986).

Tom Fox, OBE, BEc
Deputy Chairman
Non-executive Director

Director since June 1993.

Thomas Fox holds a Bachelor of Economics degree from the University of Papua New Guinea. He commenced his career with the Reserve Bank of Australia, and gained experience in senior management roles within semi-government institutions, and private sector companies, including serving as the Managing Director of the Investment Corporation of Papua New Guinea for eight years. His other current directorships include: BSP Capital Limited, Teyo No.1 Limited and Akura Limited. Mr Fox is also a trustee for the Institute of National Affairs, and a foundation member and Fellow of the PNG Institute of Directors.



Gerea Aopi, CBE, MBA
Non-executive Director

Director since April 2002.

Gerea Aopi has achieved several degrees in Papua New Guinea, and a Masters of Business Administration from the University of Queensland. Mr Aopi has substantial public service and business experience in Papua New Guinea, including Secretary of Finance & Planning and Managing Director of Telikom PNG Limited. He presently holds the position of Executive General Manager, External & Government Affairs and Sustainability at Oil Search Limited. He was previously the Chairman of Telikom PNG Limited and Independent Public Business Corporation (IPBC). Mr Aopi is a Director of Oil Search Limited, Steamships Trading Company Limited and is involved in a number of other private sector and charitable organisations in Papua New Guinea.

Dr Ila Temu, PhD, MEc
Non-executive Director

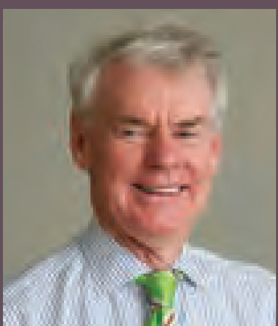
Director since 2003.

Dr Temu achieved a distinguished academic career with the University of Papua New Guinea, the National Research Institute, the Australian National University and the University of California, Davis USA where he was awarded his PhD. Dr Temu entered the private sector during 1996 when he was appointed Managing Director, Mineral Resources Development Company. From 2000 to 2008, Ila held senior positions in Placer Dome, including Country Manager, Tanzania. Since 2008, Ila has been Director of Corporate Affairs for Barrick's Australia Pacific Region. He is a member of the Management Group for the PNG Incentive Fund and an executive member of the Employers' Federation of Papua New Guinea.

Sir Nagora Bogan, KBE, LLb
Non-executive Director

Director since 2003.

Sir Nagora Bogan graduated with a Bachelor of Law from the University of Papua New Guinea in 1978. In 1992, Sir Nagora was appointed Commissioner General of the PNG Internal Revenue Commission. In 1996, he was appointed as PNG's Ambassador to the United States with accreditation as Ambassador to Mexico and High Commissioner to Canada. In 2002, Sir Nagora became a private business entrepreneur. He is Chairman and CEO of In Touch Media Limited, a multimedia/record label company, Chairman of Nambawan Super Limited and Director on several private company boards. Sir Nagora received his knighthood during 1997 in recognition of his distinguished public service.



Lyle Procter, MEc, FFin
Non-executive Director

Director since July 2004.

Lyle Procter has been a career central banker, having spent 36 years with the Reserve Bank of Australia. He also spent several years with the Australian Department of Foreign Affairs. Since retiring from the Reserve Bank, Mr Procter has worked as a consultant to the International Monetary Fund, Washington and the Asian Development Bank, Manila. He has also worked privately as a consultant to the Australian banking industry, and in several South-East Asian countries. Other current directorships include Sun Hung Kai and Co. Limited and Quality HealthCare Asia Limited.

John Jeffery, CBE
Non-executive Director

Director since June 2001.

John Jeffery had a long and successful career in Australia before moving to Papua New Guinea in 1986 to take up a position at Madang-based James Barnes PNG Limited. Mr Jeffery is a founding member of the PNG Institute of Directors Inc.

Freda Talao
Non-executive Director

Director since April 2012.

Freda Talao holds a Law Degree from University of Papua New Guinea, a Masters Degree from Bond University, Queensland and is currently undertaking Doctoral Studies at TC Beirne School of Law, University of Queensland. Freda has extensive work experience in the government, private, NGO and development sectors in PNG. Ms Talao has previously been on several Boards, including the Mama Graun Conservation Trust Fund, Liklik Dinau Trust Fund, Individual and Community Advocacy Forum (ICRAF), Civil Aviation Authority (CAA), is currently on the National Airports Corporation Board (NAC) and is Chair for the newly established Airport City Development Limited (ACDL). She is also currently a member of the External Stakeholders Advisory Panel (ESAP) to the Morobe Mining Joint Venture (MMJV) which owns the Hidden Valley Gold Mine in Morobe Province.

Geoffrey J Robb, MBA
Non-executive Director

Director since April 2012.

Geoffrey Robb is a highly qualified and experienced banker having occupied several senior executive positions including Head of complex and strategic transactions, and Global Head of Acquisition Finance with the ANZ Banking Group, and Head of Resource Finance at Bank of America. As Head of Bank of America in Melbourne, he led resource financings with BHP, CRA, Elders Resources, Bougainville Copper and Ok Tedi. He holds MBAs from the International Management Institute Geneva and Macquarie University. Mr Robb has travelled extensively in emerging markets and has received the Medal of the Order of Australia for his services to mountaineering and charity.

Group Chief Executive Officers's Report

Ian B Clyne
Group Chief Executive
Officer/Director

The Operating Environment In 2012

BSP has achieved excellent results in 2012, notwithstanding the difficulties that continue to challenge the global economy on its recovery path. Progress has clearly been slow and sometimes painful. For BSP and its customers, these difficulties have influenced local conditions, where it has been a testing time for most.

Global Conditions

The struggles of some Euro-zone economies with national debt has set much of the tone for the difficulties faced by the world's developed economies, with very low and fragile economic growth experienced across Europe and the OECD countries. The United States, Japan, and the best of the rest of the developed free market economies have all been challenged by budget management issues, at the same time as they seek to provide growth stimuli. The stronger growth impetus of the previous years in the emerging market economies of Asia, South America and Eastern Europe has weakened in 2012. One would have to conclude that overall, economic conditions have been less than impressive. The IMF estimates that global economic growth in 2012 will be around 3 percent, sub -3 percent growth in the developed economies, and 6+ percent in emerging markets; closer to home, Australia has achieved in the region of 4 percent, New Zealand and Japan will likely share a 2 percent growth statistic.

Conditions In The South Pacific

Naturally, the slowdown in the world's industrialised economies that has occurred over 2012 is negatively impacting export earnings of Pacific economies. But it would be difficult to argue that the prospects for growth have been removed, although there is much that is always needed to be done to reduce the risks and maximise the opportunities beyond what has appeared possible for some time now.

The economies of the South Pacific are on the doorstep still, of the most active economies in the world. In 2012, PNG's GDP growth is estimated by the ADB at around 8 percent, somewhat higher than the global average, and mimicking growth rates in China and other developing Asian economic systems.

Matters of politics and constitutional importance continued to occupy the minds of governments in the South Pacific. Apart from national elections in PNG, a new constitution was being drawn up in Fiji, and the Solomon Islands and its international partners were reviewing the future of the RAMSI engagement.

The PNG LNG Gas project has reached the peak of its construction phase, and as the project transitions into gas production, the local economy changes gears down in aniticipation of the next phase. In Fiji, tourism and sugar have continued to be a steady influence on economic activity in the last several years, and are now supplemented by an increasingly viable mining sector. As the world's developed markets continue their slow climb out of low growth conditions, tourism and mining look set to provide the impetus for stronger growth. Similarly, in the Solomon Islands, agriculture and natural resources are the future mainstays of this small economy, and careful management of existing agricultural and marine resource stocks is becoming increasingly important.

Around our Pacific markets, the origins of a middle class, and an entrepreneurial strata of business, is becoming more and more visible, but continued development is set against systems that still carry the legacy of bureaucracy and the rule of the pen, yet to adapt fully to an environment that is now the domain of virtual offices, cloud databases, and real time sharing of information through mobile personal telecommunications.

Large multinational corporations and the apparatus of government dominate the business landscape in the Pacific, indicating that the Pacific can still be an environment where commercial activity, if not sufficiently systemic to its locality, is both dependent on, and limited by, the business of government, or the unstable patronage of discordant customers. This also means that the Pacific is still a place where social and public wealth and infrastructure, if not properly supported by prudent and far-sighted government policies and action, can be unreliable, exposed to abuse, short-lived, and ultimately, unfairly dismissed as irrelevant in the process of economy-building.

A mismatch between the earlier adoption of global economic growth models, and the more gradual institutionalisation of the infrastructure and policies necessary to sustain them, as well as the threat of a growing perception of the irrelevance of government machinery, could likely result in regulatory responses that do not necessarily facilitate market driven private sector activities. This unintended public-private partnership needs to be properly managed for optimal long term outcomes.

PNG's Economy

The PNG economy's 2012 estimated growth is around 8.0 percent. The latest statistics indicate that strong growth has continued in the construction, transport, telecommunications, and property sectors; Agriculture has suffered somewhat from a combination of lower world prices and a strong Kina; capital investments and employment capacity in the resources sector has more or less stabilised during 2012.

BSP's PNG banking operations in 2012 continue to show a level of costly self-reliance that has become necessary in recent times, as governments struggle to keep social and national assets and services fit for purpose in an environment demanding rapid change and higher standards of operability. To the costs of self reliance, need to be added the costs of innovation, where difficulties in accessing markets, in timely processing transactions, in maintaining skilled resources, or in finding hardware and software that will endure tropical environments, are compelling the Bank towards sourcing and implementing enterprising solutions. The banking market remains competitive in both the corporate segment and the retail area. As the impetus from the construction phase of the LNG project decreases, customer preservation and defence becomes a focus; as mobile and internet telecommunications usage grows among the population, the retail market is opening up and the distinctions between microbanking and commercial retail banking become blurred. The recent and expected growth in payment volumes in the monetary system has led the Bank of PNG to start a project to introduce a National Payments System, essentially an automated gross settlement system for commercial banks.

Fiji Conditions

2012 in Fiji was flanked by disastrous floods at the start, and a damaging cyclone at the end. But the reality of Fiji is that business and commercial activity are resilient at street level, and a path to growth is being pursued. The ADB estimates that the Fiji economy grew about 1.7 percent in real terms. During the year, Bred Bank was issued a commercial banking licence in Fiji and commenced operations. Liquidity levels are strong, and the Reserve Bank of Fiji supervises the banking market at quite a detailed level.

Despite the natural physical challenges, there has been stable performance from the mainstays of sugar and tourism, with mining expected to play a greater role in the economy, and there is growing optimism that the progress towards democratic elections in 2014 will continue as planned.

Solomon Islands Economy

Declining timber exports are offset by strong earnings from the Gold Ridge mine. The agriculture sector also figures prominently, but has been impacted by low export prices and adverse weather experience. The RAMSI engagement, which has contributed to business and commercial stability, has started to transfer some of its functions to the government and its agencies.

Strong Earnings And Financial Performance For 2012

Profit and balance sheet growth statistics all indicate continuing business growth. Profitability measures are positive and market share is quite stable, if not improving. 2012 Group Profit after tax was up 14 percent on 2011 growing to K407.7m. 98 percent is attributable to banking operations. In the Life Insurance business, profits grew 9 percent.

Whilst the overall profit result has come in on target, there have been components of the result where there have been departures above and below target.

In all markets, interest earnings have been impacted by lower yields on non-lending investments, owing largely to sustained high liquidity levels and a corresponding low rate environment, despite slightly higher rates of inflation for most of the year. Increasing competition for credit has also been a feature of BSP's markets. Net interest income grew 14 percent from 2011.

For BSP, profit composition has been marked by a transition from interest to non interest income which exceeded target, indicating growing income resilience.

Group Chief Executive Officers's Report

Operating expenses increased 9 percent from 2011, because the investments to improve operational capabilities are ongoing.

Net Loan provisioning is higher in 2012, as general provisions have been increased in anticipation of stress in the PNG market, as the economy slows in response to LNG investment phase moderating, and the flow on effects of a sedentary global economy.

Group assets grew 14 percent over the year, to K13.3 billion. In the Pacific, the overall deposits market share of BSP is 47 percent and for loans, is 40 percent; Since 2010, the compound annual growth rate for assets has been a very strong 10 percent. PNG's balance sheet makes up 84 percent of the group, with Fiji at 13 percent; the insurance business in Fiji is controlled in terms of balance sheet size, at only 2 percent of the group.

The Group's regulatory capital is sufficient to support overall balance sheet growth. The capital base is adequate to match the intensity of capital investment and the accumulation of interest earning assets. At 22 percent, the banks' capital adequacy continues to be well above the limits required by the Bank of PNG; Whilst BSP enjoys adequate levels of regulatory capital overall, all prudential tolerances are now subject to closer review and testing in light of recent years strong credit growth and related risk profile changes especially in PNG. It is also known that new prudential guidelines for capital adequacy are being implemented around the world, and BSP should anticipate changes in these measures. These issues are being addressed as part of BSP's capital management strategy.

Dividend growth tracks profit growth, even though reinvestment in the business is high.; a competitive 6 percent yield is expected.

The Group achieved ROE of 29 percent, in line with historical averages, reflecting continued strong returns for a stand-alone global corporate measure.

The capitalisation of BSP at the end of 2012 was approximately K3.7 billion.

In July 2012, the banking industry journal "TheBanker" in its annual top 1000 World Banks, ranked BSP as number 4 in the world for its ratio of profit on average capital, and in the Asia Pacific, number 3 for return on capital and no. 7 for tier 1 capital growth (outside China and Japan); Many might express surprise that a Papua New Guinean entity should be ranked so competitively on a global scale, but few would expect that that entity would not be BSP.

Initiatives That Are Supporting Current Growth

Any discussion of BSP Group's strategy in the South Pacific must begin with the observation that BSP has a natural size advantage, commanding the largest market share, with the largest distribution network, in the largest South Pacific economy; In fact, BSP's network reach in each of its markets is a distinct natural advantage. In the last few years, the strategy has been to provide a secure and reliable banking platform with which to extract more performance and returns from this existing market dominance.

In 2012, the performance scorecard for BSP Group reads:

- Delivered refreshed teller training modules, and training components for a number of new operational initiaitves; In 2012 87,000 employee-hours of training across all skill areas, has been achieved
- Introduction of USSD mobile banking platform and the development of the Wantok Moni Product for its 2013 release, PIN change capability at ATMs, and the use of cheque scanners for improved cheque processing and fraud detection; An upgrade to the internet banking channel was completed; The introduction of an account opening procedure with an instanteous Kundu card & PIN issue, and tablet registration of photo and signature (which won the Mastercard Connected World Award for Best Bank-led Mobile Money Program)
- Operationally, 100 percent Data Centre availability has been achieved, and more than 97 percent branch communications uptime, BSP has a virtual server environment, and multiple levels of internet connectivity back up; Design and mobilisation commenced on large business facilities in Port Moresby and Lae
- Community projects and engagement initiaitives continued throughout the branch network in all countries, sadly including responses to natural disasters in some areas

- More than 1.2 million accounts in PNG, over 1.5 million when Fiji and Solomon Islands included; 30 percent customer account growth in PNG through initiatives such as Green Gold. The number of accounts acquired by BSP in 2012 is larger than the combined retail account population of its major competitors; on 14 December 2012, Mr Peter Gurame was announced as the winner of the K1 million grand prize in the PNG Green Gold competition. At the end of 2012, BSP had 1.550 million accounts across all three of its geographies

- 37 Rural branches have been opened in PNG, and 124 agents have been signed up to support BSP's push into the hitherto unbanked economic systems of PNG; Two full-service branches were opened, one at Arawa in the Automonomous Region of Bougainville, and one at Waterfront Shopping Mall in Port Moresby; BSP First lounges were opened in Honiara, Suva, and Lautoka

- EFTPoS devices have increased to a combined 10,013 in all three countries, the largest fleet in the South Pacific; 4.099 were additions in PNG; 48 new ATMs were also added across the three South Pacific markets, bringing the total to 388

- Transaction volumes are continuing to climb: In PNG alone, 65.2 million transactions were done, 33.3 million through ATMs and 13.5 million on EFTPoS; A total of almost 80 million transactions were recorded across all three countries

- Approximately US$50 million increase in the foreign currency loan portfolio was achieved

- Distribution of over K600 million in government school subsidies to more than 10,000 schools over a 14 day period, to help deliver PNG's free education policy in 2012; and a landowner liaison program which has yielded over 2,000 new accounts

- 40 percent Corporate loan portfolio growth in Fiji, and 16 percent growth in total loans in the Solomon Islands

- Life Insurance new business growth of 15 percent

- The portfolio of wholesale funds managed at BSP Capital increased a moderate 9 percent, but could not prevent an operating loss of K4 million for the year.

Strategies To Develop Growth Opportunities

For the medium term, the strategy is clearly moving towards extending the reach of BSP's distribution even further beyond the confines of its physical retail establishments, into the commercial and social spaces where people perform their transactions. This same shift is reflected in the corporate banking market, where the imperative is to move relationships beyond the head offices of corporate clients, to match services to their operations, and link them to chains of supply and/or distribution.

BSP's medium term strategy, which is reviewed annually, remains focused on opportunities in the following areas:

- Comprehensive servicing of customer segments, growth in retail and small business, trade finance and foreign currency business growth, branch efficiency, technology based channel and product delivery, and capital markets development.

These outcomes have been translated into several clear objectives:

- Train people for proficiency in basic banking and sales, and employ efficient employment practices

- Apply technology to automate for efficient processes, improved management information, and communication

- Extend the BSP brand into previously unbanked areas, new markets, and/or related financial services

- Maximise market, segment and product revenues, and diversify the customer base.

These objectives will be targeted by implementing some well defined imperatives:

- Trade Finance and Treasury Sales customer acquisition in corporate and SME segments

- Selling the BSP "whole of bank" offer in the corporate segment

- Rapid roll out of the BSP branchless banking model based on an agency eco-system, related electronic channels, card, accounting and other support ICT systems

- Introduction of automated loan origination, collections, and cheque processing systems

- Improvements to the core system test environment for product and process development purposes

- MIS support for key operating initiatives

- Use a College approach to design and deliver effective training

- A focus on cost control and market share increase in Fiji and building strong electronic banking channels in the Solomon Islands

Group Chief Executive Officers's Report

- Reclamation of BSP Capital funds management business by offering superior expertise and client-specific services
- The construction in Port Moresby of a regional operations centre, a state of the art back up data facility and security command centre, and a new commercial centre in Lae.

A program of work is already in progress to deliver these key imperatives.

The capital support of these investments and growth is a critical element of the strategy. The BSP Group's capital management plan is reviewed regularly to ensure there will be adequate support for balance sheet growth and prepare for anticipated adoption of Basel III capital management measures.

People And Community Relations: A Dynamic Relationship

An institution like BSP depends very much on the commitment, initiative and teamwork of the people who are prepared to contribute the equivalent of nearly half of the daylight hours of every year, to ensure that customers receive banking services from BSP.

Many BSP staff also, then find the time, to involve themselves and their families in BSP's community projects, and also in other worthwhile social pursuits that all go towards creating a special and unique BSP brand of community engagement. It's a type of community engagement that is more than a gesture of goodwill, or even charity; In the South Pacific, it more closely resembles the attachment of a family or a tribe to its home, where hard-won heritage is decorated with legend, carefully nurtured wealth is the product of devoted hard work, and where experiences and relationships extend across generations.

Within this setting, the Board of BSP has provided its guidance with the usual professionalism; It has been critical, enquiring, and pragmatic, when the occasion has demanded it, and I commend and thank the Board for their support of the change that is occurring at BSP. The execution of strategy by BSP continues to improve, considering the full program of strategic and operational activities that needs to be undertaken. As conditions have started to get difficult, the team at BSP has worked hard together to produce exceptional, impressive results in 2012. I am fortunate and proud to be associated with the dedicated and hardworking management and staff at BSP, and I sincerely thank them for this support.

We expect even more challenging conditions in 2013, but I anticipate that a continuation of the discipline that has yielded results to date, will produce another competitive outcome.

Ian B Clyne
Group Chief Executive Officer/Director


Ravalien House, Port Moresby and location of the first concierge banking facility, BSP First.

2012 Strategic Business Unit Review

The daily execution of the Bank's business operations is the responsibility of the strategic business units (SBUs), Retail Banking, Corporate, Network, Treasury, Paramount Banking, Credit & Risk, Human Resources, Operations and Finance & Planning.

Highlights of each SBU performance in 2012 include:

Retail Banking

The main strategy of Retail Banking SBU is the development and management of products and channels providing service excellence to our customers. Our goal is to create standard, understandable and affordable products based on the requirements of our different customer segments provided via various and easy accessible channels so our customers can bank with us wherever and whenever they want. Eighty-five percent of PNG's population live in rural areas. It is part of our strategy to provide banking services to the people through our agent network as an alternative to customers traveling long distances to access services at our 42 branches across PNG.

2012 Highlights

To further deliver on this strategy, we introduced the use of software using computer tablet technology to enable our staff to acquire new customers in the field. Moreover, we have adopted processes that can instantly issue debit cards and PINs as soon as a new account is established. During 2012, using this technology, together with a campaign to stimulate usage of our debit cards through our EFTPoS and ATM networks, BSP staff travelled throughout PNG to remote settlements and villages to sign up more than 250,000 new customers.

Meanwhile, the Bank continues to roll out a large network of rural agencies under the flag of BSP Rural. At the end of December 2012, BSP Rural was operating 30 rural agencies located in the remote districts of PNG. Each rural agency forms a part of a value chain providing a payment system linkage between commodity growers and buyers as well as basic banking services to regional communities. Our staff ensure that even the smallest retail stores are supplied with EFTPoS terminals, so that people can use debit cards to pay for goods and services instead of cash. The use of these cards has led to improvements in security and created awareness about the value of money which is leading to increased savings. In addition to rolling out BSP Rural agents, we are engaging merchants to become BSP agents using their EFTPoS for cash-in as well as cash-out. These activities are contributing significantly to financial inclusion and, together with Financial Literacy Programs, are providing our customers with the opportunity for greater participation in the development of PNG.

We continue to focus on improving our electronic banking channels and in particular, mobile banking. To complement our SMS mobile banking option, we have introduced a USSD menu based mobile banking system which is easily understood and more convenient for our customers.

A special product package has been introduced for students. Since these young men and women are the future leaders of our nation, we consider it important to provide them with the tools to develop lifelong sound financial habits. The student package is geared towards mobile and internet banking to recognise the computer literacy and early adopter characteristics of this demographic.

Significant effort has been devoted to the development of a Smart Banking business unit to service the needs of the small business segment with a straight forward product suite. The package we are providing has already been well received by the small business community.

During 2012 we continued a massive roll-out of EFTPoS merchant facilities in a genuine effort to reduce cash usage in the country and improve security and convenience for our personal and business customers. By the end of 2012, we had placed 9,000 EFTPoS terminals in merchant outlets.

We are also proud to announce that by the end of 2012 we had reached the milestone of 1 million retail customers. We will continue to provide a good and affordable service, accessible through a large range of channels and with the largest network of branches, agencies, EFTPoS and ATMs, not only in PNG but also in Fiji and Solomon Islands.

2012 Strategic Business Unit Review

2013 Challenges and Opportunities

BSP is the premier bank in the South Pacific with the largest customer base. We provide our services across multiple channels with different fee structures to allow our customers to choose the style of account that suits them best. While we offer this selection today, our challenge remains to educate our customers to allow them to select the product suite that offers them the optimum choice of delivery channels and fee types. Currently, too many BSP customers still choose BSP branches as their service channel. By shifting more volume to other channels, better outcomes will occur which will help both our retail customers and the Bank.

Corporate

Building on the strong platform built in previous years, Corporate Banking delivered a record result during 2012. The service and sales programs initiated during the year have delivered a significant uplift in net interest income, non-lending fees and bank wide cross-sell.

BSP is proud to have a large and experienced national relationship management team, covering Port Moresby, Lae, Kokopo, Madang and Mt Hagen. Our team has extensive local knowledge that enables them to partner with our customers to achieve good results. The team is now supported by a market-leading range of corporate financial solutions covering foreign exchange, business internet banking, electronic payroll processing, working capital & transaction facilities, cash management, asset finance plus an extensive range of kina and foreign currency lending solutions.

The Corporate SBU vision was reinvigorated during the year with a clear focus on customer service.

Our vision is: ***'to be the leading financial services team excelling in customer service; through customer first, best people, innovation & communication'.***

During 2012 BSP changed its focus from the previous years' Transformation programme to Customer First. As the name implies, the programme involves putting customers at the top of our priorities - establishing a 'customer first – I care' culture. It was the Corporate SBU that championed this change in culture in the Bank. The three minimum service standards proposed by BSP as part of this program include:

1. **Own Up (Wok Bilong Yu)** — ensuring we all take ownership to follow-up every customer's request until they are completed
2. **The Sundowner Rule (San i go daun Rule)**—Always returning a customer's and future BSP prospect's communications by "sundown" that day
3. **Remind Me (Toksave Long Mi)** — reminding individuals, at appropriate times, about customer matters that require attention.

Best People— as part of our Personal Development Pathways training program we have increased our investment in our people. During the year, we expanded our training with Moody's Training Services to include both online and face-to-face sessions.

Innovation— we continue to invest in new product and system development to ensure we have reliable and appropriate financial solutions to meet our customers' needs.

Communication— our focus is to ensure accurate communication with our customers by listening closely to their requests.

In realising this vision for BSP, a service and sales program supported by business tools commenced during the second half of 2011. These initiatives involve the entire corporate team in client planning, call reporting, deal pipeline development, weekly sales topics, cross-sell, one-on-one reporting and pitch presentations.

We will continue to strive for excellence in customer service and across all aspects of our business including reputation, asset quality, market share, profitability, client satisfaction, innovation, governance and community engagement.

In 2012 the Corporate lending book increased by 18 percent and deposits increased by 19 percent. The loan growth trend is above system growth indicators published by BPNG. This includes BSP's diversification into USD lending for our local and international customers. During the year, we took the role as Co-Lead Arranger and USD50 million participation for InterOil's five year amortizing USD 100 million secured term loan facility with BNP Paribas Singapore Branch.

With respect to credit and operational risk, we continue to focus on a strategic and responsible approach. We vigilantly monitor and control the quality of the loan book especially during this period of slowing economic activity.

During 2012, we continued to leverage the work completed in 2010 and 2011 in relation to Transformation initiatives such as customer segmentation, redesign of the loan suite covering working capital, short & long term lending and asset finance. In addition, we made further enhancements to online business banking and the business MasterCard Corporate Debit Card.

New product initiatives in 2012 included the launch of foreign currency loans and deposits. We have also invested, using the services of Wells Fargo, in a state-of-the-art trade finance solution to be launched in 2013.

Given its important role in our focus on customer service, the Client Service Centre (established in 2011) has been bolstered with additional resources. This 24/7 call centre provides an immediate response to customers' telephone and email enquiries including: stop cheques, cheque tracing, new cheque book ordering, lost/stolen cards, statement ordering, internet banking enquires and loan enquires.

As outlined in other SBUs within this annual report, what truly makes Corporate an outstanding business partner is our dedicated relationship management team, extensive product suite and most importantly BSP's 'whole of bank' solution incorporating electronic channels and access to the largest retail branch network in the country.

Network

2012 Achievements

2012 heralded the following significant achievements in the Network SBU:

- Our new Waterfront Branch in Port Moresby successfully opened for business in mid-2012.
- After a 23 year absence, BSP returned to Arawa, Bougainville Island. The successful resumption of services to the region in the first half of 2012 was a significant occasion for BSP and the community.
- In December 2012, the combined efforts of Network and BSP Rural achieved a milestone of one million retail accounts on file.
- A significant effort from both Network and BSP Rural resulted in a successful 2012 Green Gold campaign which realized the opening of 160,000 new accounts for the 6 month campaign period. This represented an average of 27,000 new accounts per month.
- Community Projects were completed by all branches in the network, generating much good will and a favourable image for BSP. These projects ranged from general community clean-ups to repainting and repair of schools.


PNG Executive Team

Front row L-R: Robert Loggia (Group Chief Operating Officer), Robin Fleming (Group Chief Risk Officer), Ian B Clyne (Group Chief Executive Officer), Johnson Kalo (Group Chief Financial Officer), Aho Baliki (General Manager Paramount Banking.)

Middle row L-R: Neil Gamble (Deputy GM/Head of IT), Frans Kootte (General Manager Retail Banking), Giau Duruba (General Manager Human Resources), Ian Mason (General Manager BSP Capital), Bob DeBrouwere (Deputy General Manager Human Resources - Training Development & Employee Relations), Paul Russell (Deputy General Manager Paramount Banking).

Back row L-R: Christophe Michaud (Head of Strategic Client Support & Deputy General Manager Corporate Banking), Paul Thornton (Deputy General Manager Retail Banking), Peter Beswick (General Manager Corporate Banking), Peter Boutcher (Deputy General Manager Network), Marius Fourie (Deputy General Manager Human Resources - Operations & Change), George Loverock (Head of Security), Frank Gamble (Chief Credit Officer & Deputy General Manager Credit & Risk), Robert Mantel (Deputy Chief Financial Officer), Eddie Ruha (Chief Financial Officer - PNG).

Absent: Mark Railston (General Manager Treasury), Mark Ryan (Deputy General Manager Treasury).

- Fraud losses for Network were significantly lower than previous years. While this is a pleasing result, there were also cases during the year that highlighted staff collusion can contribute to fraud. Similarly, other non-lending losses were reasonably well contained.
- Network contributed significantly to the production and launch of the Bank's new teller training modules.
- A mobile ATM and EFTPoS terminal were successfully piloted at the Morobe Show and were very well received by the general public.

On a general note, our network officers managed ever increasing transaction volumes in all delivery channels in addition to increasing ATM and Merchant EFTPoS deployment, often under difficult circumstances. Our branches made a significant contribution to the Bank in 2012.

Looking Ahead to 2013

The coming year promises to be an exciting one for BSP and for the Network SBU. We have the following major initiatives in the pipeline for deployment in 2013.

Cheque processing via integrated scanners to be introduced to the branch network in preparation for BPNG KATS (National Payment System). (See the Operations and IT SBU report for more information on the scope of KATS).

Network has plans to reduce **in-branch queues** with the introduction of an electronic queuing system. We are a major contributor to the retail banking initiatives to migrate customers to other delivery channels (eg mobile banking, EFTPoS and ATMs), in order to reduce unnecessary volumes at the counter.

Introduction of **SMS alerts** to advise customers that they can visit their branch to collect services they have requested, such as new & replacement debit cards, new cheque books and deposit books. This will eliminate time wasted with customers visiting branches before the items are delivered. Alerts will also be used to advise customers about the results of their loan applications.

Instead of capturing and **destroying customer cards in our ATM's** after three failed PIN attempts, we will mark the card as unusable, return it to the customer and it will become active again the next day. This will provide significant efficiencies. An average of 6,500 cards are captured and destroyed each month. This represents unnecessary generation of replacement cards & PINs and thousands of customer visits to the branch each month.

A **restructure of the Network Branches** is planned for the future in order to re-align our strategic focus on sales and service.

Treasury

PNG, Fiji and Solomon Islands share similar characteristics of being small in the international context, with few market participants and still incomplete, illiquid financial markets.

The role of BSP Treasury remains to:

(a) foster relationships with clients and BSP's network to profitably provide financial markets services

(b) act as 'banker' to the Bank— managing market risks, funding, liquidity, capital and providing capital planning. This includes managing the Bank's exposures and liquidity levels in line with prudential and ALCO directives and delegated authorities.

In PNG, foreign currency capital inflows relating to the PNG Liquid Natural Gas project construction phase continued as the main drivers of the PNG kina appreciating about 4 percent between January and May 2012 from USD 0.4665 cents to USD 0.4850 cents. In addition, lower coffee, copra and palm oil prices and higher imports contributed to the Kina slipping back about 2 percent from the peak to USD 0.4755 by year end. Consequently, the PNG Kina rose about 2 percent over the 2012 in USD terms.

In 2012, kina-equivalent system foreign exchange turnover rose fractionally by about 1 percent compared to 17 percent in 2011 with BSP Treasury intermediated volume rising about PGK1.14 billion equating to a market share of about 26 percent (in comparison with 24 percent in 2011). We were able to intermediate a relatively bigger share of volume whilst maintaining the spread on this higher volume although this did require a higher risk assumption with higher average limit utilisation. Overall, PNG BSP bank foreign exchange earnings rose by about 10 percent in 2012 to reach K224 million.

Despite our country-risk related S&P long term issuer credit rating of B+, we used our growing capabilities to diversify our funding base over 2012. This helped increase our USD funding access which in turn enabled a greater ability to provide USD funding to customers with good usage of whole-of-bank customer solutions (rather than a solely transactional relationship).

High levels of domestic financial system liquidity contributed to a low domestic nominal and negative real interest rate regime. The yield curve flattened and fell by more than planned, from 2.70 percent for 28 days and 3.85 percent for 182 days in 2011 to 1.98 percent and 2.32 percent in 2012 respectively. Inscribed stock yields also fell, for example from about 12 percent for the 2027 issue to about 9 percent. Low monetary policy rates risk implicitly taxes savers, disrupting the signalling function of interest rates for efficient capital allocation in PNG and increases the value of unfunded pension liabilities. The cash reserve requirement increased twice in 2012 adding to the earnings drag in 2012. It rose from 6 percent to 7 percent in March and then again to 8 percent in June to 7 percent on top of the two 1 percent increases in 2011. Offshore yields also fell over the year which, along with the appreciating Kina, reduced earning rates on offshore deposits. All these factors contributed to earnings on the **PNG Bank's** liquids and investments to be about K236 million at an average yield of 5.06 percent on an average balance of about PGK4.5 billion for 2012. If the average yield had remained at 2011 levels of 5.51 percent, income would have been about K21 million higher.

Paramount

Highlights for Paramount Banking included the national general elections, which occur approximately every five (5) years.

The election was widely publicised in the media and the country experienced many highs, lows and unprecedented challenges. We saw significant funds injected into the economy by political parties and over three thousand candidates standing for election.

The Ombudsman Commission stepped in to place a ban on use of all District Services Improvement Program accounts which created some anxiety with incumbent politicians.

The other highlight in 2012 was the launching of premium banking centres for corporate and Paramount clients.

BSP launched the premium and express teller banking facilities (similar to boutique banking in western countries) for high valued clients, enhancing the Bank's emphasis on customer care.

Paramount Banking, Kundu Pei and the Branch Network assisted the National Government, especially the Education Department, with the distribution of free tuition fees (involving over K300 million) to more than 10,000 schools in PNG. However, a good number of schools missed out on the subsidies as a result of not having an account with any PNG bank.

PNG's economy continues to enjoy steady growth with the resources boom (mainly in LNG/Mining) supported by high commodity prices.

The banking system continued to experience high levels of liquidity and BSP had over 50 percent of the liability portfolio in 2012. Paramount banking liability portfolio stood at K4.411 million with over K800 million in various government trust funds.

Our focus on the partnership with the National Government and its banking relationship is critical and Paramount will ensure this relationship is maintained for 2013 and the future.

In July, a community liaison officer was employed by Paramount to maintain landowner groups banking relationships.

About seventy new landowner group bank accounts were established with another 214 related accounts providing Paramount with over two thousand landowner group accounts.

In 2012, Paramount Banking continued with a consistent and sustainable growth strategy and maintained operations within budget forecast. Economic projections for the next two to three years point to a slow down until 2015 when various LNG/Mining projects will come online.

Credit and Risk

Risk management in BSP is independently overseen by various business units within the Credit & Risk strategic business unit. The specific business units are: (a) Credit, which has credit underwriting and portfolio management responsibilities; (b) Operational Risk, which has broad operational risk involvement across the network; (c) Asset Management, which manages the distressed asset portfolio; and (d) Credit inspection, which provides an independent assessment of credit policy compliance.

Highlights of the individual business units in Credit & Risk are summarised below. Audit and Legal business units report to the CEO and their respective business highlights are included in the Credit & Risk report for 2012 for purposes of completeness.

Credit

Credit risk is defined as the potential failure of a borrower or counterparty to meet its contractual obligations. Within BSP we manage credit risk by developing and reviewing a credit risk strategy that defines our target market acceptance criteria for acceptable business to build a quality portfolio.

2012 Strategic Business Unit Review

Senior BSP management have the responsibility to implement credit risk strategy and for developing policies and procedures for identifying, measuring, mitigating, monitoring & controlling and reviewing the effectiveness of the credit risk strategy and credit culture.

The construction and development activity associated with the PNG LNG project continued to underpin economic activity and consequent lending growth, across all sectors of the PNG economy. Diversification of loans across key economic sectors continues to be closely monitored to ensure no significant concentration risks develop that may affect the stability of the asset performance.

Whilst economic growth forecasts for PNG are positive and, in many respects, envied by more developed economies, the property market appears to be moving to a situation of over-supply after many years of excess demand in the market. This, will impact rental yields and capital growth. BSP will continue to exercise caution in lending to this sector.

Performance of the loan portfolio remains sound. During the course of 2012, overall delinquency in the Corporate book has reduced and the expectation is that 2013 should see a continuation of this trend. The retail loan portfolio did experience some delinquency volatility during 2012 due to internal changes in the loan repayment collection process. This has now stabilised and retail delinquencies are trending closer to historical means.

Significant changes are anticipated for 2013 in the Retail portfolio processing with the introduction of an automated loan origination system for personal loans, housing loans and the small-to-medium business sector. This automated processing system will incorporate customer loan application automation, auto loan decisioning, and loan documentation.

Another major change anticipated for 2013 is the introduction of Smart Business products. This is a series of new products designed for the SME segment of the economy. Credit Management was significantly involved in designing components of the processes and the credit standards to launch this.

Lending policies and procedures continued to be reviewed on an ongoing basis with further policy changes made during 2012. These changes focused on improving controls and reporting in order to move the Bank towards compliance with best practice credit risk management standards. We have continued to bed down the Bank's social and environmental policies and processes.

Training has been a key focus in 2012 and will continue strongly into 2013. During 2012, BSP introduced Moody's Online Credit Training which is being undertaken by up to 75 staff, predominantly in Credit and Corporate. The online training is now being complemented by classroom training delivered by a Moody's accredited trainer. Again most of the 75 Corporate and Credit staff will participate in this seven course classroom-based programme after completing their online training.

Credit Inspection

Credit Inspection reports to the Board Audit Risk & Compliance Committee and is responsible for completing an independent examination and assessment of credit risk activities and operations within BSP.

Credit Inspection evaluates compliance with BSP Credit policies and procedures and the effectiveness of credit risk controls that are in place.

In 2012, Credit Inspection completed the following projects for BSP Corporate and Retail:

- **Corporate Loan Review:** An examination of individual corporate customer loan facilities and a random sample of loan facilities to validate collateral and standing data integrity
- **Review of BSP Panel Valuers:** the introduction of new selection criteria, including minimum standards of analysis and reporting and the mandatory requirement for professional indemnity insurance
- **Property Valuation Analysis Training:** Workshops were conducted in PNG for approximately 65 staff in various business units to acquire the skills to analyse a valuation report.

The Credit Inspection activities for 2013 will involve a Credit Inspection for six large Corporate Relationship Management Portfolios, including a review of BSP Corporate 'High Risk' Customer Groups complemented by a security packet audit for these selected portfolios.

Asset Management

During 2012, a combination of sound economic conditions over an extended period and responsible credit underwriting saw a marked reduction in new loans migrating to Non-Accrual compared to previous years. This improved portfolio performance, in conjunction with effective loan recovery processes, resulted in the outstanding non-

BSP is determined to earn business with a one-on-one customer relationship philosophy.
BSP - Ravalien House, PNG.

accrual loan volume experiencing a year-on-year reduction of 33 percent at year end for 2012.

In retail collections, manual activity associated with transfer of personal loans from the core operating system to the non-accrual system was automated which resulted in productivity gains for the asset management team involved in this market segment. It is expected that further automation development will continue in 2013 with consequent productivity benefits.

Court/legal litigations continue to be adversely affected by delays; however, where considered necessary or commercially viable, the Bank will continue to pursue this avenue of recovery.

Operational Risk

Operational risk is defined as the risk of direct or indirect impacts resulting from human factors, inadequate or failed internal processes and systems or external events. Operational risks are inherent in the Bank's business activities. It is not cost effective to attempt to eliminate all operational risks and it would not be possible to do so. Small losses from operational risks are expected to occur and are accepted as part of the normal course of business. Those of material significance are rare and the Bank seeks to reduce the likelihood of these in accordance with its risk appetite.

The management of operational risk has two key objectives:

- To minimise the impact of losses suffered in the normal course of business (expected losses) and to avoid or reduce the likelihood of suffering a large (or unexpected) loss; and
- To improve the effective management of the BSP Group and strengthen its brand and external reputation.

Operational risk management has now become part of the daily work of the operating units within the Bank. Opportunities and risks are identified, assessed and managed on a daily basis and reported to and managed by the appropriate management level. On a periodic basis, the status of the opportunities and risks are reviewed and further actions are taken.

Highlights of the operational risk initiatives undertaken during 2012 include:

- Continuation of the business process mapping exercise across the BSP Group
- Participation in the delivery of key projects relating to core banking systems and products
- Enhancement of operational risk reporting to Business Unit heads, executive management and Board by way of risk dashboards
- Increased communication and partnership with key internal stakeholders to improve the identification, assessment and/or investigation of risk incidents
- Ongoing risk awareness provided to staff across the BSP Group. This was achieved through risk workshops and presentations to business units and branches throughout the year
- Cross training of Operational Risk staff in key roles within the department such as in fraud investigations, monitoring of money laundering transactions and risk & control assessments
- Higher utilisation of the existing risk management software tools in identifying, recording and reporting of operational related risks across the BSP Group
- Updating of the business continuity documentation and staff training across the Bank.

Some of these risk initiatives will continue into 2013 and will form part of the continual refinement and embedding of the operational risk management framework into the organization.

Internal Audit

BSP has independent internal audit functions in PNG, Fiji (both the Bank and Life Insurance operations) and Solomon Islands with these various teams reporting, through the Head of Group Internal Audit, functionally to the Board Audit Risk & Compliance Committee in Port Moresby and administratively to the Group Chief Executive Officer (via the respective Country Managers).

The PNG internal audit unit includes four regional audit officers and seven branch audit officer positions (based in selected branches throughout PNG) in its total of 30 positions.

The ongoing engagement of the Port Moresby-based accounting practice PricewaterhouseCoopers (PWC) continued during 2012, following their prior years' review of the Bank's audit processes, procedures (methodology) and technology. The two year engagement was a major exercise whereby PWC provided specialised training and coaching in both classroom situations and workshops to upskill the staff across all of the audit teams. To further consolidate the training, PwC led cross functional audits of a number of key business areas in 2011 and 2012.

Audit & risk software and other 'continuous monitoring' audit technology is now in place in PNG, Fiji and Solomon Islands and is assisting the BSP Group with ongoing standardisation of audit fieldwork (work papers) and audit reports across the various audit teams.

Priority in the latter part of 2012, and going forward into 2013, was the strengthening of the teams' information technology audit capabilities (in PNG & Fiji) and this will see the recruitment of two specialised IT audit personnel in 2013.

Legal Services & Company Secretary

Legal Services provides an in-house legal counsel and advisory function for BSP. It is involved in legal advice on a range of matters to branch and head office staff, many of which are time critical with prompt and accurate advice being vital. The head of legal is also responsible for legal advice to the Executive. All contracts, leases and agreements are reviewed by Legal prior to execution and Legal also manages litigation matters involving the Bank.

Company Secretary has responsibility for compliance with PomSoX reporting requirements, BPNG regulatory requirements, corporate compliance requirements, investor relations and also board secretarial functions within the Bank.

Human Resources

The Human Resources SBU continued to support the operations of the Bank through its core HR Management functions.

In 2012, the HR SBU implemented the following key initiatives:

Recruitment & Selection

- Recruited key expatriate officers in Operations & IT, Corporate Banking, Treasury, Retail Banking and Finance SBUs
- In collaboration with the Department of Labour Industrial Relations, facilitated the recruitment of a number of IT project-related skilled expatriate officers with short term work permit / visas
- Renewed twenty (20) work permits/visas for existing expatriate officers whose work permits/ visas expired on 31 January 2013
- Conducted a three-day Assessment Centre refresher program for recruitment coordinators
- Advertised and screened applications from university students for the scholarship scheme in 2013. Short listed candidates will be interviewed and scholarships awarded in the first quarter of 2013;
- Hired new staff for the new Arawa Branch, and the new BSP Rural agents with the Branch Network and BSP Rural business units;
- Visited the PNG based university for career talks and recruited 16 university graduates for the 2013 Graduate Development Program.

Training and Development

Training focused on up-skilling in the technical skills matrix, industry standard accreditation and leadership for change management areas in balance with soft-skill development. Key initiatives in 2013 were:

- In line with the upgrade of Network Systems, developed and rolled out a ten module training program for the tellers in the branches
- In response to a training needs analysis (TNA) survey, delivered a bank-wide MS Office Excel program for PNG and Solomon Island based employees
- Facilitated the Credit and Risk initiated Moody's training in credit skills and business finance for Credit and Risk, Corporate Banking and Finance employees
- As part of career development pathways and succession planning, developed and rolled out the Team leadership for change management program in PNG, Fiji and Solomon Island.

Remuneration and Benefits Management

- Conducted a market survey on total salary and benefits, aligned salaries in a number of keys business units to remain competitive in the market
- Eliminated all non-statutory payroll deductions reducing payroll related reconciliation tasks and replacing them with automated features found in BSP's core banking system
- Identified 160 plus national employees based in Port Moresby, eligible to purchase a house at K285,000 (land plus housing) under the Bank's First Home Owners Home Ownership Scheme. Currently holding talks with a potential developer who has land at the nine mile area.

HR Operation

- Conducted parallel runs for a system to replace the CHRIS Payroll System
- Introduced the revised business travel, bank uniform and leave policies, conducted work place meetings especially for the leave policies as part of the Change Management program in the first quarter of 2013
- Successfully hosted the 2012 BSP Employee Family Day in Port Moresby and the outer Branches. Close to 2500 employees and family members attended the family day in Port Moresby.

Total head count was 2,912 (BSP PNG) and 3,890 (BSP group). Staff turnover in 2012 was 17.0 percent compared to 12.0 percent in 2011.

Total training mandays increased to 10,868 mandays from 8,861 in 2012. This equals to about 4.0 mandays per employee.

2012 Strategic Business Unit Review

Operations

The Operations & IT Strategic Business Unit (SBU) is responsible for transactional and support services delivery within the Bank. The Business Units which comprise it are as follows:

- International Operations
- Electronic Channels Operations
- Lending Support & Collections
- Strategic Business Initiatives (SBI)
- Information Technology (IT)
- Information Security (IS)
- Support Services
- Integrated Property Developments
- Security Services.

The sole structural change from the previous year was the formation of Integrated Property Developments as distinct from Support Services to manage the large portfolio of new properties being developed for the Bank's usage.

A major focal point for our activities was the Green Gold campaign which saw the Bank increase its retail customer base by more than 30 percent or about 265,000 new clients. This was the largest client acquisition exercise in the history of PNG and placed constructive stress of many parts of the organization including IT, Electronic Channels Operations and SBI, not to mention the outstanding work done by the Network branches and BSP Rural. From an Operations & IT perspective, it resulted in our teams delivering an infrastructure enabling a retail account to be opened using a tablet device for capturing client documentary details (including photo and signature in an electronic format) as well as issue a Kundu card and PIN on the spot. This tied in with the increase in ATM numbers within PNG from 224 to 268 and almost doubling the EFTPoS devices in the market to 9,000. All these initiatives required day-to-day support and maintenance while managing an increase in the overall quality of the service levels.

During October, the Bank moved its cash distribution centre from the Head Office Building to a new location beneath the BSP security base at Gordons. This new CDC facility, in addition to being in a more safe and secure environment for staff, has been built to reflect state-of-the-art design principles and procedures to provide security from both external and internal elements. Intense activity took place in the construction and design to accommodate the Bank's growing needs from both a client and internal perspective.

The year saw the introduction of BSP Premium Lounges, as well as express tellers, in all Port Moresby locations to provide preferential service to our premium clients in both the corporate and retail segments. The rollout of the same concept across the network within PNG is continuing into 2013.

From a construction perspective, we are developing a portfolio of new properties with an investment of approximately K200 million. These include the Pacific Operations Centre, the new Gordons Security Facility, the new data centre and Lae Commercial Centre. These are all long-term projects with targeted completion dates in 2014. In all cases, the full range of design activities have been finalised. Early foundation work has been completed and the construction phases went to tender during October. As at the end of the year, negotiations with preferred tenderers was taking place with final decisions and signing of contracts expected in January 2013. In all cases, ground-breaking is expected within February/ March 2013.

From a new branch perspective, we opened two new network branches during the course of the year. The first being the return of BSP to Arawa which has been built as a cost effective container branch to ensure that all parties can count on a stable law and order situation before any major investment is undertaken with a long-term view. The Bank also opened a presence in Waterfront, the newest shopping mall to open in Port Moresby. Considerable activity was also undertaken in support of BSP Rural with the construction of thirty rural branches nationwide.

Work is also under way on BSP Haus in Harbour City which will be the first location to service the mass market in that neighbourhood of Port Moresby. As a one-third owner of the development, BSP will also occupy the first and third floors of this new building on which we have the naming rights and will transfer its Finance & Planning SBU to that location.

During October 2011, BSP rolled out its new Sierra Treasury System. The system is stable and has been integrated with the Bank's internet banking platform to allow both retail and corporate clients to initiate and complete foreign currency transactions on a completely self-service basis. Customisation has also allowed for corporate tiering to allow parent companies to transact online on behalf of holdings and subsidiaries.

Additional key projects which were completed under the project management of SBI include:

- Mobile banking with USSD — a menu driven mobile banking interface for ease of use by clients. The user friendly nature of this system has seen a significant increase in volumes compared to the tag-based SMS banking system it replaces.

- Real-time fees which have automated the posting of cash handling and other account transaction fees resulting in a greatly improved success rate in necessary charging fees.

- Technical upgrade of our card processing system for greater robustness as well as allowing cardholders to change PINs at ATMs.

- Rollout of cheque scanners to all locations as an initial step towards electronic clearing of cheques but also to identify fraudulent cheque presentations.

- Wantok Moni Project allowing funds to be transferred to mobile phone numbers with cash disbursement capabilities at agents and ATMs. Further improvements in functionality are expected to this system in the first half of 2013.

Numerous other strategic projects are in development and planned to be completed during 2013. These include, but are not limited to, the new National Payments System, KATS, as well as cheque truncation such that only electronic images of cheques will be cleared between banks resulting in shorter clearing periods with no need to exchange and store physical paper, etc. Another major project which will change the manner in which retail lending is transacted in PNG is the Loan Origination Project. This project is designed to deliver an end-to-end workflow process for personal and SME lending beginning mid-2013. Lending applications data will be captured in real-time during the client interview stage which will be processed on a fully automated basis with credit scoring, credit bureau verification, generation of agreements and fund disbursement.

From an IT perspective, 2012 has been a good year in terms of system availability, infrastructure upgrades and project delivery.

We have had 100 percent availability of our data centre facility versus an international standard for our data centre facility of 99.67 percent. This is a good outcome when considering the challenges which PNG presents in terms of power infrastructure. Our ability to maintain effective communications links with our branch network was between 98 percent for major branches and 97 percent for other branches. This is slightly below our target of 99 percent and 98 percent, respectively, and we are working actively with our telecom service providers to improve their infrastructure and service levels for BSP.

From an infrastructure perspective, numerous improvements were made to the technology environment such as:

- Introduction of virtual server environments

- Significant implementation of our enterprise security architecture

- Expansion of internet connectivity to the outside world.

Although IT components exist in almost all the projects the Bank undertakes, the major IT project completed in 2012 was that of Branch Risk Mitigation. This work included a complete overhaul of all IT infrastructure throughout the branch network including cabling, racks, servers, etc. This has enabled the branches to become more resilient because all the hardware is new, has redundancy where possible and, importantly, its performance can be analysed and remediated remotely.

In 2013, it is anticipated that the work on projects and buildings will continue unabated. With the changes brought about as a result of the delivery of our strategic business projects, we will continue to modernise and streamline back office processes to improve front-end customer service as well as operational efficiency. Ultimately, this will lead to a lower cost base for services provided.

Finance and Planning

Projects

In 2012, the benefit of ICBS General Ledger re-structure was realised and Finance aimed to meet the needs of its business partners (SBUs). The changing of the account code numbers to 10 digits has been a major project for IT & Finance. In 2013 IT will continue to remap the more complex subsidiary accounts. The building of relevant periodical reports (eg product history files) has been streamlined for quicker processing and timely availability for stakeholders to utilise in making business decisions.

Middle Office (Treasury) was set up in April 2012 to manage the flow of data from the front office to the back office using the new Treasury system which was implemented in October 2011. Reconciliations done via the Accurate system and re-aligning of transactions were a major function of the new team. This will continue in the first quarter of 2013.

The new version of Customer Profitability Model was implemented in September 2012. This reporting tool allowed corporate relationship managers and credit analysts to retrieve data directly from the system without Finance intervention. This system provide a more robust reporting tool for Business to make appropriate decisions for their clients' reviews as well as credit assessment for new and existing clients. The Bank has a target for the Paramount Relationship Managers to utilise this tool in 2013.

2012 Strategic Business Unit Review

Management Reporting

Business controllers continue to focus on practices and techniques aimed at providing managers with financial information in a timely manner to help them make informed decisions and maintain effective control over their SBU resources. Appropriate resources needed to be recruited in key priority areas and continue to be a focus to ensure effective communication with the businesses.

The main areas of focus for this year were to: embed the SBU monthly performance reporting templates; develop and understand the essential business & financial information requirements; ensure data integrity through automation; implement better processes & standardisation. These are areas that require continuous improvement.

Further areas of focus in 2013 are:

- Proactively challenging SBUs on cost overruns or revenue deficiencies
- Develop Key Performance Indicators for Group, Bank and SBU levels
- Improved understanding of more specific stakeholder requirements
- Improve drill-down capabilities in systems (GL and core banking) to facilitate meaningful analysis
- Improve the overall quality, accuracy, timeliness and relevance of management information provided to stakeholders
- Develop a financial scenario modelling tool
- Continuous review of end-to-end reporting processes including opportunities for automation
- Development of product knowledge.

People

Maintaining and attracting skilled and experience staff continues to be a challenge given the high demand for finance and accounting resources in PNG and the Pacific. Focus on succession planning and encouragement of high performance will produce committed and results-oriented staff.

Staff continue to work under pressure to meet deadlines, resulting in increased demands in reporting requirements due to increase in business and the expansion of BSP. The development of finance staff with CPA/CA qualifications through the professional accounting programs was the main area for training during the year. Developing required skillsets to enable analytical thinking and financial modelling was another key focus of training. More staff will undergo this training in 2013.

Finance & planning's objective is to develop staff with analytical skills and to advance the skills to apply their analysis in a commercial sense.

Finance & planning's continuous focus for improvement will centre around the following areas:

- Develop F&P career path framework with Human Resources SBU
- Recruitment at a higher level
- Better workforce management of resources through coaching and specific training
- Revised programs to increase retention of high performers in Finance and succession planning
- Develop KPIs to assess Finance's performance (individual and collective) through ongoing feedback from the business.

Business Planning & Analysis

The business planning and analysis function in finance and planning is responsible for Global Planning, Budgeting and Forecasting, mid-month financial preview, end-of-month financial review and analysis, and end-of-month management accounting procedures.

The team coordinates the Bank's eight-quarter rolling budget and re-forecast processes. These budgets provide a financial map of the plans for implementing the Bank's strategies, which are formulated in accordance with the Bank's vision of being the leading bank in the South Pacific. The Budget is an integral component of the Bank's planning framework and is developed in the context of the Bank's strategic priorities. It reflects the Bank's overall objectives and strategies, and incorporates targets with respect to operating expenditure and revenue generation.

The 2013-2014 budget covered all aspects of the Bank's Operations in all SBUs. Business planning & analysis played a major role in co-ordinating the current strategy review process for the Bank's SBUs and subsidiaries, and assisted in compiling the accompanying financial plans.

A review of the cost allocation method was a major task that was approved in principle to be rolled out in the 2013 budget process and will determine the actual performance of the SBUs in 2013.

Compliance and Risk Control

Compliance and Risk Control is one of the functional areas of Finance and Planning. The main functions include: risk and internal control management, policy and procedure documentation, compliance reporting, business continuity and audit response.

Planned 2013 activities in Compliance & Risk Control are:

- Update current finance policies and procedures, including standardised documentation
- Monitor compliance to policies and procedures
- Develop and undertake training for business and finance staff in new policies and procedures.

Financial Accounting

The main purpose of financial accounting is to manage general ledger operations, and prepare financial reports that provide information about BSP's performance to external parties such as investors, creditors, and tax authorities.

Financial accounting is responsible for the production of the financial accounts of BSP Group. The team in Financial Accounting produce the half-year and the full-year accounts, as well as the statutory POMSOX reporting. The quarterly International Finance reporting was a new and major reporting requirement for the Bank in 2012.

Appropriate taxation advice was provided to various SBUs for compliance with the tax law. This team will be further boosted in 2013 with additional resources including expert advice from professional firms.

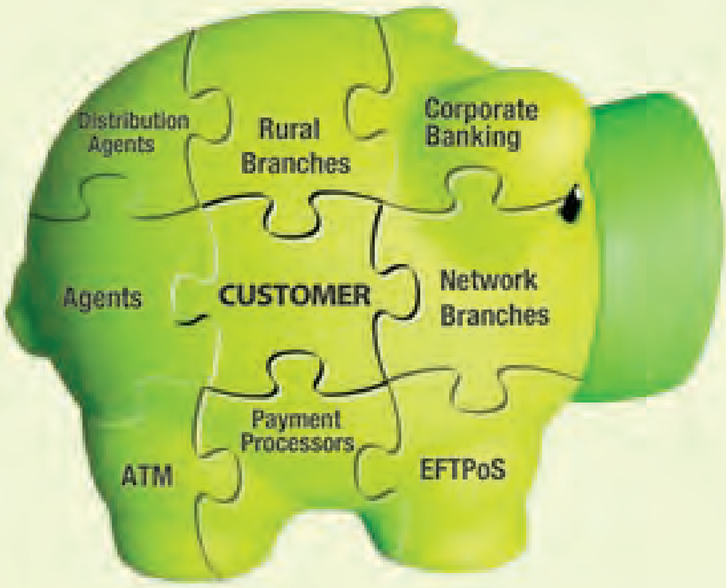
The team now oversees the accounting consolidation of group assets of more than K13 billion across four countries.

Procurement

Review of internal business practices and processes developed a higher level of visibility for expenditure management and a subsequent reduction in expenditure. Internal process improvements continue to be made to achieve substantial reductions in the payment process time for BSP suppliers. There was also a significant improvement in the payment process with suppliers despite the increase in volume. Relevant teams/resources were transferred from Support Services business unit to foster efficiency and effectively delivery of service to internal customers and supplier payments. This is an area which requires continuous improvement for cost savings.

The BSP Ecosystem represents our interconnected relationships.

At BSP we each have a role in serving all of our diverse customers whether rural or urban, business or personal. Working together allows us to better meet our customers needs by developing and delivering meaningful services.



Corporate Governance

BSP has adopted an approach to Corporate Governance that is underpinned by its core values of Integrity, Leadership, People, Professionalism, Quality and Teamwork. This approach is supported by a comprehensive framework of Corporate Governance principles and policies. The BSP Board has demonstrated its commitment to developing and maintaining a standard of corporate governance that seeks to match global practice.

The Board ensures that it complies with the requirements of BSP's home exchange, Port Moresby Stock Exchange ('POMSOX'). It also closely monitors developments in corporate governance principles and practice within Australia and has benchmarked itself against:-

1. ASX Corporate Governance Council 'Corporate Governance and Best Practice Recommendations'
2. Australian Prudential Regulatory Authority Prudential Standard APS 510
3. Standard Australia AS 8000-2003 Good Governance Principles

BSP is mindful of the advantages of demonstrating to investors that its corporate governance standards meet the requirements expected of companies listed in countries such as Australia. This Corporate Governance Statement therefore compares BSP's corporate governance practices to the ASX Corporate Governance Council and Best Practice Recommendations.

BSP manages in excess of half the banking market in Papua New Guinea, and is predominantly owned by institutions and individuals in Papua New Guinea. The Board, management and staff of BSP are very much aware of their responsibilities to the people of Papua New Guinea. The set of Corporate Governance principles developed by BSP is intended to provide a framework that will help to ensure that BSP deals fairly and openly with all its stakeholders — shareholders, customers and staff alike.

BSP publishes its corporate governance practices on its website. This is available at www.bsp.com.pg in the shareholders section.

1. The Board Of Directors

a) Role and Responsibility of the Board

The roles and responsibilities of the Board are defined in the Board Charter. This document also details the matters reserved for the Board and matters that have been delegated to management. The Board, with the support of its committees, is responsible to the shareholders for the overall performance of the company including its strategic direction; establishing goals for management; and monitoring the achievement of those goals with a view to optimising company performance and increasing shareholder value.

Key functions of the Board include:

- overall strategy of the company, including operating, financing, dividends, and risk management
- appointing the Group Chief Executive Officer and setting an appropriate remuneration package
- appointing General Managers and setting appropriate remuneration packages
- appointing the Company Secretary and setting an appropriate remuneration package
- endorsing appropriate policy settings for management
- reviewing Board composition and performance
- reviewing the performance of management
- approving an annual strategic plan and an annual budget for the company and monitoring results on a regular basis
- ensuring that appropriate risk management systems are in place, and are operating to protect the company's financial position and assets
- ensuring that the company complies with the law and relevant regulations, and conforms with the highest standards of financial and ethical behaviour
- acquisition and disposal of material to the business
- establishing authority levels

- Directors' remuneration via the Remuneration & Nomination Committee
- selecting, with the assistance of the Audit, Risk and Compliance Committee, and recommending to shareholders, the appointment of external auditors
- approving financial statements.

A number of these responsibilities have been delegated by the Board to various committees. The committees and their responsibilities are detailed below under Board Committees.

The Board has delegated to management responsibility for:

- developing the annual operating and capital expenditure budgets for Board approval, and monitoring performance against these budgets
- developing and implementing strategies within the framework approved by the Board, and providing the Board with recommendations on key strategic issues
- appointing management below the level of General Manager and preparing and maintaining succession plans for these senior roles
- developing and maintaining effective risk management policies and procedures
- keeping the Board and the market fully informed of material developments.

b) Membership, expertise, size and composition of the Board

The Corporate Governance Principles affirm that the majority of the Board should be independent. As is typical of small financial markets generally in Papua New Guinea, there are very considerable demands on the relatively small numbers of people with the skills and experience to fill the demanding role of Non-executive Director on the Boards of the Nation's larger corporate institutions. In these circumstances, it is inevitable that a number of the Non-Executive Directors of BSP will also have roles on the Boards, or in Senior Management, of institutions that may be significant shareholders in, or substantial customers of, the Bank. Directors of BSP are meticulous in handling situations where there could potentially be conflicts of interest, by declaring their interests in advance, and absenting themselves from any consideration of matters where a conflict might arise. The Bank's Corporate Governance Principles require Directors to disclose any new Directorships and equity interests at each Board meeting.

The maximum number of Directors, as prescribed by the Constitution approved by shareholders, is ten. At the date of this report there are ten Directors, with nine Non-executives designated as independent, plus the Group Chief Executive Officer. Under the Constitution, at each annual general meeting one-third of the company's Directors, in addition to any Director appointed during the year, excluding the Group Chief Executive Officer, must offer themselves for re-election by the shareholders. Normally, Non-executive Directors are expected to serve a maximum of four three-year terms, dating from the AGM at which the newly elected Director is first confirmed by shareholders. This provision has effect from the date the Bank took its present form, following the merger of BSP with the Papua New Guinea Banking Corporation in April 2002. The Board will apply this provision with a degree of flexibility should it be necessary to ensure appropriate continuity, bearing in mind the particular circumstances of the Papua New Guinea market.[1]

The Board has a broad range of skills, experience and expertise that enables it to meet its objectives. Details of the Directors' business backgrounds and experience are provided on pages 10 and 11.

The Board accepts that it has a responsibility to shareholders to ensure that it maintains an appropriate mix of skills and experience (without gender bias) within its membership, and consequently gives careful consideration to setting criteria for new appointments it may recommend to shareholders in accordance with the company's Constitution. It has delegated the initial screening process involved to its Remuneration and Nomination Committee which, in accordance with its Charter, may seek independent advice on possible new candidates for Directorships. All Directors must be satisfied that the best candidate has been selected.

Nominees of the Board and/or shareholders must meet the 'fit and proper person' criteria established by the Bank of Papua New Guinea before they can take their

[1] For example, to avoid a situation where a number of Directors would otherwise be approaching retirement date at around the same time, or to recognise circumstances when suitably qualified candidates may not be immediately available.

place on the Board. The Board does not accept that any office bearer and/or employee of an institutional shareholder, by virtue only of his/her position within that organisation, have an automatic right to be appointed to the Board.

On joining the Board, new Directors will be provided with a comprehensive orientation programme.

c) Role and selection of the Chairman

The Chairman is elected by the Directors every two years and holds the position for a maximum of three terms. His role includes:

- ensuring all new Board members are fully aware of their duties and responsibilities
- providing effective leadership on the company's strategy
- presenting the views of the Board to the public
- ensuring the Board meets regularly throughout the year, and that minutes are taken and recorded accurately
- setting the agenda of meetings and maintaining proper conduct during meetings
- reviewing the performance of Non-executive Directors.

The Chairman is not permitted to occupy the role of Group Chief Executive Officer.

Kostas Constantinou, OBE, who sits on the Board as an independent Non-executive Director, is the current Chairman.

d) Director independence and Conflict of Interest

Directors are determined to be independent if they are judged to be free from any material or other business relationship with the Bank that would compromise their independence. Prior to appointment Directors designated, are required to provide information to the Board for it to assess their independence.

In assessing the independence of Directors, the Board will consider a number of criteria including:

- the Director is not an executive of the Bank
- the Director is not a substantial shareholder of the Bank or otherwise associated directly with a substantial shareholder of the Bank
- the Director has not within the last three years been a material consultant or a principal of a material professional adviser to the Bank or a group member, or an employee materially associated with the service provided
- the Director is not a material supplier to, or customer of the Bank or other group member, or a material consultant to the Bank or other group member, or an employee materially associated with the material supplier or customer
- the Director has no material contractual relationship with the Bank or other group member other than as a Director of the Bank
- the Director is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the Director's ability to act in the best interests of the Bank.

This information is assessed by the Board to determine whether on balance the relationship could, or could reasonably be perceived to, materially interfere with the exercise of the Director's responsibilities. Materiality is assessed on a case-by-case basis.

As noted earlier, the Board is cognisant of the need to avoid conflicts of interest and it has in place policies and procedures for the reporting of any matter, which may give rise to a conflict between the interests of a Director and those of the company. These arrangements are designed to ensure that the independence and integrity of the Board are maintained.

The Bank of Papua New Guinea sets prudential limits on loans to 'associated persons': Bank South Pacific fully complies with these requirements.

Financial Note 29, Related party transactions, on pages 98 - 101, provides details of Directors' interests.

e) Meetings of the Board and attendance

Scheduled meetings of the Board are held at least every two months, and the Board meets on other occasions as necessary to deal with matters requiring attention. Meetings of Board Committees are scheduled regularly during the year. The Board has a policy of rotating its meetings between locations where the company has a significant presence. On these occasions, the Board also visits company operations and meets with local management and key customers.

The Chairman, in consultation with the Group Chief Executive Officer, determines meeting agendas. Meetings provide regular opportunities for the Board to assess BSP management of financial, strategic and major risk areas. To help ensure that all Directors are able to contribute meaningfully, papers are provided to Board members one week in advance of the meeting. Broad ranging discussion on all agenda items is encouraged, with healthy debate seen as vital to the decision making process.

Financial Note 26, Directors' and Executive remuneration, on pages 94 - 96, provides attendance details of Directors at Board meetings during 2012.

Corporate Governance

f) Review of Board Performance

The Remuneration and Nomination Committee reviews the processes by which the Board regularly assesses its own performance in meeting its responsibilities. It is intended to extend the assessment of the Board as a whole to include an assessment of the contribution of each individual Director. The Board is cognisant of the need to continually identify areas for improvement; to ensure that it meets the highest standards of corporate governance; and for the Board and each Director to make an appropriate contribution to the company's objective of providing value to all its stakeholders. The performance review is conducted annually, and may involve assistance from external consultants.

g) Board Access to Information and Advice

All Directors have unrestricted access to company records and information and receive regular detailed financial and operational reports to enable them to carry out their duties. The General Managers make regular presentations to the Board on their areas of responsibility. The Chairman and the other Non-executive Directors have the opportunity to meet with the Group Chief Executive Officer and the General Managers for further consultation, and to discuss issues associated with the fulfilment of their roles as Directors.

The Board recognises that in certain circumstances individual Directors may need to seek independent professional advice, at the expense of the company, on matters arising in the course of their duties. Any advice so received is made available to other Directors. Any Director seeking such advice is required to give prior notice to the Chairman of his or her intention to seek independent professional advice.

2 Board Committees

a) Board Committees and Membership

The Board has established two committees whose functions and powers are governed by their respective charters. These committees are the Audit Risk and Compliance Committee, and the Remuneration and Nomination Committee.

Membership of the committees and a record of attendance at committee meetings during the year is detailed in table below. Remuneration details are provided in Financial Note 26 on page 94.

Membership of Board Committees as at 31 December 2012

	Board Audit Risk and Compliance Committee	Remuneration and Nomination Committee
John Jeffery	Chair 4/7	
Nagora Bogan	5/7	
Gerea Aopi	5/7	
Geoff Robb	4/7	
Arthur Sam	3/7	
Tom Fox		Chair 6/6
Lyle Procter		5/6
Ila Temu		6/6

b) Committee Charters

The Committee Charters are available in the shareholders information section of the BSP website www.bsp.com.pg

c) Committee Structure

Committee members are chosen for the skills, experience and other qualities they bring to the committee. At the next Board meeting following each committee meeting, the Board is given a report by the Chairman of the respective committee and minutes of the meeting are tabled.

The Audit Risk and Compliance Committee is comprised of three Non-executive Directors, a majority of whom should be independent, and who are duly appointed by the Board. The Chairman of the Audit Risk and Compliance Committee must be one of the independent Directors, other than the Chairman of the Board. Each member should be capable of making a valuable contribution to the committee and membership is reviewed annually by the BSP Board.

The Remuneration and Nomination Committee comprises three Non-executive Directors, the majority of whom should be independent, and who are duly appointed by the Board. The Chairman of the Remuneration and Nomination Committee must be one of the independent Directors, other than the Chairman of the Board. Each member should be capable of making a valuable contribution to the committee, and membership is reviewed annually by the BSP Board.

A review of the performance of committee members will form part of the Board's performance review.

d) Board Audit Risk and Compliance Committee

The Audit Risk and Compliance Committee is delegated by the Board with responsibility for reviewing and monitoring the:

- integrity of the financial statements and the financial reporting and audit process
- external auditor's qualifications, performance and independence
- performance of the internal audit function of the Bank
- performance of the operational risk function of the Bank
- systems of internal control and management of all risks
- systems for ensuring operational efficiency and cost control
- systems for approval and monitoring of expenditure including capital expenditure
- processes for monitoring compliance with laws and regulations (both in Papua New Guinea and overseas)
- implementation of Board decisions by management and making recommendations to the Board for the appointment of the external auditor
- annual internal audit plan and its ongoing review.

In the course of fulfilling its mandate, the committee meets with both the internal and external auditors without management present.

i. Annual Financial Statements

The Audit Risk and Compliance Committee reviews the annual financial statements to determine whether they are complete and consistent with the information known to committee members and to assess whether the financial statements reflect appropriate accounting principles. In particular it:

- pays attention to complex and/or unusual transactions
- focuses on judgmental areas, for example those involving valuation of assets and liabilities, provisions, litigation reserves, and other commitments and contingencies
- meets with management and the external auditors to review the financial statements and the results of the audit
- reviews the other sections of the Annual Report before its release and considers whether the information is understandable and consistent with members' knowledge about the Bank and its operations
- satisfies itself as to the accuracy of the financial accounts, reconciles them with management accounts presented to the committee, and signs off on the financial accounts of the Bank before they are submitted to the Board.

ii. External Audit

The Audit Risk and Compliance Committee is responsible for making recommendations to the Board on appointment and terms of engagement of BSP external auditors. The selection is made from appropriately qualified companies in accordance with Board policy. The Board submits the name of the recommended appointee to shareholders for ratification. In line with the policy of the Bank of Papua New Guinea, the signing partner in the external audit firm must be rotated at least every three years.

The committee reviews annually the performance of the external auditors and makes recommendations to the Board regarding the continuation or otherwise of their appointment, consistent with the Bank of Papua New Guinea's Prudential Standard No. 7/2005— External Auditors, while ensuring their independence is in line with Board policy.

There is a review of the external auditor's proposed audit scope and approach, to ensure there are no unjustified restrictions. Meetings are held separately with the external auditors to discuss any matters that the committee or the external auditors believe should be discussed privately. The external auditor attends meetings of the Audit Risk and Compliance Committee at which the external audit and half yearly review are agenda items.

The committee ensures that significant findings and recommendations made by the external auditors are received and discussed promptly, and that management responds to recommendations by the external auditors in a timely manner.

The duly appointed external audit firm may not be engaged by the company to provide specialist consultancy services relating to financial, strategic and/or taxation matters.

The external auditor is invited to the Annual General Meeting of shareholders and is available to answer relevant questions from shareholders.

The Bank of Papua New Guinea Prudential Standards provide for a tri-partite meeting BPNG, the external auditors, and the Bank, if required.

iii. Internal Audit

The Audit Risk and Compliance Committee approves, on the recommendation of management, the appointment of Head of Internal Audit. The committee meets regularly with Head of Internal Audit.

Reviews are undertaken of the scope of the work of the internal audit function to ensure no unjustified restrictions or limitations have been placed upon Audit and Risk Departments. The Audit Risk and Compliance Committee also reviews the qualifications of internal audit personnel and endorses the appointment, replacement, reassignment or dismissal of the internal auditors.

An independent review by an expert consultant is made regularly as to the effectiveness of the internal audit and risk function. These reports are presented to the Board Audit Risk and Compliance Committee, and the Board. The Audit Risk and Compliance Committee meets separately with the internal auditors to discuss any matters that the committee, or the internal auditors, believe should be discussed privately. The Internal Auditor has direct access to the Audit Risk and Compliance Committee and to the full Board. The committee ensures that significant findings and recommendations made by the internal auditors are received and discussed promptly, and that management responds to recommendations by the internal auditors on a timely basis.

Internal Audit meets with the external auditors half yearly, to review the scope and findings of internal audit's annual audit plan, and the extent of the external audit plan, having regard to internal audit's findings.

iv. Compliance

The Audit Risk and Compliance Committee reviews the effectiveness of the systems for monitoring compliance with all legal and regulatory obligations and the Constitution of the Bank. It also reviews the results of management's investigation and follow-up (including disciplinary action) of any fraudulent acts, or non-compliance.

The committee obtains regular updates from management and the Bank's legal officers regarding compliance matters, and satisfies itself that all regulatory compliance matters have been considered in the preparation of the financial statements.

Reviews of the findings of any examinations by regulatory agencies are undertaken and the Chairman of the Board Audit Risk and Compliance Committee has the right to approach a regulator directly in the event of a prudential issue arising.

v. Risk Management

The committee's role in the Bank's risk management processes are detailed in 3(b).

e) Board Remuneration and Nomination Committee

The Remuneration and Nomination Committee has been established to assist the Board in fulfilling its oversight responsibilities in respect of Board and Senior Executive Management selection, appointment, review and remuneration.

The responsibilities of the Remuneration and Nomination Committee are:

- oversee the selection and appointment of a Group Chief Executive Officer and recommend an appropriate remuneration and benefits package to the full Board
- determine and review appropriate remuneration and benefits of Directors for recommendation to the full Board, and subsequently to the shareholders
- identify and maintain a clear succession plan for the Executive Management Team, ensuring an appropriate mix of skills and experience as well as appropriate remuneration and benefits packages are in place and reviewed regularly
- ensure that the Board itself maintains an appropriate mix of skills and experience necessary to fulfil its responsibilities to shareholders while maintaining a world class Corporate Governance regime
- receive and endorse positions/titles recommended by the Group Chief Executive Officer from time to time as applying to designated Senior Executive Management positions
- review the procedures in place to ensure that all new Senior Executive appointees are adequately qualified and experienced, and that proper recruitment procedures are followed
- review and make recommendations to the Board on the appointment and terms and conditions of employment to all Senior Executive Management positions

- review and approve all termination arrangements for such Senior Executives
- review transactions between the company and any of the Directors or relevant Senior Executives
- review and make recommendations to the Board on employee remuneration and benefits policies and practices generally
- engage external consultants as and when deemed appropriate to benchmark remuneration packages for Executives and Senior Management
- review Board performance, tenure, and succession planning.

The Board has in place a review process, led by the Chairman, that involves a peer review of performance based on a broad range of criteria. A performance review was performed in 2010 and early 2011.

3 Risk Management

a) Approach to Risk Management

The Bank's Risk Management activities are aligned to the achievement of the Bank's Objectives, Goals and Strategy. The Board, in consultation with the Executive Committee, determines the Bank's risk appetite and risk tolerance. These benchmarks are used in the risk identification, analysis and risk evaluation processes.

BSP distinguishes the following major risks:

Credit Risk— The potential for financial loss where a customer or counter party fails to meet their financial obligation to the Bank.

Market Risk— The potential financial loss arising from the Bank's activities in financial, including foreign exchange, markets. More detailed commentary on financial risk management is provided in the Notes to the Financial Accounts.

Liquidity Risk— The risk of failure to adequately meet cash demand in the short term without incurring financial losses.

Interest Risk— Risk to earnings from movement in interest rates.

Operational Risk— The risk of loss resulting from inadequate or failed internal processes, people, or from external events, including legal and compliance risk.

The Bank's Asset & Liability Committee monitors market risk, interest risk, and liquidity risk, and the Credit Committee monitors credit risk. Operational risk is monitored by the Operational Risk Committee, including the maintenance of a risk register system that has been implemented across the Bank. The Executive Committee and the Board overview the highest tier of risks within these risk registers.

The Bank's risk management policy ensures that the Bank has in place acceptable limits for the risks identified by the Bank's employees. The risk management approach encompasses the following:

- defining the types of risks that will be addressed by each functional or policy area (i.e., credit risk, interest rate risk, liquidity risk, operational risk, etc.)
- ensuring that mechanisms for managing (identifying, measuring, and controlling) risk are implemented and maintained to provide for organisation-wide risk management
- developing information systems to provide early warning, or immediate alert, of events or situations that may occur, or already exist, that could create one or more types of risk for the Bank
- creating and maintaining risk management tools, including those requested by the Board, such as policies, procedures, risk registers, controls and independent testing, personnel management and training, and planning
- instituting and reviewing risk measurement techniques that Directors and management may use to establish the Bank's risk tolerance, risk identification approaches, risk supervision or controls, and risk monitoring processes
- developing processes for those areas that represent potential risks
- establishing appropriate management reporting systems regarding these risks so individual managers are provided with a sufficient level of detail to adequately manage and control the Bank's risk exposures.

b) Risk Management Roles and Responsibilities

The Board accepts responsibility for ensuring it has a clear understanding of the types of risks inherent in the Bank's activities. Therefore, responsibility for overall risk management in BSP is vested with the Board. However, every employee from Executive Management to the newest recruit has a responsibility and a part to play in the process.

There is a formal system of financial and operational delegations from the Board to the Group Chief Executive Officer, and from the Group Chief Executive Officer to the General Managers. These delegations reflect the Bank's risk appetite, and are cascaded down to managers who have skills and experience to exercise them judiciously.

The Board defines the accountabilities (including delegated approval/control authorities/limits) and reporting/monitoring requirements for the risk management process. The severity of risks identified in the risk identification, analysis and evaluation processes, and noted in the Strategic Business Unit Risk Registers, is used to determine the approval/control authorities/limits. The Board reviews these risk limits annually along with an annual review of the Bank's significant risks.

The Board has adopted guidelines, with the help of management analysis, covering the maximum loss exposure the Bank is able and willing to assume. These guidelines are detailed in the Bank's Risk Policy and Procedures Manual which has been externally reviewed and approved by the Board.

The Board has also delegated to the Audit Risk and Compliance Committee responsibility for overview of loss control and for overseeing the risk management function.

The Board Audit Risk and Compliance Committee is responsible for providing regular reports and recommendations to the Board on the risk management activities of the Bank, especially relating to risk issues that are outside of the authority of the Bank's Executive Committee to approve.

The Bank's Executive Committee is responsible for deliberating on risk management issues which are outside of the delegated authorities/ limits of the Credit Committee, Asset and Liability Committee (ALCO) and General Managers, with escalation of these issues to the Audit Risk and Compliance Committee, and the Board itself, in case of need.

c) Management Assurance

The Board is provided with regular reports about BSP financial condition and its operating performance. Annually, the Group Chief Executive Officer and the Chief Financial Officer certify to the Board that:

- the financial records of the Bank have been properly maintained and that they accurately record the true financial position of the company
- the financial statements and notes meet all appropriate accounting standards
- there are sound systems of risk management and control that are operating effectively.

Additionally all General Managers provide bi-annual statements attesting that:

- they have assessed and documented the risks and internal control procedures in their Strategic Business Unit
- they have identified any changes in business, operations and computer systems and the risks that may arise from those changes
- the risk management and internal compliance and control systems are appropriate and operating efficiently and effectively
- any weaknesses in the risk management and internal compliance and control systems have been identified and remedial action taken.

4 Ethical Behaviour

BSP acknowledges the need for Directors and employees at all levels to observe the highest standards of ethical behaviour when undertaking company business. To this end, the Board has adopted:

- a Code of Conduct for both Directors and members of the Executive Management team of the company and stipulated that each Director, and relevant employees, acknowledge in writing having read, understood and agreed to abide by the Code
- a Corporate Mission, Objectives, and Core Values Statement which establishes principles to guide all employees in the day to day performance of their individual functions within the company.

To ensure the maintenance of high standards of corporate behaviour on an ongoing basis, the Board further stipulates that senior management periodically undertake an appropriate communication programme to reinforce both the Code and Core Values Statements. All Directors are encouraged to maintain membership of an appropriate Directors' Association to keep abreast of current trends in Directors' duties, responsibilities and corporate governance issues.

BSP is committed to a culture in which it is safe and acceptable for employees, customers and suppliers to raise concerns about poor or unacceptable practices, irregularities, corruption, fraud and misconduct.

Corporate Governance

The Bank has adopted a whistle-blowing policy that is designed to support and encourage staff to report in good faith matters such as:

- unacceptable practices
- irregularities or conduct which is an offence or a breach of laws of Papua New Guinea (actions and decisions against the laws of Papua New Guinea including non-compliance)
- corruption
- fraud
- misrepresentation of facts
- decisions made and actions taken outside established BSP policies & procedures
- sexual harassment
- abuse of Delegated Authorities
- misuse of company assets
- disclosures related to miscarriages of justice
- health and safety risks, including risks to the public as well as other employees
- damage to the environment
- other unethical conduct
- failure to comply with appropriate professional standards
- abuse of power, or use of the Bank's powers and authority for any unauthorised purpose or personal gain
- breach of statutory codes of practice.

Directors and management of the company are subject to Securities Act 1997 restrictions for buying, selling or subscribing for securities in the company if they are in possession of inside information, i.e. information which is not generally available and, if it were generally available, a reasonable person would expect to have a material effect on the price or value of the securities of the company.

Further, Directors and management may only trade in the securities of the company, subject to the foregoing insider trading restrictions, during each of the eight weeks following the announcements of half yearly profit and yearly profit or the date of issue of a prospectus. Management should discuss proposed share trades with the Group Chief Executive Officer in advance, who in turn will keep the Chairman of the Board appraised of management activities. Directors should discuss proposed share trades with the Chairman in advance.

In addition, Directors and management must not trade in any other entity if inside information on such entity comes to the attention of the Director or management by virtue of holding office as an Officer of the Bank.

5 Market Disclosure

The Bank's continuous disclosure regime is fundamental to the rights of shareholders to receive information concerning their securities. The most important aspect of the Bank's shareholder communication policy is to comply with the continuous disclosure regime and to implement best practice disclosure policy.

Market announcements are posted to BSP's website immediately after release to the market. All market announcements made by the Bank since its listing in August 2003 are currently available on the website.

Where BSP provides financial results briefings to analysts or media, these briefings are published on the website as soon as possible after the event. In any event, no material information which has not been previously released to the market is covered in such briefings. The material upon which the briefing is based (such as slides or presentations) is released to the market prior to the briefing.

The Bank's insider trading rules are important adjuncts to the continuous disclosure regime in ensuring that shareholders are given fair access to material information regarding securities. BSP seeks to limit the opportunity for insider trading in its own securities through its continuous disclosure policies and the dealing rules applying to its employees and Directors.

6 Shareholder Communications

BSP Code of Conduct requires its employees to act with high standards of honesty, integrity, fairness and equity in all aspects of their employment with the Bank.

With this in mind, BSP commits to dealing fairly, transparently and openly with both current and prospective shareholders using available channels and technologies to communicate widely and promptly. The Bank commits to facilitating participation in shareholder meetings, and dealing promptly with shareholder enquiries.

Our shareholder communication policy is built around compliance with disclosure obligations and aspiring to be at the forefront of best practice in disclosure. Our framework for communicating with shareholders is to concisely and accurately communicate:

- our strategy
- how we implement that strategy
- the financial results consequent upon our strategy and its implementation.

The Bank uses shareholder forums such as the Annual General Meeting, and group meetings with larger shareholders, within disclosure policies, to communicate financial performance and strategies.

7 Remuneration

BSP remuneration policy for senior management is comprised of a fixed component and an at risk component that is a combination of short term rewards and long term incentives. The remuneration packages of General Managers and the Group Chief Executive Officer are approved by the Remuneration and Nomination Committee, and details are provided by the committee to the Board.

Fixed remuneration of senior management is reviewed at the time of contract renewal taking into account the nature of the role, the pay position relative to comparable market pay levels, and individual and business performance.

The 'at risk' component of the remuneration package is a performance based Executive Management Share Option Plan (EMSOP). This plan is structured to provide senior management with the incentive to deliver sustained growth in value for shareholders. Performance hurdles are incorporated in the EMSOP and senior staff are selected to participate based on their annual performance, potential, and the business need to retain critical skills.

Further information about the EMSOP is provided in Note 22 to the Annual Accounts on pages 88 - 90. Under PNG tax law individuals who participate in the EMSOP are responsible for any related taxation liabilities.

Non-executive Directors are remunerated on a fixed basis within an aggregate Directors' fee pool approved periodically by shareholders. The shareholders last approved a pool of K1.5 million in December 2011. During 2012 K1.4 million of the pool was utilised (2011: K1.00 million).

A table of fees paid to Directors during 2012 is produced on page 94. Non-executive Directors are not paid any retirement or superannuation benefits, nor do they participate in any share option programmes.

"Photo of the Year 2011" Award was given to Cricket PNG for a promotional shot taken by Australian Photographer Mark Dadswell of a young boy participating in the BSP School Kriket Programme in Central Province.

Historical Summary 2012

Profit and Loss (K'000)	2007	2008	2009	2010	2011	2012
Net interest income	276,872	377,100	473,969	544,002	597,479	681,554
Non interest income	202,510	243,828	251,743	410,973	584,867	671,870
Bad and doubtful debt (expense)/recovery	4,345	(11,353)	(15,020)	(20,581)	(25,234)	(70,952)
Other operating expenses	(188,871)	(229,599)	(335,146)	(522,827)	(688,621)	(748,346)
Operating profit	294,856	379,976	375,546	411,566	468,490	534,126
Impairment of non-current asset	(10,373)[2]	(50,000)	2,37 2	-	-	-
Share of profit from associates	-	-	-	-	6,496	11,170
Profit before tax	283,571	328,798	378,143	410,804	474,986	545,296
Income tax (expense)	(92,499)	(100,464)	(121,025)	(127,657)	(119,039)	(137,552)
Profit/(loss) after tax	191,072	228,334	257,118	283,147	355,947	407,744
Dividends (toea)						
Dividends paid per share[3]	1.60	2.20	2.20	5.37	47.3	55.0
Balance Sheet (K'000)						
Net loans and advances	1,550,271	2,343,844	3,638,562	4,091,297	4,300,913	4,804,626
Total assets	5,819,549	6,807,868	9,397,821	10,027,290	11,681,293	13,333,102
Deposits	5,055,917	5,782,020	7,493,779	7,984,657	9,366,281	10,860,522
Capital	571,700	744,254	934,097	1,134,397	1,344,188	1,465,893
Performance Ratios						
Return on assets	3.8%	3.6%	3.2%	2.9%	3.3%	3.3%
Return on equity	39.5%	34.7%	30.6%	27.4%	28.7%	29.0%
Expense/Income	39.4%	45.0%	46.0%	54.7%	58.2%	55.3%
Key Prudential Ratios						
Capital adequacy	29.0%	22.8%	22.1%	23.6%	24.2%	22.3%
Liquid asset ratio	50.3%	47.5%	50.1%	43.0%	43.6%	38.9%
Leverage ratio	9.2%	10.4%	9.1%	10.5%	10.0%	9.0%
Exchange rates (One (1) PNG Kina buys):						
US dollar	0.3525	0.3735	0.3700	0.3785	0.4665	0.4755
AUS dollar	0.3999	0.5396	0.4127	0.3724	0.4591	0.4580

(Source – Bank of Papua New Guinea Quarterly Economic Bulletin)

[2] Impairment of remaining goodwill in respect of acquisitions of Capital Stockbrokers Ltd (2005), Habib Bank Ltd - Fiji Branch (2006) and National Bank of Solomon Islands (2007).

[3] Dividends per share has been adjusted for 1/10 share split 2008. In 2010, BSP paid a full and final dividend for the 2009 year in July, and an interim dividend for 2010 year, in November. Dividends per share has been adjusted for 10/1 share consolidation 2011. In 2011, BSP paid a full and final dividend for the 2010 year in June, and an interim dividend for 2011 year, in October. In 2012, BSP paid a final dividend for the 2011 year in June, and an interim divdend for 2012 year in October

Contributions By BSP To PNG

All amounts are expressed in K'000	2008	2009	2010	2011	2012
Company income taxes paid to PNG Government	100,829	101,372	213,771	119,590	212,080
Other taxes paid to PNG Government (IWT, FCWT,BWT)	4,833	11,169	9,780	10,091	6,204
Dividends paid	100,305	182,373	149,845	231,368	93,970*
Payments to PNG based suppliers/creditors	72,282	171,761	153,200	240,402	489,754
Payments to PNG training institutions	3,207	1,858	2,908	2,133	8,471
Superannuation payments	3,623	3,599	4,336	5,176	8,187
Salaries paid in PNG	38,491	42,982	53,751	65,518	88,527
Commercial rental payments	3,416	6,532	15,038	21,094	19,565
Residential rental payments	2,756	2,612	2,745	10,396	33,609
Water	172	178	169	144	90
Power	4,633	5,319	5,067	5,544	11,489
Telecommunication	8,025	8,006	8,986	8,507	14,809
Total	**342,572**	**537,761**	**619,596**	**719,963**	**986,755**

*Interim Dividend

Overseas Branches and Subsidiaries

Summary Financial Information
All amounts are expressed in K'000

	Total Asset	Total Liabilities	Turnover	Net Profit After Tax
Solomon Islands	410,144	342,865	11,630	8,688
Fiji Branches	1,388,054	1,271,623	82,450	4,142
BSP Life	538,018	435,246	144,824	12,082
Niue	2,583	1,898	178	(203)
BSP Capital	20,038	14,454	2,407	(3,908)
BSP Convertible Notes	18,677	19,516	28	(18)

Overseas Branches

2012 Highlights

Fiji

Economic Conditions

Major flooding in the Western Division in January and March caused widespread destruction and damage to agricultural production. This was followed by Cyclone Evan in December. Cyclone Evan was a category four cyclone which caused damage to the Northern and Western divisions, including the key cities of Nadi and Lautoka.

Despite these natural disasters, economic growth for 2012 is expected to be in the vicinity of 2 percent. Sugar Cane production declined by 22 percent, but due to better mill efficiency and higher cane quality, sugar production only declined by 3 percent. Tourism looks like it will record a flat performance in 2012, but this is still well up on 2010.

Inflation has reduced from nearly 9 percent at the end of 2011 to 2.1 percent. Foreign reserves remain strong at F$1.6 billion and 5.2 months import cover.

Monetary conditions remained challenging with system liquidity consistently over F$500 million with little opportunity for investment of these surplus funds. Credit growth improved to just under 6 percent. This was led by an increase in consumption lending and also an increase in lending for investment purposes. The full implementation of investment projects remains a challenge for the country.

It is expected that as the Government continues on the road to democratic elections in 2014, there will be a continued improvement in investment activities and economic growth.

2012 Achievements

Financial results for 2012 showed a net profit after tax of $3.5 million compared to the 2011 result of $0.7m. This is an increase of 500 percent.

This result reflects the realisation of returns on our investment in electronic banking facilities and also the strong growth in our Corporate Banking portfolio as we move towards achieving a critical mass of business lending. The Corporate portfolio increased by over 40 percent in a market that was very competitive. This competition has resulted in decreased margins across the market. We also saw strong growth in our unsecured personal loan product after its underwriting guidelines were adjusted to better suit the Fiji market. This growth has been achieved alongside a strong improvement in portfolio quality. Non-accrual, problem loans and delinquencies have reduced across the board.

Our investment in electronic banking channels is seeing strong revenues from our fleet of 102 ATMs. We are also achieving excellent returns on the SMS banking channel, which still remains a unique product in the Fiji market. We continue to roll out our Point of Pay EFTPoS terminals with just under 1,000 terminals now in the market place. We continue to look at innovative technologies to provide the best possible EFTPoS services. We have seen an increased take up of our Personal Internet Banking product and now have our innovative Business Internet Banking product in trial with a select group of business clients.

We have continued to invest in our branch network. In July, we opened our new expanded Suva Central branch which also included a Premium Service Centre and a BSP First Centre. The opening of our BSP First introduces the very successful initiative from PNG and is receiving strong attention. It is planned to expand this concept to include centres in Nadi and Lautoka. We also refurbished our Thompson Street, Suva branch and our Nausori branch.

On the personnel front, we introduced a new aptitude test which included testing for emotional intelligence. This is seeing a new cadre of recruits with great customer service attitudes. We continue to invest in training to ensure we can provide high levels of service.

Overseas Branches and Subsidiaries

2013 Initiatives and Challenges

Our major challenge in 2013 will be to continue to achieve growth in an increasingly competitive marketplace.

The opening of Bred Bank in November has intensified competition. Their pursuit of market share at the expense of reasonable profit margins will challenge the market. The Reserve Bank of Fiji has also announced the awarding of a provisional banking license to Home Finance Corporation. This will bring the number of licensed commercial banks in Fiji to six, which is very high by Pacific standards.

Another challenge in Fiji is the lack of any consultation when making legislative or policy changes that directly affect the banking industry. This impacts on our ability to operate in a predictable market.

We are embarking on an upgrade of our BaNCS core banking system. This is a major opportunity for the Fiji business to automate and simplify processes. Many resources during 2013 and 2014 will be dedicated to the successful completion of this project.

Solomon Islands

The 2012 financial result for the Solomon Islands saw a strong above-budget performance resulting from good growth in our lending portfolio, whilst at the same time containing costs. The growth in loan balances of 16.1 percent was especially pleasing considering the Solomon's market remained extremely liquid and competitive throughout 2012, thereby placing pressure on lending margins.

Along with growing the lending portfolio, there was focus on improving our arrears position which saw delinquent loans as percentage of the total portfolio decline from 8.39 percent in December 2011 to 3.30 percent in December 2012. This is a pleasing result and our efforts to further reduce this will continue in 2013.

Electronic service delivery channels remained an emphasis and saw an increase of 24.5 percent in transactional activity for the year. BSP Solomon Islands continues to have the largest ATM network of 18 machines throughout Honiara and provincial areas and is clearly the market leader. Internet banking also continued to see an increase in users with many clients commenting favourably on the service.

Fiji Bank Management

Front row (L-R): Haroon Ali (Chief Risk Officer), Kevin McCarthy (Country Manager), Howard Politini (GM Microfinance, Government & Community Relations)

Back row (L-R): William Wakeham (Chief Operating Officer), Cecil Browne (General Manager Corporate & International), Lew Kenah (General Manager Retail Banking), Alvina Ali (General Manager Legal), Ravindra Singh (General Manager Human Resource), Omid Saberi (Chief Information Officer), Ronesh Dayal (Chief Financial Officer)

The Solomon Islands Team

Sitting (L-R): Rose Murray (Manager Commercial Banking) Mark Corcoran (Country Manager) Lynnette Taoti (Manager Credit Administration)

Middle row (L-R): Tupou Halofaki (Manager Retail Banking Services) Janet Marau (Manager Retail Banking Operations) Vincent Misi (Financial Controller), Joan Ramo (Manager International Operations)

Back row (L-R): Rob Bochman (Relationship Manager) Alphonse Taoti (Acting Manager Special Projects) Peter Lemon (Manager Operations & Corporate Services) Winterford Maehau (Acting Manager Information Services)

Life Management Team

Front row: Malakai Naiyaga (Managing Director BSP Life)

Back row (L-R): Michael Nacola (General Manager Distribution & Marketing) Glenis Yee (General Manager Legal) Munendra Naidu (Chief Financial Officer) Pramesh Sharma, (General Manager Investments)

Overseas Branches and Subsidiaries

March 2012 saw the launch of our BSP First Lounge for our high valued clients. Many positive and encouraging comments have been made about the personal attention and the performance of our BSP First staff.

Various training programs completed during 2012 resulted in a 25 percent increase in total training hours compared to 2011. Programs were directed to BSPSI staff at all levels and included:

- Microsoft Excel (all staff levels)
- Team Leadership for Change Management (Supervisory & Management)
- Leadership Effectiveness and Advancement Program (Senior Management)
- Customer Sales and Services (frontline staff)
- Operational Risk and Anti Money Laundering (Risk Management staff)
- Advanced Forensic Accounting and Fraud Investigation (Risk Management and Operations staff)
- EB technical support for our ATM network (Electronic Banking staff)
- Numerous BSPSI in-house procedural programs facilitated by our own local training officer

Our achievements in increasing the development opportunities for our staff throughout 2012 was strongly supported by BSP's global training resources.

2013 Strategic Focus

Software development necessary for the introduction of mobile banking commenced late 2012 mirroring the very successful suite of products available in PNG. This is an exciting opportunity and will enable BSP Solomon Islands to bring banking facilities to the remote rural communities which currently do not have access to banking services. Another focus for 2013 will be to continue our efforts to migrate simple transactions to electronic banking channels. Growing our EFTPoS network will be a key component of this.

Following the completion of process mapping project, 2013 will see the project moving to the implementation stage. This will entail extensive training but the outcome will be a uniformity of process across our network, reducing risk and driving efficiencies.

BSP Capital Limited

2012, like 2011, continued to present its challenges not only for BSP Capital but the PNG economy as a whole. We saw the unfolding of GFC 2 with problems in the US combined with the Greek and Southern European economies' financial woes. Locally, the official inflation rate eased to 4.1 percent for calendar year 2012. In the fixed interest market, yields remained depressed throughout the year, resulting from a high level of liquidity in the financial system coupled with limited debt investment opportunities.

2012 could be best described as a consolidation year for BSP Capital. Major milestones can be segmented into the three principal areas of BSP Capital's operations:

- Share broking and Corporate advisory
- Funds Management
- Port Moresby Stock Exchange (POMSoX).

Sharebroking and Corporate Advisory

- BSP Capital continues to dominate the local market, accounting on average 80 percent or more of all transactions put through POMSoX.
- Through our Corporate Research, we now have six Global Funds seeking locally listed stocks for portfolio investments. The activity from this Group is expected to increase in 2013 with the expected provision of share price indices by POMSoX.
- A number of large PNG projects to which BSP Capital is the corporate advisor, are now at an advanced stage of development.

Funds Management

- Wholesale Funds under Management, despite the market downturn in 2012, increased by 9 percent, with Nambawan Super being the most notable addition to BSP Capital's Funds base.
- Our Retail Funds Management base increased substantially in calendar 2012, growing 110 percent.
- Despite low fixed interest yields and a lacklustre

equities market in 2011 and 2012, BSP Capital's largest client outperformed the benchmark set by 3 percent for calendar year 2011. Performance results for 2012 are being processed, where we expect a similar trend to that of 2011.

- We continue to seek to develop strategic alliances with offshore groups who have the expertise we need to assist with developing key initiatives such as the promotion of an active secondary fixed interest market.

Port Moresby Stock Exchange

BSP Capital has a 62.5 percent shareholding in POMSoX. Market capitalization of all PNG listed stocks as at 31 December 2012 fell during the year from K85.3 billion to K67.3 billion, on the back of the global market downturn.

Major initiatives taken in 2012 include:

- The appointment of an additional Independent Director. This appointment adds experience to the Board as this Director has worked for many years in the financial services industry in Australia and comes with a wealth of experience in all facets of stock exchange operations.
- The development of market indices for its local and dual-listed companies which it will publish on a daily basis. This is an essential tool required by Global Funds in determining country and sector portfolio allocations. These indices should be available by end of March 2013.
- During 2013, POMSoX will undertake a major upgrade of its current trading platform to ensure listed entities and sharebrokers have access to a world class trading engine.
- Investigate the possibility of introducing an electronic settlement and registration system, similar to CHESS as used by ASX in Australia.
- Education and investor awareness programs continue to be high on the active list for 2013.

Our strategic market focus for 2013 and onwards is to promote active secondary markets, particularly in the area of fixed interest securities, thereby freeing up funds which can be used for alternate investment opportunities rather than being held to maturity, as is the case currently. Similarly, by providing analytical tools for global fund managers interested in PNG, the ability to invest directly into locally listed companies is made much easier, facilitating greater local market investment activity.

BSP Life Limited

Overview

The full year 2012 results provide both financial and strategic actions that were very pleasing. Our strong financial performances from 2011 in both our Life and Health businesses continued into 2012 with actual profit results exceeding targets. Significant progress was also achieved in our key strategic initiatives.

2012 saw the continuation of major initiatives implemented since 2011:

- We completed the re-branding exercise with focus on positioning our BSP Life brand as distinct from the Bank. Our new brand has been well received by the market.
- We completed our business split from the Bank with the final exercise involving the areas of IT and lending.
- We set future strategies for our health business.
- We are at the final stages of core system assessment for selection in early 2013.
- We further improved performance of our investment subsidiaries through stronger performance oversight.

We had strong growth in new business which, together with increased focus on conservation, saw the Life in-force portfolio increasing by $2.9 million compared to $0.8 million in 2011. On the Health side, significant progress was made in the acquisition of large groups which increased the in-force portfolio by $2.0m compared to $0.4m in 2011. This growth is largely attributed to strengthening of Health broker sales relations and a more innovative approach was adopted in Health product offerings to large schemes.

Financial Performance

The Insurance Group NPAT for 2012 was $10.1 million; $5.1 million above budget. After adjustment for non-operating and one-off items, NPAT is $7.3 million; $3.5 million above budget. The Life business NPAT was $10.8 million against a budget of $6.3 million while the Health business showed a loss of $0.7 million against a budget loss of $1.3 million. Life insurance sales grew by 15 percent and Health insurance sales grew by 50 percent resulting in an overall insurance new business growth of 23 percent.

Investment performance, particularly with our private equities, was excellent contributing to high investment income overall.

Insurance Market

The life insurance market is dominated by endowment products. There are two major players. BSP Life market share on in-force annual premium basis (excluding single premiums) was at 60 percent at the end of 2011. Competition remains strong from our Life competitor which has been successful in the sale of a single

Overseas Branches and Subsidiaries

premium product. Focus in 2013 will be on the roll-out of a few product initiatives which should place us on par with the competitor on product innovation.

Health insurance also remains very competitive with four active competitors. BSP Health market share on premium income was 33 percent at the end of 2011. The market is saturated but we are making excellent progress in increasing our share which should further improve in 2012.

Strategic Initiatives

In 2013, BSP Life will build on the strong results achieved in 2012. Strategic initiatives underway include:

- Maintaining the current aggressive growth stance on both Life and Health new business through product innovation and ongoing channel development with focus on business quality and business retention.
- Finalisation of selection and commencement of imp-lementation of our new core life and health insurance systems which should take 18 months to complete. The system change will require an effective change management approach on our people resources.
- Continued focus on process transformation and the development of skills and expertise within the insurance business ensuring that appropriately skilled staff work in critical areas.
- Close management of the Health Company to ensure that profitability is sustained.
- Proactive approach to investment management. Int-erest rates will remain at low levels. We will continue to pursue growth assets opportunities while max-imising returns from our current private equity investments.

BSP'S 'Sport for Life' School Sports Programme

Directors' Report

Ian B Clyne
Group Chief Executive
Officer/Director

Kostas Constantinou, OBE
Chairman

for the Year Ended 31 December 2012

The Directors take pleasure in presenting the Financial Statements of Bank of South Pacific Limited and its subsidiaries (Bank and the Group) for the year ended 31 December 2012. In order to comply with the provision of the Companies Act 1997, the Directors Report as follows:

Principal activities

The principal activity of the Bank of South Pacific Limited (BSP) is the provision of commercial banking and finance services. The Group's activities include the provision of commercial banking and finance services, stock broking and fund management and life business services throughout Papua New Guinea and the Pacific region. BSP is a bank listed on the Port Moresby Stock Exchange (POMSoX), incorporated under the Companies Act of Papua New Guinea, and is an authorised bank under the Banks and Financial Institutions Act of Papua New Guinea. The Bank and the Group are licensed to operate in the Solomon Islands, Fiji Islands and Niue. The registered office is at Douglas Street, Port Moresby.

Review of operation

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

Dividends

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

Directors and officers

The following were Directors of the Bank of South Pacific Limited during the year ended 31 December 2012:

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

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

The Company secretary is Mary Johns.

Independent Audit Report

The financial statements have been audited and should be read in conjunction with the independent audit report on page 115. Details of amounts paid to the auditors for audit and other services are shown in Note 5 of the Notes to the Financial Statements.

Donations & Sponsorships

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

Interests Register

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

Change in accounting policies

No change in accounting policies occurred during the year.

For, and on behalf of, the Directors.

Dated and signed in accordance with a resolution of the Directors in Port Moresby this 20th day of March 2013.

Kostas Constantinou, OBE
Chairman

Ian B Clyne
Group Chief Executive Officer/Director

Statement By The Directors

for the Year Ended 31 December 2012

The Directors declare that:

a) in the Directors' opinion, there are reasonable grounds to believe that the Bank and the Group will be able to pay their debts as and when they become due and payable; and

b) in the Directors' opinion, the attached financial statements and notes thereto are in accordance with the PNG Companies Act 1997, including compliance with accounting standards and give a true and fair view of the financial position and performance of the Bank and the Group.

Additional Statutory Information

The results of the Bank and the Group's operations during the financial year have, in the opinion of the Directors, not been materially affected by items of an abnormal nature, other than those disclosed in the financial statements.

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

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

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

Dated and signed in accordance with a resolution of the Directors at Port Moresby this 20th day of March 2013.

Kostas Constantinou, OBE
Chairman

Ian B Clyne
Group Chief Executive Officer/Director

Statement Of Comprehensive Income

for the Year Ended 31 December 2012

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

The attached notes form an integral part of these financial statements

Statement Of Financial Position

for the Year Ended 31 December 2012

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

The attached notes form an integral part of these financial statements

Statement Of Changes In Shareholders' Equity

for the Year Ended 31 December 2012

Bank **All amounts are expressed in K'000**	**Note**	**Share capital**	**Assigned capital**	**Reserves**	**Retained Earnings/ (Accumulated losses)**	**Total**
Balance at 1 January 2011	22&23	461,633	-	69,339	578,372	1,109,344
Net profit	23	-	-	-	348,989	348,989
Dividend paid	22	-	-	-	(223,526)	(223,526)
Deferred income 2011		-	-	-	(307)	(307)
Prior year adjustments		-	-	-	(5,830)	(5,830)
Share buyback	22	(35,189)	-	-	-	(35,189)
Assigned capital – Fiji		-	24,883	-	-	24,883
Other comprehensive income		-	-	113,328	-	113,328
Capital adequacy reserve - Fiji		-	-	67,912	-	67,912
Balance at 31 December 2011	22&23	**426,444**	**24,883**	**250,579**	**697,698**	**1,399,604**
Net profit	23	-	-	-	399,588	399,588
Dividend paid	22	-	-	-	(259,994)	(259,994)
Share buyback	22	(41,630)	-	-	-	(41,630)
Other comprehensive income		-	-	10,046	-	10,046
Balance at 31 December 2012	22&23	**384,814**	**24,883**	**260,625**	**838,292**	**1,508,614**

Group **All amounts are expressed in K'000**	**Note**	**Share capital**	**Assigned capital**	**Reserves**	**Retained Earnings/ (Accumulated losses)**	**Total**
Balance at 1 January 2011	22&23	461,633	-	83,787	588,977	1,134,397
Net profit	23	-	-	-	355,947	355,947
Dividend paid	22	-	-	-	(223,526)	(223,526)
Share buyback	22	(35,189)	-	-	-	(35,189)
Other comprehensive income		-	-	112,559	-	112,559
Balance at 31 December 2011	22&23	**426,444**	-	**196,346**	**721,398**	**1,344,188**
Net profit	23	-	-	-	407,744	407,744
Dividend paid	22	-	-	-	(258,994)	(258,994)
Share buyback	22	(41,630)	-	-	-	(41,630)
Other comprehensive income		-	-	14,585	-	14,585
Balance at 31 December 2012	22&23	**384,814**	-	**210,931**	**870,148**	**1,465,893**

The attached notes form an integral part of these financial statements

Statement of Cash Flow

for the Year Ended 31 December 2012

All amounts are expressed in K'000	Note	Group 2012	Group 2011	Bank 2012	Bank 2011
CASH FLOW FROM OPERATING ACTIVITIES					
Interest received		740,819	681,599	739,443	670,606
Fees and other income		638,579	534,491	524,618	426,261
Interest paid		(71,974)	(77,097)	(70,626)	(75,747)
Amounts paid to suppliers and employees		(565,607)	(669,331)	(452,221)	(482,100)
Operating cash flow before changes in operating assets	27	**741,817**	**469,662**	**741,214**	**539,020**
Decrease/(increase) in loans		(571,582)	(372,982)	(585,771)	(254,547)
Decrease/(increase) in bills receivable and other assets		(257,224)	(3,475)	(239,171)	(3,475)
(Decrease)/increase in deposits		1,465,780	1,463,007	1,474,302	1,439,572
(Decrease)/increase in bills payable and other liabilities		57,261	45,102	57,377	19,660
Net cash flow from operations before income tax		**1,436,052**	**1,601,314**	**1,447,951**	**1,740,230**
Income taxes paid		(238,675)	(119,878)	(233,720)	(119,590)
Net cash flow from operating activities		**1,197,377**	**1,481,436**	**1,214,231**	**1,620,640**
CASH FLOW FROM INVESTING ACTIVITIES					
Decrease/(increase) in government securities		(70,246)	(898,299)	(6,965)	(834,886)
Expenditure on property, plant and equipment		(210,373)	(239,714)	(205,460)	(234,600)
Proceeds from disposal of property, plant and equipment		(3,822)	7,016	(3,818)	7,016
Proceeds from other investments		25,215	23,345	-	-
Movement in share trading activities		8,252	(10,291)	-	-
Additional funding in associate		-	(513)	-	-
Net cash flow from investing activities		**(250,984)**	**(1,118,456)**	**(216,243)**	**(1,062,470)**
CASH FLOW FROM FINANCING ACTIVITIES					
Share buyback	22	(41,630)	(35,189)	(41,630)	(35,189)
Client management trust		(7,243)	4,345	-	-
Settlement of amount due to holding company		-	(583)	-	-
Dividends paid	22	(258,994)	(223,526)	(258,994)	(223,526)
Net cash flow from financing activities		**(307,867)**	**(254,953)**	**(300,624)**	**(258,715)**
Net increase/(decrease) in cash and cash equivalents		**638,526**	**108,027**	**697,364**	**299,455**
Effect of exchange rate movements on cash and cash equivalents		(710)	(4,910)	(710)	(4,910)
Cash and cash equivalents at the beginning of the year		1,423,569	1,320,452	1,304,356	1,009,811
Cash and cash equivalents at the end of the year	27	**2,061,385**	**1,423,569**	**2,001,010**	**1,304,356**

The attached notes form an integral part of these financial statements

Notes To The Financial Statements

for the Year Ended 31 December 2012

1. Accounting Policies

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

a. Basis of presentation and general accounting policies

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

Estimates and assumptions have been used to achieve conformity with generally accepted accounting principles in the preparation of these 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.

b. Consolidation

The consolidated financial statements incorporate the assets and liabilities of all controlled entities of the Bank and the Group as at 31 December 2012, and their results for the year then ended.

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

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

- Acquisition cost is measured at fair value of assets transferred, equity issued, liabilities assumed and any directly attributable costs of the transaction
- Identifiable net assets are recorded initially at acquisition, at their fair values
- Any excess of the acquisition cost over the relevant share of identifiable net assets acquired is treated as goodwill, and any deficiency is recognised directly in the statement of comprehensive income
- All intercompany transactions and balances are eliminated.

c. Investment in Associates and Joint Ventures

Investments in Associates

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

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

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

Interests in Joint Ventures

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

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

for the Year Ended 31 December 2012

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 yield 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 policy holder. There are no maturity or surrender benefits.

For all these contracts, premiums are recognised as revenue (earned premiums) proportionally over the period of coverage. The portion of premium received on in-force contracts that relates to unexpired risks at the balance sheet date is reported as the unearned premium liability. Premiums are shown before deduction of commission.

Claims and loss adjustment expenses are charged to income as incurred based on the estimated liability for compensation owed to contract holders or beneficiaries. They include direct and indirect claims settlement costs and arise from events that have occurred up to the balance sheet date even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Group and statistical analyses for the claims incurred but not reported, and to estimate the expected ultimate cost of more complex claims that may be affected by external factors (such as court decisions).

Long term insurance contracts

These contracts insure human life events (for example death or survival) over a long duration. They protect the Group's customers from the consequences of events such as death, disability or critical illness. Guaranteed benefits paid on occurrence of the specified insurance event are fixed or linked to the level of bonus declared to the contract holder. Most of the policies have maturity and surrender benefits.

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

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

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

The policy liability is calculated in a way that allows for the systematic release of planned profit margins as services are provided to policy owners and the revenues relating to those services are received (Margin on Service 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 experience on claims, expense, mortality and investment returns.

e. Fee and commission income

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

f. Borrowing expenses

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

g. Loans and provisions for loan impairment

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

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

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

h. Goodwill

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

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

i. Computer systems development costs

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

j. Property, plant and equipment

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

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

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

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

for the Year Ended 31 December 2012

The following basis and method of depreciation is used:

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

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

k. Leases

Bank is lessee

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

Bank is lessor

Finance leases are included in Loans and Advances to Customers (Note 16) and are accounted for under the finance method, whereby income is taken to account over the life of the lease in proportion to the outstanding investment balance.

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

l. Cash and cash equivalents

For the purpose of the Cash Flow Statement, cash and cash equivalents comprise notes and coins, and balances due to and from other banks.

m. Provisions

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

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

n. Employee benefits

A liability is required for benefits accruing to employees in respect of wages and salaries, annual leave, 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.

Employment benefits — defined contribution plans

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

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

o. Income tax

Current tax

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

Deferred tax

Deferred tax is accounted for using the balance sheet liability method. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities which affects neither taxable income nor accounting profit.

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

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

Current and deferred tax for the period

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

p. Investments

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

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

q. Foreign currency

The financial statements of the Bank are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of these 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 rate 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 asset and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit or loss on disposal of the foreign operation.

r. Share capital

Share issue costs

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

Dividends on ordinary shares

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

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

Share options

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

s. Asset Impairment

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

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

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

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

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

t. Non-current assets held for sale

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

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

u. Convertible Notes

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

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

v. Derivative financial instruments and acceptances

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

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

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

w. Comparatives

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

for the Year Ended 31 December 2012

2. Net interest income

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Interest Income				
Cash and short term funds	6,417	7,764	6,417	7,764
Public Securities: Treasury bills and Inscribe stock	237,558	213,381	237,558	213,381
Loans and advances	496,988	442,251	497,047	448,712
Other	2,123	2,924	2,123	2,924
	743,086	666,320	743,145	672,781
Less:				
Interest Expense				
Customer deposits	44,606	57,580	44,693	64,069
Other banks	8,023	1,484	8,023	1,484
Subordinated debt securities	8,854	8,581	8,854	8,581
Other borrowings	49	1,196	49	1,196
	61,532	68,841	61,619	75,330
	681,554	**597,479**	**681,526**	**597,451**

3. Banking fee and commission income

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Fee and commission income				
Credit related	67,808	52,404	67,808	52,404
Trade and international related	11,894	8,930	11,894	8,930
Electronic banking related	34,505	24,005	34,505	24,005
Brokerage and fee income	2,407	3,547	-	-
Other	138,175	115,156	138,175	115,156
	254,789	204,042	252,382	200,495
Less:				
Fee and commission expenses				
Agencies	920	1,906	920	1,906
	920	1,906	920	1,906
	253,869	**202,136**	**251,462**	**198,589**

4. Other banking income

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Foreign Exchange related	223,708	192,812	223,708	192,812
Other	49,470	27,981	50,141	35,566
	273,178	**220,793**	**273,849**	**228,378**
Included in other income:				
Profit/(loss) on sale of fixed assets	498	508	498	508
Change in fair value of assets held through profit and loss	5,922	18,497	-	-

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

5. Other operating expenses

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Administration	211,510	170,270	153,448	126,390
Auditors' remuneration	2,496	2,494	1,423	1,225
Computing	34,983	36,240	34,983	36,240
Depreciation	57,968	52,497	54,806	49,442
Amortisation of computer development	785	512	785	512
Non-Executive Directors' costs	1,013	623	1,013	623
Non-lending losses	15,386	26,875	15,386	26,875
Premises and equipment	55,742	49,924	55,742	49,924
	379,883	339,435	317,586	291,231
Staff costs				
Defined contribution plans	9,348	8,258	8,346	7,389
Statutory benefit contributions	9,334	6,170	9,334	6,170
Wages and salaries	211,490	189,113	197,227	173,222
Other	70,202	57,162	67,955	54,977
	300,374	260,703	282,862	241,758
	680,257	**600,138**	**600,448**	**532,989**

for the Year Ended 31 December 2012

6. Income tax

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Income tax expense				
Current tax	180,190	166,960	178,622	162,405
Deferred tax	(8,970)	(56,048)	(14,936)	(54,844)
Current year	171,220	110,912	163,686	107,561
Income tax under/(over) provided in previous years	(33,668)	8,127	(27,837)	9,645
	137,552	**119,039**	**135,849**	**117,206**
Tax calculated at 30% of profit before tax (2011:30%)	160,631	139,859	160,631	139,859
Tax calculated at 20% of profit before tax - subsidiary	2,757	3,536	-	-
Expenses not deductible for tax	3,734	(19,487)	3,056	(13,008)
Net insurance income not subject to tax	4,098	3,179	-	-
Impact of change in tax rate – Fiji subsidiary	-	79	-	-
Income tax under/(over) provided in previous years	(33,668)	(8,127)	(27,838)	(9,645)
	137,552	**119,039**	**135,849**	**117,206**
Provision for income tax				
At 1 January	(77,961)	(30,484)	(73,684)	(28,513)
Income tax provision	(180,190)	(166,960)	(178,622)	(162,405)
Previous years over/(under) provided	6,364	(108)	5,564	1,492
Foreign tax paid	4,955	3,849	-	-
Tax payments made	233,720	115,742	233,720	115,742
At 31 December	**(13,112)**	**(77,961)**	**(13,022)**	**(73,684)**
Deferred taxes				
Specific allowance for losses on loans and advances	44,912	40,548	44,912	40,548
General allowance for losses on loans and advances	19,504	8,105	19,504	8,105
Employee related provisions	21,573	13,068	15,783	12,780
Prepaid expenses	(1,112)	(599)	(1,112)	(599)
Other provisions	18,164	18,604	22,052	18,605
Depreciation and amortisation	(29,952)	(8,767)	(22,588)	(8,767)
Unrealised foreign exchange gains	(4,658)	(9,262)	(4,658)	(9,262)
Deferred expenditure	8,150	6,900	8,150	7,299
	76,581	**68,597**	**82,043**	**68,709**
Represented by:				
Deferred tax asset	111,141	87,625	110,401	87,336
Deferred tax liability	(34,560)	(19,028)	(28,358)	(18,627)
At December 31	**76,581**	**68,597**	**82,043**	**68,709**

6. Income tax (continued)

Movement in derred tax is reconciled as follows:

All amounts are expressed in K'000	Group – 2012				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing Balance
Gross deferred tax liabilities	(19,028)	(13,046)	-	(2,486)	(34,560)
Gross deferred tax assets	87,625	22,016	1,500	-	111,141
	68,597	**8,970**	**1,500**	**(2,486)**	**76,581**

All amounts are expressed in K'000	Group – 2011				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing Balance
Gross deferred tax liabilities	(30,166)	20,077	(2,027)	(6,912)	(19,028)
Gross deferred tax assets	64,968	35,971	(13,314)	-	87,625
	34,802	**56,048**	**(15,341)**	**(6,912)**	**68,597**

All amounts are expressed in K'000	Bank – 2012				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing Balance
Gross deferred tax liabilities	(18,627)	(7,245)	-	(2,486)	(28,358)
Gross deferred tax assets	87,336	22,181	884	-	110,401
	68,709	**14,936**	**884**	**(2,486)**	**82,043**

All amounts are expressed in K'000	Bank – 2011				
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Closing Balance
Gross deferred tax liabilities	(31,792)	20,077	-	(6,912)	(18,627)
Gross deferred tax assets	52,569	34,767	-	-	87,336
	20,777	**54,844**	**-**	**(6,912)**	**68,709**

for the Year Ended 31 December 2012

7. Intangible asset

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Gross carrying amount	2,243	21,933	-	-
Impairment adjustment	-	-	-	-
	2,243	21,933	-	-

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

8. Investments in Associates and Joint Ventures

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

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

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

for the Year Ended 31 December 2012

9. Cash and balances with Central Bank

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

10. Treasury and Central Bank Bills

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Treasury & Central Bank bills – face value	3,225,565	3,321,895	3,225,565	3,321,895
Premium/(discount) for interest receivable	11,952	(5,485)	11,952	(5,485)
	3,237,517	3,316,410	3,237,517	3,316,410

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

11. Amounts due from other banks

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Items in the course of collection	35,604	223,739	35,604	223,739
Placements with other banks	291,959	89,671	291,959	89,671
	327,563	313,410	327,563	313,410

12. Loans and advances to customers

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Overdrafts	1,095,419	981,748	1,095,419	981,748
Lease financing	224,464	162,340	224,464	162,340
Term loans	2,638,291	2,439,997	2,617,631	2,408,660
Mortgages	1,028,791	846,383	1,028,000	845,400
Policy loans	38,194	38,517	-	-
Gross loans and advances net of reserved interest	5,025,159	4,468,985	4,965,514	4,398,148
Less allowance for losses on loans and advances	(220,533)	(168,072)	(214,721)	(162,174)
	4,804,626	**4,300,913**	**4,750,793**	**4,235,974**

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

Lease financing

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

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Gross investment in finance lease receivable				
Not later than 1 year	27,498	28,747	27,498	28,747
Later than 1 year and not later than 5 years	244,080	153,334	244,080	153,334
	271,578	182,081	271,578	182,081
Unearned future finance income				
Not later than 1 year	(719)	(615)	(719)	(615)
Later than 1 year and not later than 5 years	(46,395)	(19,126)	(46,395)	(19,126)
	(47,114)	(19,741)	(47,114)	(19,741)
Present value of minimum lease payment receivable	**224,464**	**162,340**	**224,464**	**162,340**
Present value of minimum lease payment receivable is analysed as follows:				
Not later than 1 year	26,779	28,132	26,779	28,132
Later than 1 year and not later than 5 years	197,685	134,208	197,685	134,208
	224,464	**162,340**	**224,464**	**162,340**
Provisions for impairment				
Movement in allowance for losses on loan and advances;				
Balance at 1 January	168,072	158,678	162,174	107,278
Net new and increase provisioning	73,752	39,886	73,752	39,886
Other*	-	(16,356)	-	16,356
Loans written off against provisions / (write back of provisions no longer required)	(21,291)	(14,136)	(21,205)	(1,346)
Balance at 31 December	**220,533**	**168,072**	**214,721**	**162,174**

for the Year Ended 31 December 2012

12. Loans and advances to customers (continued)

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Provisions for impairment is represented by:				
Collective provision	174,220	123,099	173,635	122,392
Individually assessed or specific provision	46,313	44,973	41,086	39,782
Balance at 31 December	**220,533**	**168,072**	**214,721**	**162,174**
*Others related to the transfer of provisioning balance relating to the conversion of CNB to a branch of BSP in Fiji				
Loan impairment expense				
Net collective provision funding	(65,013)	(27,015)	(65,013)	(27,015)
Net new and increase individually assessed provisioning	(8,739)	(12,871)	(8,739)	(12,871)
Total new and increase provisioning	(73,752)	(39,886)	(73,752)	(39,886)
Recoveries during the year	21,133	26,241	21,133	26,241
Net write back/(write off)	(18,333)	(11,589)	(18,333)	(11,589)
	(70,952)	**(25,234)**	**(70,952)**	**(25,234)**

for the Year Ended 31 December 2012

13. Property, plant and equipment

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Carrying value				
Capital works in progress	325,821	244,401	324,982	243,498
Premises	407,608	354,658	386,707	334,496
Accumulated depreciation	(76,888)	(58,119)	(70,004)	(53,238)
	330,720	296,539	316,703	281,258
Equipment	361,790	324,463	334,239	300,367
Accumulated depreciation	(274,039)	(242,500)	(257,645)	(227,601)
	87,751	81,963	76,594	72,766
	744,292	**622,903**	**718,279**	**597,522**
Reconciliation of carry value of property, plant and equipment is set out below:				
Capital WIP				
At 1 January	244,401	94,061	243,498	77,815
Additions	230,398	534,104	221,783	531,684
Transfers	(148,978)	(383,764)	(140,299)	(366,001)
At 31 December	**325,821**	**244,401**	**324,982**	**243,498**
Premises				
At 1 January	296,539	181,675	281,258	174,855
Additions	51,841	19,449	52,634	19,271
Disposals	(422)	(292)	(422)	(292)
Net movement	-	4,565	-	5,570
Revaluation Increases	-	100,568	-	90,843
Depreciation expense	(17,238)	(9,426)	(16,767)	(8,989)
At 31 December	**330,720**	**296,539**	**316,703**	**281,258**
Equipment				
At 1 January	81,963	88,418	72,766	59,354
Additions	44,140	24,270	39,177	19,883
Disposals	(5,617)	(9,290)	(5,305)	(8,889)
Net movement	-	13,092	-	34,327
Depreciation expense	(32,735)	(34,527)	(30,044)	(31,909)
At 31 December	**87,751**	**81,963**	**76,594**	**72,766**

13. Property, plant and equipment (continued)

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

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

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Freehold land	14,531	14,531	11,434	11,434
Buildings	102,444	102,444	86,192	86,192
Aircraft	60,392	68,936	60,392	68,936
At 31 December	**177,367**	**185,911**	**158,018**	**166,562**

Freehold land and buildings carried at fair value

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

Asset subject to operating lease - aircraft

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

for the Year Ended 31 December 2012

14. Investment Properties

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

15. Other financial assets

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Securities - held to maturity				
Inscribed stock - issued by Central Bank	1,505,589	1,331,988	1,354,659	1,268,801
Financial assets carried at fair value through profit and loss:				
Equity securities	52,361	20,613	-	-
At 31 December	**1,557,950**	**1,352,601**	**1,354,659**	**1,268,801**

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

	Level 1	Level 2	Level 3	Level 4
2012				
Equity securities	-	51,278	1,083	52,361
At 31 December	-	**51,278**	**1,083**	**52,361**
2011				
Equity securities	-	19,552	1,091	20,613
	-	**19,552**	**1,091**	**20,613**

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

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16. Other assets

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Items in transit and other assets	428,730	175,185	372,716	128,253
Accrued income	76,079	65,123	76,079	65,123
Intercompany account	-	-	(11,454)	4,508
Computer development costs	3,126	4,144	3,126	4,144
Outstanding premiums	20,865	20,697	-	-
Inventory	5,575	4,337	-	-
Prepayments	14,824	12,349	14,824	12,349
Accounts receivable	(3,442)	11,414	(2,691)	629
	545,757	293,249	452,600	215,006

17. Amounts due to other banks

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

18. Amounts due to customers

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
On demand and short term deposits	9,012,413	7,614,630	9,016,405	7,618,664
Term deposits	1,848,109	1,751,651	1,904,286	1,827,725
	10,860,522	9,366,281	10,920,691	9,446,389

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

19. Subordinated debt securities

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

20. Other liabilities

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Creditors and accruals	79,054	46,858	66,330	36,728
Items in transit and all other liabilities	223,079	194,787	218,827	184,182
Policy liabilities	399,627	376,743	-	-
Premiums received in advance	5,387	4,385	-	-
Outstanding claims	6,420	4,808	-	-
Claims incurred but not reported (IBNR)	1,168	1,290	-	-
	714,735	628,871	285,157	220,910
Policy liabilty is reconciled as follows:				
Opening balance	376,743	361,554	-	-
Adjustment to policy liability	-	(18,303)	-	-
Increase in policy liability	22,884	33,492	-	-
	399,627	376,743	-	-

21. Other provisions

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

* CDO Provision (included under provision of non lending loss).

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

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21. Other provisions (continued)

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

22. Ordinary shares - Bank

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

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

In May 2011, the Directors agreed to introduce a share buyback scheme of up to K40 million in conjunction with the 1 for 10 share consideration. The share buyback commenced in July 2011 and, as at 31 December 2011, 4,855,505 shares are bought at value of K35,189 million. At the expiry of the first buyback scheme the directors approved a further buyback program K40 million which commenced on Friday 9 March 2012 for a period of 12 months.

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

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

22. Ordinary shares - Bank (continued)

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

Basic earning per 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 share equals diluted earnings per share.

All amounts are expressed in K'000	Group		Bank	
	2012	2011	2012	2011
Dividend paid on ordinary shares				
Interim ordinary dividend (2012: 20 toea; 2011: 16 toea)	93,970	73,681	93,970	73,681
Final ordinary dividend (2011: 35 toea; 2010: 3.13 toea)	165,024	149,845	165,024	149,845
At 31 December	**258,994**	**223,526**	**258,994**	**223,526**

Share Options - Executive Management Share Option Plan (EMSOP)

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

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

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

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

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22. Ordinary shares - Bank (continued)

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

Options 2012 ('000)	Opening balance	Share consolidation	Granted	Vested	Forfeited	Others	Outstanding Balance
2010	1,825	-	-	(1,825)	-	-	-
2011	1,725	1,725	-	-	-	-	1,725
2012	-	-	2,150	-	-	-	2,150
Total	3,550	1,725	2,150	(1,825)	-	-	3,875
Weighted average exercise price	6.69	6.69	8.00	6.50	-	-	7.35
Options 2011 ('000)	**Opening balance**	**Share consolidation**	**Granted**	**Vested**	**Forfeited**	**Others**	**Outstanding Balance**
2010	18,250	1,825	-	-	-	-	1,825
2011	-	-	1,725	-	-	-	1,725
Total	18,250	1,825	1,725	-	-	-	3,550
Weighted average exercise price	0.65	6.50	6.69	-	-	-	6.69

23. Reserves and retained earnings

All amounts are expressed in K'000	Group		Bank	
	2012	2011	2012	2011
Retained earnings				
At 1 January	721,398	588,977	697,698	578,372
Net profit for the year	407,744	355,947	399,588	348,989
Dividend paid	(258,994)	(223,526)	(258,994)	(223,526)
Other adjustments	-	-	-	(6,137)
At 31 December	**870,148**	**721,398**	**838,292**	**697,698**
Reserves comprise:				
Revaluation reserve	170,103	160,293	170,103	160,293
Capital reserve	635	635	68,547	68,547
Equity component of convertible notes	18,218	18,218	-	-
Options reserve	4,526	3,238	4,526	3,237
General reserve	2,875	2,875	2,875	2,875
Exchange reserve	14,574	11,087	14,574	15,627
	210,931	**196,346**	**260,625**	**250,579**
Movement in reserves for the year:				
Revaluation reserve				
At 1 January	160,293	68,776	160,293	68,776
Asset revaluation increment	12,296	98,429	12,296	98,429
Deferred tax on asset revaluation	(2,486)	(6,912)	(2,486)	(6,912)
At 31 December	**170,103**	**160,293**	**170,103**	**160,293**
Capital reserve				
At 1 January	635	635	68,547	635
BSP Fiji branch – capital adequacy reserve	-	-	-	67,912
At 31 December	**635**	**635**	**68,547**	**68,547**
Options reserve				
At 1 January	3,238	1,968	3,237	1,967
Movement during the year	1,288	1,270	1,289	1,270
At 31 December	**4,526**	**3,238**	**4,526**	**3,237**
General reserve				
At 1 January	2,875	2,875	2,875	2,875
At 31 December	**2,875**	**2,875**	**2,875**	**2,875**
Exchange reserve				
At 1 January	11,087	(8,685)	15,627	(4,914)
Movement during the year	3,487	19,772	(1,053)	20,541
At 31 December	**14,574**	**11,087**	**14,574**	**15,627**

23. Reserves and retained earnings (continued)

Exchange reserve

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

Equity component of convertible notes

On 20 April 2010, the Group issued 3,064,967 Fiji Dollars (FJD) denominated mandatory convertible notes through its wholly owned subsidiary BSO Convertible Notes Limted (BSP CN) at an issue price of FJD5.25 (K7.30) per note. Each note entitles the holder to convert to ten (10) Fiji Class shares. On conversion all notes are redeemed for their face value and the proceeds of that redemption are applied as the subscription price for Fiji Class shares. Notes can only be redeemed in cash at the election of BSP CN Fiji with regulatory approval. The amount payable at redemption will be greater of the market value or face value of the note plus accrued interest. The notes will mandatorily convert to Fiji Class Shares on 20 April 2013.

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

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

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

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

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

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

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

Statutory capital requirements in Fiji

As a requirement of the Reserve Bank of Fiji, BSP Fiji operations is required to maintain assigned capital of K24 million (2011: K24 million) and capital adequacy reserve of K68 million (2011: K68 million).

24. Contingent liabilities and commitments

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

Legal Proceedings

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

All amounts are expressed in K'000	Group 2012	Group 2011	Bank 2012	Bank 2011
Statutory deposits with the Central Bank				
Cash reserve requirement - 8% of all amounts due to customers (2011: 6 %)	873,198	586,235	742,495	496,588
Commitments for capital expenditure				
Amounts with firm commitments, and not reflected in the accounts	24,646	39,556	24,646	39,556
Operating lease commitments				
Not later than 1 year	23,048	14,696	23,048	14,696
Later than 1 year and not later than 5 years	80,914	23,045	80,914	23,045
Later than 5 years	-	10,860	-	10,860
	103,962	48,601	103,962	48,601

25. Fiduciary activities

The Group especially through BSP Capital Limited conducts investment fund management, stock broking and other fiduciary activities as responsible entity, trustee, custodian or manager for investment funds and trusts, including superannuation. These funds are not consolidated as the Group does not have direct or indirect control. When 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 probably that the Group will be required to settle the liabilities, the investments in the assets and liabilities of these activities are not included in the consolidated financial statements.

Notes To The Financial Statements

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26. Directors' and executive remuneration

Directors' remuneration

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

All amounts are in K'000

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

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

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

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

26. Directors' and executive remuneration (continued)

Executive remuneration

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

Remuneration K'000	2012 No.	2011 No.	Remuneration K'000	2012 No.	2011 No.	Remuneration K'000	2012 No.	2011 No.
100-110	28	24	350-360	3	1	650-660	3	-
110-120	26	27	360-370	2	1	670-680	2	1
120-130	16	16	370-380	2	2	680-690	1	5
130-140	23	19	380-390	1	3	700-710	4	1
140-150	10	9	410-420	2	-	710-720	1	1
150-160	9	6	430-440	1	1	720-730	1	1
160-170	5	6	440-450	2	3	730-740	-	1
170-180	7	3	450-460	-	1	740-750	-	2
180-190	5	4	460-470	1	2	750-760	2	2
190-200	4	4	480-490	2	1	760-770	1	1
200-210	4	5	490-500	3	1	770-780	-	1
210-220	3	4	500-510	3	1	800-810	1	1
220-230	3	1	510-520	5	1	810-820	3	1
230-240	2	2	520-530	-	1	870-880	-	1
240-250	5	4	530-540	3	1	900-910	-	1
250-260	5	3	540-550	2	1	940-950	-	1
260-270	5	1	550-560	2	1	950-960	1	1
270-280	-	3	570-580	5	1	970-980	-	1
280-290	5	-	580-590	2	-	1020-1030	-	1
290-300	7	1	590-600	2	2	1050-1060	1	1
310-320	2	2	610-620	4	1	1180-1190	-	1
320-330	1	3	620-630	-	2	1350-1360	3	-
330-340	1	1	630-640	1	3	1400-1410	-	1
340-350	2	1	640-650	3	3	4500-4510	1	1
Total							254	211

Executives' remuneration stated includes exercised options.

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26. Directors' and executive remuneration (continued)

Executive remuneration

The specified executives during the year were:

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

Specified executives remuneration in aggregate (K'000)

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

27. Reconciliation of operating cash flow

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Reconciliation of operating profit/(loss) after tax to operating cash flow before changes in operating assets				
Operating profit/(loss) after tax	407,744	355,947	399,588	348,989
Add: Tax expense	137,552	119,039	135,849	117,207
Operating profit before income tax	545,296	474,986	535,437	466,196
Major non cash amounts				
Depreciation	89,775	52,497	86,601	49,442
Amortisation of deferred acquisition and computer development costs	785	512	785	512
Net (profit)/loss on sale of fixed assets	(3,817)	508	(3,817)	508
Sundry write off	-	20,253	-	20,133
Movement in forex income accrual	(710)	(6,248)	(710)	(4,910)
Movement in provision for doubtful debts	(70,952)	(24,904)	(70,952)	(25,234)
Movement in payroll provisions	9,587	4,229	9,587	4,229
Net effect of other accruals	171,853	(52,171)	184,283	28,144
Operating cash flow before changes in operating assets	**741,817**	**469,662**	**741,214**	**539,020**

27. Reconciliation of operating cash flow (continued)

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.

	Group		Bank	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Cash and balances with Central Bank (note 9)	1,806,597	1,188,048	1,764,275	1,086,766
Due from other banks (note 11)	327,563	313,410	327,563	313,410
Due to other banks (note 17)	(72,775)	(77,889)	(90,828)	(95,820)
	2,061,385	**1,423,569**	**2,001,010**	**1,304,356**

28. Segment information

Bank of South Pacific Limited and the Group comprises two segments, these being the provision of banking services and products and stock broking services. For management purposes, segment information determination is based on the risks involved with the provision of core banking services and products and the Bank and Group's management reporting system. The main business lines for management purposes are the core banking segments of Retail Bank, Wholesale Bank which includes Corporate & Paramount SBUs, insurance operations in Fiji and BSP Capital's stock broking and fund management activities. The Bank of South Pacific Limited and Group's business segments operate in Papua New Guinea, Niue, Fiji and Solomon Islands. Inter segment adjustments reflects elimination entries in respect of inter segment income and expense allocations including funds transfer pricing.

Analysis by business segments:

Year ended 31 December 2012								
All amounts are expressed in K'000	**Retail**	**Wholesale**	**Fiji Bank**	**Insurance**	**BSP Capital**	**Others**	**Adjust Inter Segment**	**Total**
Revenue	395,269	636,433	83,105	155,994	2,407	56,158	268,301	1,597,667
Costs	(258,909)	(326,565)	(78,522)	(142,209)	(6,315)	(33,878)	(205,973)	(1,052,371)
Operating results	136,360	309,868	4,583	13,785	(3,908)	22,280	62,328	545,296
Income tax expense								(137,552)
Profit after tax								**407,744**
Year ended 31 December 2011								
All amounts are expressed in K'000	**Retail**	**Wholesale**	**Fiji Bank**	**Insurance**	**BSP Capital**	**Others**	**Adjust Inter Segment**	**Total**
Revenue	374,406	502,312	69,625	168,400	3,547	19,010	310,802	1,448,102
Costs	(289,291)	(201,087)	(65,416)	(155,645)	(7,481)	(38,394)	(215,802)	(973,116)
Operating results	85,115	301,225	4,209	12,755	(3,934)	(19,384)	95,000	474,986
Income tax expense								(119,039)
Profit after tax								**355,947**

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29. Related party transactions

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

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

A number of banking transactions are entered into with these related parties in the normal course of business, and include loans, deposits, property rentals, share transfers and foreign currency transactions. These transactions are carried out on commercial terms and market rates. For the year ended 31 December 2012, balances and transactions of accounts for Directors were as follows:

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

Incentive-based transactions are provided for staff. Such transactions include marginal discounts on rates, and specific fee concessions. These incentives are mainly percentage-based on market rates and fees, and as such, staff accounts are always subject to underlying market trends in interest rates and fees. As at 31 December 2012, staff account balances were as follows:

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

29. Related party transactions (continued)

Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
K. Constantinou, OBE	Director	Bank of South Pacific Ltd[1], BSP Capital Ltd[1], Airways Hotel & Apartments Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Hebou Constructions Ltd, Heritage Park Hotel Ltd, Gazelle International Hotel Ltd, Airlines PNG Ltd, Oil Search Ltd, Alotau International Hotel Ltd, Kimbe Bay Hotel Ltd, Grand Pacific Hotel Ltd, City Centre Development Ltd, Coastwatchers Court Ltd, Waigani Assets Ltd, Southern Seas Investments Ltd, Texas Chicken South Pacific Ltd.
	Shareholder	Airways Hotel & Apartments Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Texas Chicken South Pacific Ltd.
	Member	Australian Institute of Company Directors, PNG Institute of Directors, Pacific Games Authority[1,6].
T. E. Fox, OBE, BEc	Director	Bank of South Pacific Ltd[2], BSP Capital Ltd, Teyo No.1 Ltd[5], Akura Ltd.
	Shareholder	Bank of South Pacific Ltd, Teyo No. 1 Ltd, Citigold Corporation Ltd, Marengo Mining Corporation Ltd, New Guinea Energy Ltd, Akura Ltd.
	Trustee/Member	Institute of National Affairs[8], PNG Institute of Directors
I. B. Clyne	Director	Bank of South Pacific Ltd[9], BSP Capital Ltd, BSP Convertible Notes Ltd, BSP Rural Ltd, BSP Life Ltd.
	Member	Commercial Bankers' Association, Australian Institute of Company Directors, PNG Institute of Directors.
J. G. Jeffery, CBE	Director	Bank of South Pacific Ltd, Jayliss Ltd.
	Shareholder	Highlands Pacific Ltd, Oil Search Ltd, Jayliss Ltd[1].
	Member	PNG Institute of Directors
G. Aopi, CBE, MBA	Director	Bank of South Pacific Ltd, Oil Search Ltd[7], Steamships Trading Co Ltd, POMSoX Ltd, Hirad Ltd, Marsh Ltd, Wahinemo Ltd, FM Morobe Ltd, CDI Foundation.
	Shareholder	Bank of South Pacific Ltd, Oil Search Ltd[7], Newcrest Ltd, Hirad Ltd, Wahinemo Ltd, Highlands Pacific Ltd, Melanesian Trustees (ICPNG), Kumul Asset Management.
	Trustee/Member	Institute of National Affairs, Business Council of PNG, PNG Chamber of Mines & Petroleum, Oil Search Health Foundation.

29. Related party transactions (continued)

Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
Dr. I. Temu, PhD, MEc	Director	Bank of South Pacific Ltd, Tipi Enterprise Ltd, PNG Ports Corporation[1].
	Shareholder	Telstra Ltd, Nautilus Minerals Niugini Ltd.
	Employee	Barrick Gold Ltd.
	Member	Divine Word University, Chamber of Mining & Petroleum.
Sir N. Bogan, KBE, LLB	Director	Bank of South Pacific Ltd, Nambawan Super Ltd[1,5], Coprez Communications Ltd[1], Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory, In Touch Media Ltd[1], Ahi Holdings Ltd.
	Shareholder	Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory, In Touch Media Ltd.
	Member	Evangelical Lutheran Church Finance Committee.
C. C. Procter, MEc, FFin	Director	Bank of South Pacific Ltd, BSP Capital Ltd, Sun Hung Kai Ltd, Allied Overseas Ltd, Eurogold Limited.
	Member	Australian Institute of Company Directors
F. Talao	Director	Bank of South Pacific Ltd, National Airports Corporation Board, Airport City Development Ltd[1].
	Member	External Stakeholders Advisory Panel to Morobe Mining Joint Venture, Australian Institute of Company Directors.
G. Robb, MBA	Director	Bank of South Pacific Ltd, Lex Van Hessen Australian Holding Pty Ltd.
	Shareholder	St Barbara Ltd, Macquarie Bank Ltd, Woodside Petroleum Ltd.
	Member	Australian Institute of Company Directors.

[1]Chairman, [2]Deputy Chairman, [3]Managing Director, [4]Executive Director, [7]General Manager, [8]Councillor, [5]Company is shareholder of Bank of South Pacific Limited, or shareholder of company that is shareholder, [6]Companies have banking facilities with BSP, [9]Chief Executive Officer.

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

All business operations must deal with a variety of operational and financial risks. The business activities of a bank expose it to very critical and specific risks, which are principally related to the Bank and the Group's primary financial intermediary role in the financial markets, including the use of financial instruments such as derivatives. These market 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 Bank and the Group accepts deposits from customers at both fixed and floating rates and for various periods and seeks to earn above average interest margins by investing these funds in high quality assets. These margins are achieved and increased by consolidating short-term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims that might fall due.

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

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

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

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

31. Capital adequacy

The Bank and the Group is required to comply with various prudential standards issued by the Bank of Papua New Guinea (BPNG), the official authority for the prudential supervision of banks and similar financial institutions in Papua New Guinea. One of the most critical prudential standards is the capital adequacy requirement. All banks are required to maintain at least the minimum acceptable measure of capital to risk-weighted assets to absorb potential losses. The BPNG follows the prudential guidelines set by the Bank of International Settlements under the terms of the Basel Accord. The BPNG revised prudential standard 1/2003, Capital Adequacy, prescribes ranges of overall capital ratios to measure whether a bank is under, adequately, or well capitalised, and also applies the leverage capital ratio. The Bank and the Group complies with the prevailing prudential requirements for total capital and leverage capital. As at 31 December 2012, the Bank and the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for being well-capitalised. The minimum capital adequacy requirements as set out under the standard are: Tier 1—8 percent total risk base; capital ratio 12 percent; and the leverage ratio 6 percent.

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.

31. 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 percent) according to risk classification criteria set by the BPNG. Off-balance sheet exposures are risk weighted in the same way after converting them to on-balance sheet credit equivalents using BPNG specified credit conversion factors.

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

	Balance sheet / notional amount		Risk-weighted amount	
All amounts are expressed in K'000	**2012**	**2011**	**2012**	**2011**
Balance sheet assets (net of provisions)				
Currency	1,806,597	1,188,048	-	-
Loans and advances	4,804,626	4,300,913	4,594,014	4,050,768
Investments and short-term securities	4,795,467	4,669,011	-	-
All other assets	1,926,412	1,523,321	1,847,900	1,390,108
Off-balance sheet items	1,517,718	1,089,678	316,934	352,353
Total	14,850,820	12,770,971	6,758,848	5,793,229
	Capital (K'000)		**Capital Adequacy Ratio (%)**	
Audited Capital Ratios	**2012**	**2011**	**2012**	**2011**
a)				
Tier 1 capital	1,185,382	1,166,608	17.4%	19.8%
Tier 1 + Tier 2 capital	1,516,086	1,425,207	22.3%	24.2%
b) Leverage Capital Ratio			9.0%	10.0%

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32. Credit risk and asset quality

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

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

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

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

The Bank of Papua New Guinea has maintained a revised prudential standard for asset quality since October 2003. The revised standard specifies more detailed criteria for the classification of loans into various grades of default risk and corresponding loss provision levels as a consequence of those gradings. Since its introduction, the Bank and the Group has complied with the requirement at all times.

Credit related commitments

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

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

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

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

32. 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	2012	%	2011	%
As at 31 December				
Commerce, finance and other business	1,937,732	40	1,908,350	45
Private households	946,132	20	692,311	16
Government and public authorities	101,621	2	58,072	1
Agriculture	116,451	2	307,834	7
Transport and communication	723,624	15	550,568	13
Manufacturing	520,588	11	302,837	7
Construction	458,478	10	480,941	11
Net loan portfolio balance	4,804,626	100	4,300,913	100

33. Liquidity risk

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

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

Short-term mismatch of asset and liability maturity at 31 December 2012.

The maturity profile of material Assets and Liabilities as at 31 December 2012 is shown in the schedule below. The mismatching of maturity of assets and liabilities indicates an apparent negative net 'current' asset position. However, as stated in the preceding paragraph, mismatched positions are established and managed to achieve profit opportunities that arise from them, particularly in a normal yield curve environment. Accordingly, this mismatched maturity position is considered manageable by the Bank and the Group, and does not impair the ability of the Bank and the Group to meet its financial obligations as they fall due.The Directors are also of the view that the Bank and the Group is able to meet its financial obligations as they fall due for the following additional reasons:

- The Bank and the Group complies with the Minimum Liquid Asset Ratio ('MLAR') and Cash Reserve Requirement ('CRR') set by the regulatory authority, the Bank of Papua New Guinea ('BPNG'). The MLAR is the minimum ratio of liquid assets to total customer deposits considered by the regulator as sufficient to support exceptional liquidation by depositors, of their fundsThe requirement to hold a minimum of 25 percent of the value of total customer deposits in the form of prescribed liquid assets was reduced to zero percent by the BPNG in September 2010.As at 31 December 2012, the Bank and the Group's Liquid Asset Ratio was approximately 38.92 percent (2011: 43.61 percent);

- The CRR specifies that a bank must hold an amount equal to 8 percent of its total customer deposits in the form of cash in an account maintained at the BPNG. The Bank and the Group complies with this daily requirement on an ongoing basis. The balance of the CRR account is shown in Note 9, Cash and Balances with Central Bank, and Note 27, Cash and cash equivalents.

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33. Liquidity risk (continued)

Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2012	Up to 1 month	1-3 Months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and Central Bank assets	1,806,597	-	-	-	-	1,806,597
Treasury & Central Bank bills	962,220	1,154,447	1,120,850	-	-	3,237,517
Due from other banks	327,563	-	-	-	-	327,563
Loans and advances	1,653,163	118,214	506,249	802,099	1,724,901	4,804,626
Investments	-	34,250	296,750	523,060	703,890	1,557,950
Total assets	**4,749,543**	**1,306,911**	**1,923,849**	**1,325,159**	**2,428,791**	**11,734,253**
Liabilities						
Due to other banks	72,775	-	-	-	-	72,775
Due to customers	10,086,241	410,159	315,394	48,723	5	10,860,522
Other liabilities	690,298	46,365	-	-	75,525	812,188
Other provisions	65,696	49,791	-	-	6,237	121,724
Total liabilities	**10,915,010**	**506,315**	**315,394**	**48,723**	**81,767**	**11,867,209**
Net liquidity gap	**(6,165,467)**	**800,596**	**1,608,455**	**1,276,436**	**2,347,024**	**(132,956)**
As at 31 December 2011	**Up to 1 month**	**1-3 Months**	**3-12 months**	**1-5 Years**	**Over 5 years**	**Total**
Total assets	3,528,665	1,547,197	1,748,162	2,455,295	1,192,063	10,471,382
Total liabilities	7,963,556	1,148,186	664,926	444,969	115,468	10,337,105
Net liquidity gap	(4,434,891)	399,011	1,083,236	2,010,326	1,076,595	134,277

34. Operational risk

Operational risk is the potential exposure to unexpected financial or non-financial losses arising from the way in which the Bank and the Group conducts its business. Examples of operational risk 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 organisation's compliance with them. The Operational Risk Committee coordinates the management process across the organisation.

An independent internal audit function also conducts regular reviews to monitor compliance with policy and regulatory environment and examines the general standard of control.

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

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35. Foreign exchange risk

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

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

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

All amounts are expressed in K'000

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

36. Interest rate risk

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

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

Effective interest rates as at 31 December

Amounts are expressed in % p.a.	2012	2011
Assets		
Cash and Central Bank assets	6.75	7.75
Treasury and Central Bank bills	2.25	4.00
Due from other banks	3.00	7.00
Loans and advances	11.20	12.50
Investments	9.50	10.00
Liabilities		
Due to other banks	3.00	7.00
Due to customers	0.35	1.50

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36. Interest rate risk (continued)

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

All amounts are expressed in K'000

As at 31 December 2012	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non interest bearing
Assets						
Cash and Central Bank assets	-	-	-	-	-	1,806,597
Treasury & Central Bank bills	962,220	1,154,447	1,120,850	-	-	-
Due from other banks	327,563	-	-	-	-	-
Loans and advances	4,308,480	59,811	219,660	216,675	-	-
Investments	-	34,250	296,750	523,060	703,890	-
Other assets	-	-	-	-	-	1,598,849
Total assets	5,598,263	1,248,508	1,637,260	739,735	703,890	3,405,446
Liabilities						
Due to other banks	72,775	-	-	-	-	-
Due to customers	5,823,901	410,159	292,971	48,723	5	4,284,763
Other liabilities	-	-	-	-	75,525	714,735
Other provisions	-	-	-	-	-	143,652
Total liabilities	5,896,676	410,159	292,971	48,723	75,530	5,143,150
Interest sensitivity gap	(298,413)	838,349	1,344,289	691,012	628,360	(1,737,704)
As at 31 December 2011						
Assets						
Cash and Central Bank assets	-	-	-	-	-	1,188,048
Treasury & Central Bank bills	802,638	1,309,605	1,204,167	-	-	-
Due from other banks	313,410	-	-	-	-	-
Loans and advances	2,348,518	324,550	390,447	756,780	480,615	4
Investments	-	-	56,072	501,651	794,878	-
Other assets	-	-	-	-	-	1,209,910
Total assets	3,464,566	1,634,155	1,650,686	1,258,431	1,275,493	2,397,962
Liabilities						
Due to other banks	77,889	-	-	-	-	-
Due to customers	5,191,873	596,670	845,336	68,564	-	2,663,837
Other liabilities	-	-	-	-	75,525	817,410
Total liabilities	5,269,762	596,670	845,336	68,564	75,525	3,481,247
Interest sensitivity gap	(1,805,196)	1,037,485	805,350	1,189,867	1,199,968	(1,083,285)

37. Fair values of financial assets and liabilities

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

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

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

Forward exchange contracts outstanding at 31 December 2012 stated at the face value of the respective contracts are:

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

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

38. Policy liabilities

Key assumptions used in determining this liability are as follows:

Discount Rates

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

Investment and Maintenance Expenses

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

Taxation

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

38. Policy liabilities (continued)

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 by comparing them with the Group's own experience. The mortality rates used was 85 percent of the FJ90-94 Male table.

Rates of Discontinuance

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

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

Basis of Calculation of Surrender Values

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

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 archived on the pool of assets which provide security for the contract, together with other sources of profit arising from this business. Distributions are split between contract holders and shareholders with the valuation allowing for shareholders to share in distributions at a maximum allowable rate of 20 percent (31 December 2011: 20 percent). For business written between 1995 and 1998 the shareholder receives 11 percent of distributions.

In applying the contract holders' share of profits to provided 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 long-term insurance contracts were set such that their present value of the liabilities equates to the present value of assets supporting the business together with assumed future investment returns, allowing for the shareholders 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 the statements of comprehensive income when they become due and payable in accordance with the reinsurance agreements.

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

for the Year Ended 31 December 2012

39. Events occurring after balance sheet date

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

CEO Ian Clyne with children from Port Moresby lending a hand with BSP's Annual Go Green Clean Up Weekend 21/22 September. Since its launch in 2010 over 500,000 men, women and children have participated in the BSP Clean Up events throughout the South Pacific.

Deloitte.

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

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

Director's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

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

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

Audit Opinion

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

Report on Other Legal and Regulatory Requirements

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

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

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

Paul Barber

Registered under the Accountants Act 1996
Partner, Chartered Accountants

Port Moresby, 22nd day of March 2013.

Shareholder Information

The following is a summary of pertinent issues relating to a shareholding in the Company. The Constitution of BSP may be inspected during normal business at the Registered Office.

Rights attaching to ordinary shares

The rights attaching to shares are set out in Bank of South Pacific Limited's Constitution and in certain circumstances, are regulated by the Companies Act 1997, the POMSoX Listing Rules and general law.
There is only one class of share. All shares have equal rights.

Other rights attached to ordinary shares include:

(a) General meeting and notices

Each member is entitled to receive notice of, and to attend and vote at, general meetings of BSP and to receive all notices, accounts and other documents required to be sent to members under BSP's constitution, the Companies Act or the Listing Rules.

(b) Voting rights

At a general meeting of shareholders, every holder of fully paid ordinary shares present in person or by an attorney, representative or proxy has one vote on a show of hands (unless a member has appointed two proxies) and one vote per share on a poll.

A person who holds a share which is not fully paid is entitled, on a poll, to a fraction of a vote equal to the proportion which the amount paid bears to the total issue price of the share.

Where there are two or more joint holders of a share and more than one of them is present at a meeting and tenders a vote in respect of the share, the Company will count only the vote cast by the member whose name appears first in BSP's register of members.

(c) Issues of further shares

The Directors may, on behalf of BSP, issue, grant options over, or otherwise dispose of unissued shares to any person on the terms, with the rights, and at the times that the Directors decide. However, the Directors must act in accordance with the restrictions imposed by BSP's constitution, the POMSoX Listing Rules, the Companies Act and any rights for the time being attached to the shares in any special class of those shares.

(d) Variation of rights

Unless otherwise provided by BSP's constitution or by the terms of issue of a class of shares, the rights attached to the shares in any class of shares may be varied or cancelled only with the written consent of the holders of at least three-quarters of the issued shares of that class, or by special resolution passed at a separate meeting of the holders of the issued shares of the affected class.

(e) Transfer of shares

Subject to BSP's constitution, the Companies Act and the POMSoX Listing Rules, ordinary shares are freely transferable.

The shares may be transferred by a proper transfer effected in accordance with the POMSoX Business Rules, by any other method of transferring or dealing with shares introduced by POMSoX and as otherwise permitted by the Companies Act or by a written instrument of transfer in any usual form or in any other form approved by either the Directors or POMSoX that is permitted by the Companies Act.

The Directors may decline to register a transfer of shares (other than a proper transfer in accordance with the POMSoX Business Rules) where permitted to do so under the POMSoX Listing Rules or the transfer would be in contravention of the law. If the Directors decline to register a transfer, BSP must give notice in accordance with the Companies Act and the POMSoX Listing rules, give the party lodging the transfer written notice of the refusal and the reason for refusal. The Directors must decline to register a transfer of shares when required by law, by the POMSoX Listing Rules or by the POMSoX Business Rules.

(f) Partly paid shares

The Directors may, subject to compliance with BSP's constitution, the Companies Act and the POMSoX Listing Rules, issue partly paid shares upon which there are outstanding amounts payable. These shares will have limited rights to vote and to receive dividends.

Shareholder Information

(g) Dividends

The Directors may from time to time determine dividends to be distributed to members according to their rights and interests. The Directors may fix the time for distribution and the methods of distribution. Subject to the terms of issue of shares, each share in a class of shares in respect of which a dividend has been declared will share in the dividend equally.

Each share carries the right to participate in the dividend in the same proportion that the amount for the time being paid on the share (excluding any amount paid in advance of calls) bears to the total issue price of the share.

Dividend payouts over the last six years are disclosed in the schedule of Historical Financial Performance elsewhere in this Annual Report.

(h) Liquidation

Subject to the terms of issue of shares, upon liquidation assets will be distributed such that the amount distributed to a shareholder in respect of each share is equal. If there are insufficient assets to repay the paid-up capital, the amount distributed is to be proportional to the amount paid-up.

(i) Directors

BSP's constitution states that the minimum number of directors is three and the maximum is ten.

(j) Appointment of directors

Directors are elected by the shareholders in a general meeting for a term of three years. At each general meeting, one third of the number of directors (or if that number is not a whole number, the next lowest whole number) retire by rotation. The Board has the power to fill casual vacancies on the Board, but a director so appointed must retire at the next annual meeting.

(k) Powers of the Board

Except as otherwise required by the Companies Act, any other law, the POMSoX Listing Rules or BSP's constitution, the Directors have power to manage the business of BSP and may exercise every right, power or capacity of BSP to the exclusion of the members.

(l) Share buy backs

Subject to the provisions of the Companies Act and the POMSoX Listing Rules, BSP may buy back shares in itself on terms and at times determined by the Directors.

(m) Officers' indemnities

BSP, to the extent permitted by law, indemnifies every officer of BSP (and may indemnify any auditor of BSP) against any liability incurred by the person, in the relevant capacity, to another person unless the liability arises out of conduct involving lack of good faith.

BSP may also make a payment in relation to legal costs incurred by these persons in defending an action for a liability, or resisting or responding to actions taken by a government agency or a liquidator.

Twenty largest registered fully paid ordinary shareholders

At the 31 December 2012, the twenty largest registered fully paid shareholders of the Company were:

		Share Held	%
1	Independent Public Business Corporation	84,311,597	17.97
2	National Superannuation Fund Limited	51,898,901	11.06
3	Nambawan Super Limited	47,112,029	10.04
4	Petroleum Resources Kutubu Limited	46,153,840	9.84
5	Credit Corporation (PNG) Limited	36,848,331	7.85
6	Motor Vehicles Insurance Limited	31,243,736	6.66
7	PNG Sustainable Development Program Limited	29,302,767	6.25
8	IFC Capitalization (Equity) Fund LP	22,796,644	4.86
9	International Finance Corporation	22,796,644	4.86
10	Teachers Savings and Loans Society Limited	17,317,366	3.69
11	Comrade Trustee Services Limited	14,680,378	3.13
12	Tropicana Limited	4,983,653	1.06
13	Lamin Trust Fund	3,518,132	0.75
14	Credit Corporation (PNG) Ltd (CC Finance Ltd)	3,000,000	0.64
15	Mineral Resources OK Tedi No. 2 Limited	2,890,000	0.62
16	Solomon Islands National Provident Fund Board	2,500,001	0.53
17	Nominees Niugini Limited	2,369,495	0.51
18	Catholic Diocese of Kundiawa	2,165,688	0.46
19	Southern Highlands Provincial Government	2,000,000	0.43
20	Mineral Resources Star Mountains Ltd	1,975,799	0.42
	Other shareholders	39,336,447	8.37
		469,201,448	**100.00**

Distribution of shareholdings

At the 31 December 2012, the Company had 6,924 shareholders. The distribution of shareholdings is as follows:

Range (number)	Number of Shareholders	Number of Shares
1-1,000	5,869	1,523,368
1,001 - 5,000	713	1,465,664
5,001 - 10,000	103	725,925
10,001 - 100,000	155	5,667,965
100,001 and above	84	459,818,526
	6,924	**469,201,448**

Dividend reinvestment scheme

The Company has a dividend reinvestment scheme in operation.

Shareholder Information

Employee share scheme

The Company resolved on 27 May 2004 that a maximum of 1 percent of the total number of shares held in the Company may be allocated to employees each year at the discretion of the Board.

Interest in shares in the Bank

Directors hold the following shares in the Bank:

Director	Shares Held	%
T. E. Fox	160,013	0.00
Gerea Aopi	10,000	0.00

Registered Office
Bank of South Pacific Limited
PO Box 78,
PORT MORESBY
National Capital District
PAPUA NEW GUINEA
Telephone: +675 322 9700

Share Registry
PNG Registries Limited
PO Box 1265,
PORT MORESBY
National Capital District
PAPUA NEW GUINEA
Telephone: +675 321 6377

Website
www.bsp.com.pg

Home Exchange for BSP Shares
Port Moresby Stock Exchange Ltd (POMSOX)
PO Box 1531
PORT MORESBY
National Capital District
PAPUA NEW GUINEA
Telephone: +675 320 1980

Home Exchange for BSP Convertible Notes
South Pacific Stock Exchange
GPO Box 11689
SUVA
FIJI
Telephone: +675 330 4130

Branch Network

Senior Management

Group Chief Executive Officer
Ian B Clyne

Group Chief Risk Officer
Robin Fleming

Group Chief Financial Officer
Johnson Kalo

Group Chief Operating Officer
Robert Loggia

General Manager Corporate Banking
Peter Beswick

General Manager Human Resources
Giau Duruba

General Manager Paramount Banking
Aho Baliki

General Manager Retail Banking
Frans Kootte

General Manager Treasury
Mark Railston

Branch Network

Branches	Phone Numbers
AITAPE Branch Manager Alex Wafimbi	(675) 457 2042
ALOTAU Branch Manager Ben Umba	(675) 641 1284
ARAWA Branch Manager Patrick Buibui	(675) 276 9244
BIALLA Branch Manager Marco Hamen	(675) 983 1095
BOROKO Branch Manager Anne Baniyamai	(675) 323 2288
BUKA Branch Manager Julie Warren	(675) 973 9042
BULOLO Branch Manager Joe Makinta	(675) 474 5366
COMMERCIAL CENTRE Manager Operations Madeleine Leka	(675) 325 5999
DARU Branch Manager Ivy David	(675) 645 9062
DOUGLAS STREET Branch Manager John Kubar	(675) 321 2444
GOROKA Assistant Branch Manager Reuben Elijah	(675) 532 1633

Branches	Phone Numbers
KAINANTU Branch Manager Billy Veveloga	(675) 537 1065
KAVIENG Branch Manger Maureen Wanu	(675) 984 2066
KIMBE Branch Manager Misbil Alfred	(675) 983 5166
KIUNGA Branch Manager Damaris Tarere	(675) 649 1073
KOKOPO Branch Manager Albert Burua	(675) 982 9088
KUNDIAWA Branch Manager Albert Seri	(675) 535 1025
LAE Branch Manager Mary Kundi	(675) 473 9801
LAE COMMERCIAL Branch Manager Agnes Mark	(675) 473 9800
LAE MARKET Branch Manager Quillan Nongi	(675) 473 9606
LIHIR Branch Manager Robinson Panako	(675) 986 4052
LORENGAU Branch Manager Karen George	(675) 970 9050

Branches	Phone Numbers
MADANG Branch Manager Cecilia Pasum	(675) 422 2477
MENDI Branch Manager Joseph Was	(675) 549 1070
MORO Branch Manager Meck Kaum	(675) 276 1566
MOTUKEA Branch Manager Navu Urro	(675) 321 7701
MOUNT HAGEN Branch Manager Alex Kuna	(675) 542 1877
POPONDETTA Branch Manager Maudy Ruruga	(675) 629 7171
PORGERA Branch Manager John Basanu	(675) 547 6900
PORT MORESBY Branch Manager Magai Kavailon	(675) 322 9790
RABAUL Branch Manager Bevilon Homuo	(675) 982 1744
TABUBIL Branch Manager Tony Waningu	(675) 649 9179
VANIMO Branch Manager Josephine Komoru	(675) 457 1209
VISION CITY Branch Managers Andrew Bokame	(675) 310 0008
WABAG Branch Manager Jerry Marie	(675) 547 1176

Branches	Phone Numbers
WAIGANI BANKING CENTRE Branch Manager Stanley Bole	(675) 300 9600
WAIGANI DRIVE Branch Manager Mathias Manowo	(675) 325 6788
WEWAK Branch Manager Cecilia Raepa	(675) 456 2344
FIJI (Fiji) Country Head Kevin McCarthy	679) 330 4011
BA (Fiji) Branch Manager Albertina Lilo	(679) 662 7335
CENTREPOINT (Fiji) Branch Manager Manjila Goundar	(679) 334 2333
LABASA (Fiji) Branch Manager Anand Nair	(679) 881 1360
LAUTOKA (Fiji) Branch Manager Josefa Tuitubou	(679) 666 2466
NADI (Fiji) Branch Manager Davendran Pillay	(679) 662 7310
NAMAKA (Fiji) Branch Manager Madhur Lata Kumar	(679) 662 7320
NAUSORI (Fiji) Branch Manager Shailendra Roy	(679) 347 8499
PACIFIC HARBOUR (Fiji) Branch Manager Eka Seduadua	(679) 345 2030

Branches	Phone Numbers
PACIFIC HOUSE (Fiji) Branch Manager Rajesh Chand	(679) 321 4580
RAKIRAKI (Fiji) Officer In Charge Ronika Prakash	(679) 662 7341
SAMABULA (Fiji) Branch Manager Mere Vuinakelo	(679) 338 7999
SAVUSAVU (Fiji) Branch Manager Ram Rattan	(679) 885 0221
SIGATOKA (Fiji) Branch Manager Sera Kasaqa Petueli	(679) 662 7332
SUVA – CENTRAL (Fiji) Branch Manager Arif Mohammed	(679) 321 4455
TAVEUNI (Fiji) Branch Manager Marica Mara	(679) 888 0433
TAVUA (Fiji) Branch Manager Reginald Kumar	(679) 662 7338
THOMSON ST (Fiji) Branch Manager Susie Fesaitu	(679) 321 4671
NIUE (Niue) Branch Manager Ann Margaret Andrews Pesamino	(683) 4220
SOLOMON ISLANDS (SI) Country Head Mark Corcoran	(677) 21874
AUKI (SI) Branch Manager Samuel Misi	(677) 40484
COMMERCIAL BANKING (SI) Branch Manager Rose Murray	(677) 23620

Branches	Phone Numbers
GIZO (SI) Relieving Branch Manager Clotilda Londeka	(677) 60539
HONIARA (SI) Branch Manager Michael Kahamana	(677) 21814
MUNDA (SI) Branch Manager Rebecca Hickie	(677) 62177
NORO (SI) Branch Manager Tewia Laore	(677) 61222
POINT CRUZ (SI) Branch Manager Rose Funa	(677) 21874
RANADI (SI) Branch Manager Joy Vave	(677) 39403

Rural Branches	Phone Numbers
AIYURA Priscilla Bob	(675) 7230 8313
BANZ Jonathan Philip	(675) 7100 9078
BUIN Melchior Tania	(675) 7100 7855
CHUAVE Anita John	(675) 7197 6001
DAULO Delilah Gahale	(675) 7100 6763
GEMBOGL Rose Kawage	(675) 7313 4177
GUMINE John Sii	(675) 7100 7860
HENGANOFI Norgie Komprino	(675) 7100 7859
HOSKINS Rudy Samson	(675) 7346 1426

Rural Branches	Phone Numbers
IALIBU Betty Goraiye	(675) 7197 6004
KAMTAI Shirley Kaupa	(675) 7243 4695
KEREVAT Cathy Kabiu	(675) 7190 8231
KEROWAGI Boyd Arag	(675) 7100 9077
KINIM Malapun Bannick	(675) 7100 7861
KONOS Terryane Langu	(675) 7197 6006
LABA Edward Tani	(675) 7197 6008
LAIAGAM Roselyn Joel	(675) 7196 6002
LAKURUMAU Christine Gawi Frank	(675) 7197 6005
LUFA Nevlyn Netu	(675) 7100 6761
MAPRIK Christian Tatu	(675) 7168 7815
MINJ Pauline Kapal	(675) 7100 9076
MUTZING Frank Godfrey	(675) 7100 2488
NAMATANAI Victoria Matkar	(675) 7197 6007
OKAPA Mele Aron	(675) 7374 5623
PALMALMAL Stanford Talmar	(675) 7323 9181
PANGIA Job Kaiyo	(675) 7197 6003
TAMBUL Joseph Wanjil	(675) 7100 7863

Rural Branches	Phone Numbers
TELEFOMIN Donna Yarkin	(675) 7255 8421
WAKUNAI Anthonia Montai	(675) 7100 7856
WALIUM Brenda Igusam	(675) 7106 8357
WAPENAMANDA Grace Reto	(675) 7100 7862
YANGORU Michael Paul Java	(675) 7127 0000
YONKI Stephanie Yapate	(675) 7185 5768
ZENAG Nicko Morris	(675) 7318 5855

Notes


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