

Bank of South Pacific Limited and Subsidiaries

Financial Statements

For the year ended

31 December 2006



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Directors Report

for the Year Ended 31 December 2006

The Directors take pleasure in presenting the Financial Statements of the Company and the Group for the year ended 31 December 2006. 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 throughout Papua New Guinea and the Pacific region. BSP is a company 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 registered office is at Douglas Street, Port Moresby. On 15 December 2006 the company acquired the assets & liabilities of the Habib Bank Ltd Fiji branch.

Review of operations

For the year ended 31 December 2006, the Company's profit after tax was K109.790 million (2005: K98.519 million profit). The group's profit after tax was K111.616 million (2005: K99.224 million).

Future Developments

The directors also advise that following formal announcement to POMSoX in September 2006, formal submissions and discussions with respective authorities both in Papua New Guinea and Solomon Islands for the acquisition of the National Bank of Solomon Islands is continuing at the date of this report. The acquisition will be finalized once all conditions of the Sale and Purchase Agreement are satisfied. This is expected to take place at or around the end of March 2007.

Dividends

No dividends have been declared by the Company in respect of the year ended 31 December 2006 (2005: K60.425 million dividend was paid on 21st July 2006 in respect of the year ended 31 December 2005).

Directors and officers

The following were directors of the Bank of South Pacific Limited during the year ended 31 December 2006:

Mr. N N Beangke	Mr. J G Jeffery	Mr. V Reva	John Kapi Natto (Appointed May 2006)
Mr. T E Fox	Mr. G McIlwain	Mr. G Aopi	
Mr. N Bogan	Mr. C C Procter	Dr. I Temu	

Details of directors' tenure and directors and executives' remuneration during the year are provided in Note 28 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 43. 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

Donations made by the Company during the year amounted to K80,179 (2005: K163,311).

Interests Register

Transactions recorded in the Interests Register are disclosed in Note 27 of the Notes to the Financial Statements.

For, and on behalf of, the Directors.

Dated and signed in accordance with a resolution of the directors in Port Moresby this 10th day of March 2007.



N.N. Beangke
Chairman



Garth McIlwain
Managing Director

Statement by the Directors

for the Year Ended 31 December 2006

The directors declare that:

- (a) in the directors' opinion, there are reasonable grounds to believe that the Company & 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 giving a true and fair view of the financial position and performance of the consolidated entity.

Additional Statutory Information

The results of the Company 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 Company 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 Company 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 10th day of March 2007.



N.N. Beangke
Chairman



Garth McIlwain
Managing Director

Income Statement

for the Year Ended 31 December 2006

	Note	Consolidated		Bank	
		2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>					
Interest income	1	235,221	179,680	235,063	179,616
Interest expense	1	(25,640)	(17,876)	(25,640)	(17,876)
Net interest income		209,581	161,804	209,423	161,740
Fee and Commission income	2	55,472	53,579	52,080	52,549
Other income	3	79,059	90,595	77,157	90,291
Net operating income		344,112	305,978	338,660	304,580
Bad and doubtful debts (expense)/recovery	4	1,311	3,968	1,311	3,968
Other operating expenses	5	(180,328)	(167,265)	(177,231)	(166,625)
Operating profit		165,095	142,681	162,740	141,923
Share of loss from associates accounted for using the equity method	10	(577)	(451)	(577)	(451)
Profit before tax		164,518	142,230	162,163	141,472
Income tax expense	6 (a)	(52,902)	(43,006)	(52,373)	(42,953)
Operating profit/(loss) from ordinary activities after tax		111,616	99,224	109,790	98,519
Earnings per share - basic & diluted (in toea per share)	30	25.4	22.8	25.0	22.6

The attached notes form an integral part of these financial statements

Balance Sheet

As at 31 December 2006

	Note	Consolidated		Bank	
		2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>					
ASSETS					
Cash and balances with Central Bank	11	271,097	211,344	268,522	211,230
Treasury & Central Bank bills	12	1,235,374	652,940	1,235,374	643,918
Amounts due from other banks	13	144,716	179,049	144,716	179,049
Loans and advances to customers	14	1,163,252	873,538	1,163,252	873,538
Properties held for sale	15(a)	614	1,305	614	1,305
Property, plant and equipment	15(b)	150,470	129,967	150,377	129,877
Assets subject to operating lease	15(c)	99,141	-	99,141	-
Investment securities	16	1,141,355	828,925	1,141,355	828,925
Investment in associates	10	2,972	3,549	2,972	3,549
Investment in subsidiary		-	-	7,107	6,302
Intangible asset	9	9,414	2,990	6,424	-
Deferred tax assets	17	17,260	14,738	17,236	14,736
Other assets	18	501,256	54,113	94,270	46,204
Total assets		4,736,921	2,952,458	4,331,360	2,938,633
LIABILITIES					
Amounts due to other banks	19	2,908	5,866	2,908	5,866
Amounts due to customers	20	4,177,060	2,542,935	3,776,380	2,536,226
Other liabilities	21	71,915	51,159	70,274	45,721
Provision for income tax	6(b)	53,706	19,553	52,566	18,586
Deferred tax liabilities	17	13,932	7,055	13,932	7,055
Other provisions	22	21,105	17,590	21,004	17,590
Total liabilities		4,340,626	2,644,158	3,937,064	2,631,044
SHAREHOLDERS EQUITY					
Ordinary shares	23	212,206	185,242	212,206	185,242
Retained earnings	24	147,592	100,719	145,689	100,008
Other reserves	24	36,497	22,339	36,401	22,339
Total shareholders' equity		396,295	308,300	394,296	307,589
Total equity and liabilities		4,736,921	2,952,458	4,331,360	2,938,633

The attached notes form an integral part of these financial statements

Statement of Changes in Shareholders Equity

For the year ended 31 December 2006

Bank	Notes	Share capital	Reserves	Retained earnings	Total
<i>All amounts are expressed in K'000</i>					
Balance as at 1 January 2005	23 & 24	191,131	19,816	44,685	255,632
Net profit		-	-	98,519	98,519
Emsop revaluation		-	2,523	-	2,523
Final dividend paid for 2004		-	-	(43,196)	(43,196)
Net share buy back/Issue of ordinary shares	23	(5,889)	-	-	(5,889)
Balance at 31 December 2005	23 & 24	185,242	22,339	100,008	307,589
Net profit		-	-	109,790	109,790
Final dividend paid for 2005		-	-	(60,425)	(60,425)
Revaluation of property		-	22,350	-	22,350
Deferred income 2005		-	-	(3,684)	(3,684)
Deferred tax liability for revaluation		-	(6,491)	-	(6,491)
Emsop revaluation		-	(1,797)	-	(1,797)
Net share buy back / Issue of ordinary shares	23	26,964	-	-	26,964
Balance at 31 December 2006	23 & 24	212,206	36,401	145,689	394,296
Consolidated					
Balance at 31 December 2005	23 & 24	185,242	22,339	100,719	308,300
Net profit		-	-	111,616	111,616
Final dividend paid for 2005		-	-	(60,425)	(60,425)
Net share buy back / Issue of ordinary shares	23	26,964	-	-	26,964
Revaluation of property		-	22,350	-	22,350
Deferred tax liability for revaluation		-	(6,491)	-	(6,491)
Deferred Income 2005		-	-	(3,684)	(3,684)
Emsop revaluation		-	(1,797)	-	(1,797)
Tax adjustments		-	-	(634)	(634)
Exchange movement reserve		-	96	-	96
Balance at 31 December 2006	23 & 24	212,206	36,497	147,592	396,295

The attached notes form an integral part of these financial statements

Cash Flow Statement

For the year ended 31 December 2006

<i>All amounts are expressed in K'000</i>	Notes	Consolidated		Bank	
		2006	2005	2006	2005
CASH FLOW FROM OPERATING ACTIVITIES					
Interest received		233,257	181,484	233,257	181,484
Fees and other income		134,267	145,730	126,976	140,155
Interest paid		(24,487)	(18,502)	(24,487)	(18,502)
Amounts paid to suppliers and employees		(142,212)	(138,887)	(138,851)	(136,595)
Operating cash flow before changes in operating assets	29	200,825	169,825	196,895	166,542
Decrease/(increase) in loans		(288,403)	(189,396)	(288,403)	(189,396)
Decrease/(increase) in bills receivable and other assets		(67,132)	(16,948)	(67,132)	(17,781)
(Decrease)/increase in deposits		1,240,154	696,675	1,240,154	699,497
(Decrease)/increase in bills payable and other liabilities		15,504	10,512	15,504	10,512
Net cash flow from operations before income tax		1,100,948	670,668	1,097,018	669,374
Income taxes paid		(20,407)	(22,476)	(19,767)	(22,474)
Net cash flow from operating activities		1,080,541	648,192	1,077,251	646,900
CASH FLOW FROM INVESTING ACTIVITIES					
Decrease/(increase) in Government securities		(903,886)	(344,930)	(903,886)	(344,930)
Expenditure on property, plant & equipment		(125,857)	(11,068)	(125,815)	(10,931)
Proceeds from disposal of property, plant & equipment		1,599	2,814	1,560	2,650
Movement in share trading activities		3,406	(3,730)	-	-
Purchase of shares in Associates	10	-	(4,000)	-	(4,000)
Cash paid for purchase of subsidiary		(805)	(6,302)	(805)	(6,302)
Net cashflow on acquisition of branch	8	10,462	-	10,462	-
Net cash flow from investing activities		(1,015,081)	(367,216)	(1,018,484)	(363,513)
CASH FLOW FROM FINANCING ACTIVITIES					
Issue of share capital		26,964	(5,889)	26,964	(5,889)
Repayment of borrowings		(84)	(10,000)	-	(10,000)
Client Management Trust		(6,971)	508	-	-
Dividends paid	24	(60,425)	(43,196)	(60,425)	(43,196)
Net cash flow from financing activities		(40,516)	(58,577)	(33,461)	(59,085)
Net Increase/(decrease) in cash and cash equivalents		24,944	222,399	25,306	224,302
Effect of exchange rate movements on cash and cash equivalents		611	620	611	620
BSP Capital take on opening cash balance		-	2,017	-	-
Cash and cash equivalents at the beginning of the year		387,350	159,491	384,413	159,491
Cash and Cash Equivalents at the end of the year	26	412,905	384,527	410,330	384,413

The attached notes form an integral part of these financial statements

Accounting Policies

For the year ended 31 December 2006

The principal accounting policies adopted in the preparation of these 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 2006, 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 purchase method of accounting, where:

- acquisition cost is measured at fair value of assets acquired, 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 income statement.
- All intercompany transactions and balances are eliminated

C Investment in Associates

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

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

- The investment is initially recognised at cost;
- The group's share of post acquisition profits or losses are recognised in the income statement, and the group's share of post acquisition reserve movements are recognised in reserves; Cumulative post acquisition movements are adjusted against the carrying value of the investment.

D 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 Income statement.

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.

Accounting Policies

For the year ended 31 December 2006

E Interest income and expense

Interest income and expense are recognised in the Income Statement 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 and accrued discount and premium on treasury bills.

F Fee and commission income

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

G Borrowing expenses

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

H 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 income statement.

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 Income Statement.

I 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 balance sheet 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.

J 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.

Accounting Policies

For the year ended 31 December 2006

K Property, plant and equipment

Land and buildings are measured at fair value. Fair value is determined on the basis of an annual 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 income statement 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 profit or loss 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 lives, residual values and depreciation method is reviewed at the end of each annual reporting period.

The following basis and method of depreciation is used:

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

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

L Leases

Bank is lessee

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

Bank is lessor

Finance leases are included in Loans and Advances to Customers (Note 14) 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 balance sheet, 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.

M 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.

Accounting Policies

For the year ended 31 December 2006

N Provisions

Provisions are created when a legal or constructive obligation arises as a result of a past event, it is probable that an outflow of economic value will be required to settle the obligation, and the amount of the obligation can be reliably estimated.

O Employee benefits

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

Provisions made 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.

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

Post employment benefits - defined contribution plans

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

The Bank and the Group pays contributions to publicly or privately administered superannuation plans on a mandatory, contractual or voluntary basis in respect of services rendered up to balance sheet date by all Papua New Guinean staff members. The contributions are at the current rate of eight point four per cent (8.4%) of employees' gross salary (2005: 8.4%). 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.

P Income tax

Current Tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by 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 comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

The major temporary differences relate to depreciation of property, plant and equipment, employee provisions, tax losses carried forward, provisions for bad and doubtful debts and lease receivables.

Deferred income tax is calculated using tax rates ruling at balance sheet date. Deferred income tax assets are recognised only if it is probable that future profits will be available against which temporary differences can be utilised.

Income tax payable on profits, based on the relevant tax legislation, is recognised as an expense in the period in which the profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Accounting Policies

For the year ended 31 December 2006

Q Investments

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

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

R Foreign Currency

Foreign exchange held and amounts payable or receivable in foreign currencies have been translated into Papua New Guinea Kina at the mid-market exchange rates applicable at balance sheet date.

Foreign currency transactions are recorded at the exchange rates in effect at the date of the transaction. Monetary assets and liabilities arising from trading transactions or overseas borrowings are translated at closing rates. Gains and losses due to currency fluctuations on these items are included in the Income Statement.

Foreign operations

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

S 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 income statement, 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.

Accounting Policies

For the year ended 31 December 2006

T 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.

U Comparatives

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

Financial Risk Management

For the year ended 31 December 2006

A Bank operations, risks and strategies in using financial instruments

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

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

The Bank and the Group also seeks to raise 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 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.

B 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 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 introduces the leverage capital ratio (see below for details). In all months, the Bank and the Group complied with the prevailing prudential requirements for total capital and leverage capital. As at 31 December 2006, the Bank and the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for well-capitalised. The minimum capital adequacy requirements set out under the standard are: Tier 1 8%, total 12% and the leverage ratio 6%.

The measure of capital used for the purposes of prudential supervision is referred to as base capital. Total base capital varies from the balance of capital shown on the balance sheet and is made up of tier 1 capital (core) and tier 2 capital (supplementary), after deducting the value of investments in other banks and financial institutions. 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.

Financial Risk Management

For the year ended 31 December 2006

B Capital adequacy (continued)

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

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

<i>All amounts are expressed in K'000</i>	Balance sheet / notional amount		Risk-weighted amount	
	2006	2005	2006	2005
Balance sheet assets (net of provisions)				
Currency	226,811	69,680	1,087	2,036
Loans and advances	1,163,324	873,587	1,143,281	800,088
Investments and short term securities	2,770,385	1,481,865	-	-
All other assets	577,352	527,326	372,194	229,271
Off balance sheet items	602,523	157,452	54,074	8,128
Total	5,340,395	3,109,910	1,570,636	1,039,523

Capital Ratios	Capital (K'000)		Capital Adequacy Ratio (%)	
	2006	2005	2006	2005
a) Before YTD profits included in Tier 1 Capital				
Tier 1 capital	239,771	183,612	15.6%	17.7%
Tier 1 + Tier 2 capital	400,473	312,057	25.9%	29.4%
b) After YTD profits included in Tier 1 Capital				
Tier 1 capital	351,387	282,837	22.9%	27.2%
Tier 1 + Tier 2 capital	400,473	312,057	25.9%	29.4%
c) Leverage Capital Ratio – Before YTD profits included in Tier 1 Capital			5.1%	6.2%
d) Leverage Capital Ratio – After YTD profits included in Tier 1 Capital			7.4%	9.6%

C 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 customer. Individual exposures are measured using repayment performance, reviews and statistical techniques. Comprehensive credit standards and approval limits have been formulated and approved by the Credit Committee. The Credit Committee (which reports to the Board through the Executive and Managing Director) 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 H – 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.

Financial Risk Management

For the year ended 31 December 2006

C Credit risk and asset quality (continued)

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 2006, the 25 largest exposures totaled K731 million, accounting for over 60.2% of the Bank and the Group's total loan portfolio (2005: K473 million, accounting for over 52.4%).

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

Credit related commitments

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

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

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

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

Economic sector risk concentrations

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

All amounts are expressed in K'000

As at 31 December	2006	%	2005	%
Commerce, finance and other business	550,947	47	348,120	40
Private households	215,954	19	193,237	22
Government and Public Authorities	14,733	1	2,962	1
Agriculture	123,777	11	74,287	8
Transport & communication	52,890	4	59,184	7
Manufacturing	114,029	10	104,615	12
Construction	90,922	8	91,133	10
Net loan portfolio balance	1,163,252	100	873,538	100

Financial Risk Management

For the year ended 31 December 2006

D 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 2006

The maturity profile of material Assets and Liabilities as at 31 December 2006 is shown in the following schedule. The mismatching of maturity of assets and liabilities indicates an apparent negative net “current” asset position. However, as stated in the preceding paragraph, mismatched positions are established and managed to exploit profit opportunities that arise from them, particularly in a normal yield curve environment. Accordingly, this mismatched maturity position is considered manageable by the Bank and the Group, and does not impair the ability of the Bank and the Group to meet its financial obligations as they fall due. The Directors are also of the view that the Bank and the Group is able to meet its financial obligations as they fall due for the following additional reasons:

- The Bank and the Group complies with the Minimum Liquid Asset Ratio (“MLAR”) and Cash Reserve Requirement (“CRR”) set by the regulatory authority, the Bank of Papua New Guinea (“BPNG”). The MLAR is the minimum ratio of liquid assets to total customer deposits considered by the regulator as sufficient to support exceptional liquidation by depositors, of their funds. All commercial banks are required to hold a minimum of 25% of the value of total customer deposits in the form of prescribed liquid assets. As at 31 December 2006, the Bank and the Group’s Liquid Asset Ratio was approximately 51.40% (2005: 56.19%), significantly in excess of the minimum requirement of 25%.
- The CRR specifies that a bank must hold an amount equal to 3% 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 11, Cash and Balances with Central Bank, and Note 26, Contingent Liabilities and Commitments.

Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2006	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and central bank assets	271,097	-	-	-	-	271,097
Treasury & Central Bank bills	783,056	150,000	302,318	-	-	1,235,374
Due from other banks	144,716	-	-	-	-	144,716
Loans and advances	301,049	41,509	171,678	512,415	136,601	1,163,252
Investments	-	-	141,732	652,973	346,650	1,141,355
Total assets	1,499,918	191,509	615,728	1,165,388	483,251	3,955,794

Financial Risk Management

For the year ended 31 December 2006

D Liquidity risk (continued)

Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2006	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Due to other banks	2,908	-	-	-	-	2,908
Due to customers	3,921,601	213,983	41,078	283	115	4,177,060
Other liabilities	18,801	53,114	-	-	-	71,915
Other provisions	63,810	12,155	-	-	12,778	88,743
Total liabilities	4,007,120	279,252	41,078	283	12,893	4,340,626
Net liquidity gap	(2,507,202)	(87,743)	574,650	1,165,105	470,358	(384,832)
As at 31 December 2005						
Total assets	937,149	68,691	646,636	871,551	221,769	2,745,796
Total liabilities	2,367,220	203,887	63,922	360	11,292	2,646,681
Net liquidity gap	(1,430,071)	(135,196)	582,714	871,191	210,477	99,115

E 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. Operational risk is managed through formal policies, documented procedures, business practices and compliance monitoring. An independent internal audit function also conducts regular reviews to monitor compliance with policy and regulatory environment and examines the general standard of control.

F 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.

Financial Risk Management

For the year ended 31 December 2006

F Foreign exchange risk (continued)

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

All amounts are expressed in K'000

As at 31 December 2006	USD	AUD	EURO	PGK	Other	Total
Assets						
Cash and Central Bank assets	1,072	1,119	152	268,040	714	271,097
Treasury & Central Bank bills	-	-	-	1,235,374	-	1,235,374
Due from other banks	42,946	76,166	163	11,117	14,324	144,716
Loans and advances	9,167	53	-	1,153,336	696	1,163,252
Investments	-	-	-	1,141,355	-	1,141,355
Other assets	-	-	-	781,127	-	781,127
Total assets	53,185	77,338	315	4,590,349	15,734	4,736,921
Liabilities						
Due to other banks	-	-	-	2,908	-	2,908
Due to customers	35,377	72,992	4	4,068,687	-	4,177,060
Other liabilities	-	-	-	160,658	-	160,658
Total liabilities	35,377	72,992	4	4,232,253	-	4,340,626
Net on-balance sheet position	17,808	4,346	311	358,096	15,734	396,295
Off-balance sheet net notional position	44,843	4,066	5,785	-	-	54,694
Credit commitments				470,739		
31 December 2005						
Total Assets	83,207	65,503	404	2,778,494	24,850	2,952,458
Total Liabilities	42,351	47,916	3	2,540,897	12,991	2,644,158
Net on-balance sheet position	40,856	17,587	401	237,597	11,859	308,300
Off-balance sheet net notional position	(29,599)	(24,325)	-	-	(980)	(54,904)
Credit commitments	-	-	-	333,421	-	-

Financial Risk Management

For the year ended 31 December 2006

G 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 2006 and prevailing rates of interest, a 1% increase in rates will result in a K1.7 million decrease in net interest income, whilst a 1% decrease in rates will result in a K478 thousand decrease in net interest income. A change from the prevailing low interest rate environment is likely to impact upon net interest income in the manner described above, because of the following factors:

- A risk mitigation strategy that has resulted in the overall lengthening of asset maturities as rates have declined;
- An upward change in rates will have a more immediate impact on liabilities because of the re-pricing mismatch;
- A downward change in rates will have a significant impact on assets whilst the impact will be muted in respect of liabilities because further decreases are limited by the current low interest rates on liabilities.

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

All amounts are expressed in K'000

As at 31 December 2006	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	-	-	-	-	-	271,097
Treasury & Central Bank bills	783,056	150,000	302,318	-	-	-
Due from other banks	144,716	-	-	-	-	-
Loans and advances	807,599	21,035	79,270	198,749	56,562	37
Investments	-	-	141,732	652,973	346,650	-
Other assets	-	-	-	-	-	781,127
Total assets	1,735,371	171,035	523,320	851,722	403,212	1,052,261
Liabilities						
Due to other banks	2,908	-	-	-	-	-
Due to customers	2,914,930	213,983	41,078	283	115	1,006,671
Other liabilities	-	-	-	-	-	160,658
Total liabilities	2,917,838	213,983	41,078	283	115	1,167,329
Interest sensitivity gap	(1,182,467)	(42,948)	482,242	851,439	403,097	-

Financial Risk Management

For the year ended 31 December 2006

G Interest rate risk (continued)

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

As at 31 December 2005	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	25,089	-	-	-	-	186,255
Treasury & Central Bank bills	337,160	29,997	285,783	-	-	-
Due from other banks	179,049	-	-	-	-	-
Loans and advances	643,333	17,094	58,531	109,836	23,691	21,053
Investments	-	-	207,408	463,655	157,862	-
Other assets	-	-	-	-	-	206,662
Total assets	1,184,631	47,091	551,722	573,491	181,553	413,970
Liabilities						
Due to other banks	5,866	-	-	-	-	-
Due to customers	1,574,125	148,666	63,922	360	-	755,862
Other liabilities	-	-	-	-	-	95,357
Total liabilities	1,579,991	148,666	63,922	360	-	851,219
Interest sensitivity gap	(395,360)	(101,575)	487,800	573,131	181,553	-

Effective interest rates as at 31 December

Amounts are expressed in % p.a.

	2006	2005
Assets		
Cash and Central Bank assets	4.00	3.04
Treasury & Central Bank bills	4.45	3.54
Due from other banks	3.00	3.00
Loans and advances	10.46	11.07
Investments	9.69	10.33
Liabilities		
Due to other banks	3.00	3.00
Due to customers	0.74	0.87

Financial Risk Management

For the year ended 31 December 2006

H 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 2006, 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 2006		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	4,933			2,323		
	Kina	28,841	13,269			1,266	43,376
Buying	FCY	(9,557)	(5,569)			(594)	
	Kina	(14,905)			(13,788)		(28,693)
As at 31 December 2005		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	3,996	-	-	300	-	
	Kina	12,346	-	-	1,602	-	13,948
Buying	FCY	(13,449)	(10,548)	-	-	(52,474)	
	Kina	(41,945)	(24,325)	-	-	(2,582)	(68,852)

Notes to the Financial Statements

For the year ended 31 December 2006

1	Net Interest income	Consolidated		Bank	
		2006	2005	2006	2005
	<i>All amounts are expressed in K'000</i>				
	Interest income				
	Cash and short term funds	806	1,069	806	1,069
	PNG Public Securities: Treasury bills, Central Bank bills and Inscribed stock	124,946	81,056	124,946	80,992
	Loans and advances	108,597	96,788	108,597	96,788
	Other	872	767	714	767
		<u>235,221</u>	<u>179,680</u>	<u>235,063</u>	<u>179,616</u>
	Less:				
	Interest expense				
	Customer deposits	25,540	17,356	25,540	17,356
	Other banks	99	230	99	230
	Other borrowings	1	290	1	290
		<u>25,640</u>	<u>17,876</u>	<u>25,640</u>	<u>17,876</u>
		<u>209,581</u>	<u>161,804</u>	<u>209,423</u>	<u>161,740</u>
	2 Net fee and commission income				
	Fee and commission income				
	Credit related	17,057	17,616	17,057	17,616
	Trade and international related	4,629	4,413	4,629	4,413
	Electronic banking related	4,000	3,293	4,000	3,293
	Brokerage & fee income	3,392	1,030	-	-
	Other	26,549	27,385	26,549	27,385
		<u>55,627</u>	<u>53,737</u>	<u>52,235</u>	<u>52,707</u>
	Less:				
	Fee and commission expenses				
	Agencies	173	148	173	148
	Other	(18)	10	(18)	10
		<u>155</u>	<u>158</u>	<u>155</u>	<u>158</u>
		<u>55,472</u>	<u>53,579</u>	<u>52,080</u>	<u>52,549</u>

Notes to the Financial Statements

For the year ended 31 December 2006

3 Other income	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Foreign Exchange related	64,577	87,262	64,577	87,022
Other	14,482	3,333	12,580	3,269
	79,059	90,595	77,157	90,291
Included in other income:				
Profit/(loss) on sale of fixed assets	336	169	336	169
Foreign Exchange related income includes gains and losses from spot and forward contracts and translated foreign currency assets				
4 Bad and doubtful debts (expense)/recovery				
Bad debts recovered - net	7,334	11,427	7,334	11,427
Net charge to doubtful debts provision	(6,023)	(7,459)	(6,023)	(7,459)
	1,311	3,968	1,311	3,968
5 Other operating expenses				
Administration	33,391	31,109	32,115	31,044
Auditors remuneration	528	688	471	648
Computing	22,665	20,210	22,665	20,210
Depreciation	30,356	26,844	30,320	26,829
Amortization of computer development	602	235	602	235
Amortisation of deferred acquisition costs	-	159	-	159
Non-executive Directors costs	781	559	781	559
Non-lending losses	5,324	3,812	5,324	3,734
Fixed Asset write off	-	724	-	724
Goodwill write off	1,755	-	1,755	-
Premises and equipment	17,578	15,819	17,578	15,948
Staff costs				
Defined contribution plans	2,300	2,128	2,265	2,128
Statutory benefit contributions	1,975	1,959	1,975	1,959
Wages and salaries	49,879	51,040	48,226	50,635
Employee bonus shares	437	2,039	437	2,039
Other	12,757	9,940	12,717	9,774
	67,348	67,106	65,620	66,535
	180,328	167,265	177,231	166,625

Notes to the Financial Statements

For the year ended 31 December 2006

6(a) Income tax expense

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Current tax	51,864	47,694	51,158	47,720
Deferred tax	(1,446)	(4,966)	(1,446)	(4,966)
Current year	50,418	42,728	49,712	42,754
Prior year adjustments	2,484	278	2,661	199
	52,902	43,006	52,373	42,953
Tax calculated at 30% of profit before tax (2005: 30%)	49,355	42,670	48,649	42,442
Expenses not deductible for tax	1,235	148	1,235	402
Deductible expenses not recognised for accounting purposes	(172)	(90)	(172)	(90)
Prior year under provision	2,484	278	2,661	199
	52,902	43,006	52,373	42,953

Further information about deferred taxes is presented in note 17.

6(b) Income tax recoverable / (Provision for income tax)

Recoverable / (provision) comprise:

At 1 January	(19,553)	7,511	(18,586)	7,511
Subsidiary take on provision	-	(335)	-	-
Income tax provision	(56,522)	(43,902)	(55,889)	(43,093)
Deferred tax movement	(1,352)	(4,966)	(1,446)	(4,966)
Expenses not deductible for tax	1,235	(148)	1,235	(402)
Deductible expenses not recognised for accounting purposes	172	90	172	90
Prior year over / (under) provision	(2,661)	(279)	(2,661)	(200)
Tax credit received	4,842	-	4,842	-
Tax payments made	20,133	22,476	19,767	22,474
At 31 December	(53,706)	(19,553)	(52,566)	(18,586)

Notes to the Financial Statements

For the year ended 31 December 2006

7 Acquisition of Capital Stock Brokers

In September 2005, Bank South Pacific under its investment plans purchased Capital Stock Brokers as a going concern for K6.3million. The Bank and the Group has 100% shareholding. This company is one of the two stock broking firms in the country. The directors determine that this purchase will strengthen the Bank and the Group's position in the country and enhance returns through having access to other investments through the broking business.

Assets and liabilities acquired and goodwill arising:

<i>All amounts are expressed in K'000</i>	Consolidation		Bank	
	2006	2005	2006	2005
Cash & cash equivalents	-	-	-	44,872
Trading securities	-	-	-	2,655
Other assets	-	-	-	2,039
Client funds	-	-	-	(42,949)
Other liabilities	-	-	-	(3,305)
Net assets & liabilities	-	-	-	3,312
Goodwill on acquisition	-	-	-	2,990
Total purchase consideration (discharged by cash)	-	-	-	6,302

8 Acquisition of Habib Bank Limited's Branch

In December 2006, Bank South Pacific under its investment plans acquired the assets and liabilities of the Habib Bank Limited's Fiji Branch for K14.681 million. This branch has only one office in Suva and management has plans to further open other branches in other major centers. This acquisition provides strategic opportunities for the Bank and the Group in the region.

Assets and liabilities acquired and goodwill arising:

Cash & cash equivalents	25,143	-	25,143	-
Loans & advances to customers	9,234	-	9,234	-
Other assets	6,508	-	6,508	-
Amounts due to customers	(26,758)	-	(26,758)	-
Other liabilities	(7,625)	-	(7,625)	-
Net assets & liabilities	6,502	-	6,502	-
Goodwill on acquisition	8,179	-	8,179	-
Total purchase consideration (discharged by cash)	14,681	-	14,681	-

Net cashflow on acquisition

Portion of consideration discharged by cash	(14,681)	-	(14,681)	-
Cash acquired	25,143	-	25,143	-
Net cashflow on acquisition	10,462	-	10,462	-

Notes to the Financial Statements

For the year ended 31 December 2006

9 Intangible asset

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Gross carrying amount	2,990	2,990	-	-
Additional amount recognised during acquisition	8,179	-	8,179	-
Write off of goodwill	(1,755)	-	(1,755)	-
	9,414	2,990	6,424	-
Represented by:				
BSP Fiji Branch	6,424	-	6,424	-
BSP Capital Limited	2,990	2,990	-	-
Total	9,414	2,990	6,424	-

The acquisition of the Fiji branch was completed in December 2006. The assessment of the carrying value of the goodwill of K8.179m arising from this acquisition for 31 December 2006 has been performed on the basis of net selling price, and the directors determine that this asset be written down by K1.755m.

The directors determine that the carrying value of the goodwill arising from the 2005 acquisition of BSP Capital remains appropriate on the basis that the company continues to trade profitably.

10 Investments in Associates

Bank South Pacific continues to have 40% of the shareholding in PNG Microfinance for an amount of K4 million. This transaction was accounted for using the equity method. Total loss incurred by the associate for the year ended December 2006 was K1.443 million. The share of the loss to be absorbed by the Bank and the Group is K577 thousand.

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Investment in associate	3,549	4,000	3,549	4,000
Share of loss for year ended December 2006	(577)	(451)	(577)	(451)
Net investment in associate	2,972	3,549	2,972	3,549
Summarised financial information of associates:				
Total assets	30,479	15,932	30,479	15,932
Total liabilities	(24,999)	(8,568)	(24,999)	(8,568)
Net assets	5,480	7,364	5,480	7,364
Net profit/(loss)	(1,443)	(1,128)	(1,443)	(1,128)
Share of associates' profit or loss:				
Share of profit/(loss) before income tax	(779)	(645)	(779)	(645)
Income tax expense	202	194	202	194
Share of associate's profit/(loss)	(577)	(451)	(577)	(451)

Notes to the Financial Statements

For the year ended 31 December 2006

11 Cash and balances with Central Bank

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Notes and coins	81,715	69,680	79,140	69,566
Balances with central bank other than statutory deposit	79,774	65,323	79,774	65,323
Included in cash and cash equivalents	161,489	135,003	158,914	134,889
Statutory deposits with central bank	109,608	76,341	109,608	76,341
	271,097	211,344	268,522	211,230

12 Treasury & Central Bank bills

Treasury & Central Bills - face value	1,249,432	662,259	1,249,432	653,237
Discount for interest receivable	(14,058)	(9,319)	(14,058)	(9,319)
	1,235,374	652,940	1,235,374	643,918

Treasury & Central Bank Bills are debt securities issued by the Bank of Papua New Guinea for a term of 1 month, three months, six months or a year respectively. These Bills are classified as assets held for trading and carried at fair value.

13 Amounts due from other banks

Items in the course of collection	19,101	20,280	19,101	20,280
Placements with other banks	125,615	158,769	125,615	158,769
Included in cash and cash equivalents	144,716	179,049	144,716	179,049

14 Loans and advances to customers

Loans originated by the bank

Overdrafts	294,004	183,804	294,004	183,804
Leases	50,297	26,705	50,297	26,705
Term loans	757,260	598,640	757,260	598,640
Mortgages	94,864	93,845	94,864	93,845
Gross loans and advances net of reserved interest	1,196,425	902,994	1,196,425	902,994
Less allowance for losses on loans and advances	(33,173)	(29,456)	(33,173)	(29,456)
	1,163,252	873,538	1,163,252	873,538

Allowance for losses on loans and advances

Movement in allowance for losses on loans and advances:

Balance at 1 January	29,456	27,933	29,456	27,933
New Provision	9,509	8,745	9,509	8,745
Loans written off against provisions / Write back of provisions no longer required	(5,792)	(7,222)	(5,792)	(7,222)
Balance at 31 December	33,173	29,456	33,173	29,456

Notes to the Financial Statements

For the year ended 31 December 2006

14 Loans and advances to customers (continued)	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Loans and advances to customers includes finance lease receivables, analysed as follows:				
Investment in finance leases receivable				
Not later than 1 year	21,817	15,573	21,817	15,573
Later than 1 year and not later than 5 years	35,600	15,297	35,600	15,297
Later than 5 years	-	-	-	-
	57,417	30,870	57,417	30,870
Unearned future finance income	(7,120)	(4,165)	(7,120)	(4,165)
Net investment in finance leases	50,297	26,705	50,297	26,705
The net investment in finance leases is analysed as follows:				
Not later than 1 year	16,524	13,730	16,524	13,730
Later than 1 year and not later than 5 years	33,773	12,975	33,773	12,975
Later than 5 years	-	-	-	-
	50,297	26,705	50,297	26,705

15(a) Properties held for sale

Premises	771	1,509	771	1,509
Accumulated depreciation	(157)	(204)	(157)	(204)
	614	1,305	614	1,305

Assets held for sale have been identified and have not been depreciated during the year and are expected to be sold within the next 12 months.

15(b) Property, plant and equipment

(i) Carrying value

Capital Work in Progress	16,359	9,532	16,359	9,532
Premises	124,588	97,177	124,588	97,177
Accumulated depreciation	(16,478)	(13,768)	(16,478)	(13,768)
	108,110	83,409	108,110	83,409
Equipment	134,641	131,580	134,510	131,436
Accumulated depreciation	(108,640)	(94,554)	(108,602)	(94,500)
	26,001	37,026	25,908	36,936
	150,470	129,967	150,377	129,877

Notes to the Financial Statements

For the year ended 31 December 2006

15(b) Property, plant and equipment (continued)

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
(ii) Reconciliations				
Capital WIP				
At 1 January	9,532	5,454	9,532	5,454
Additions	17,254	11,851	17,254	11,851
Disposals	(10,406)	(7,776)	(10,406)	(7,776)
Adjustments	(21)	3	(21)	3
At 31 December	16,359	9,532	16,359	9,532
Premises				
At 1 January	83,409	89,402	83,409	89,402
Additions	3,018	1,078	3,018	1,078
Disposals	(997)	(2,270)	(997)	(2,270)
Held for sale	(614)	(1,305)	(614)	(1,305)
Adjustments-prior year	1,451	(4)	1,451	(4)
Revaluation Increases	25,350	-	25,350	-
Write offs	-	(144)	-	(144)
Depreciation expense	(3,507)	(3,348)	(3,507)	(3,348)
At 31 December	108,110	83,409	108,110	83,409
Equipment				
At 1 January	37,026	53,258	36,936	53,258
Additions	10,590	8,195	10,590	7,994
Disposals	(380)	(275)	(380)	(218)
Adjustments prior year	1,214	(37)	1,175	(37)
Write offs	-	(580)	-	(580)
Depreciation expense	(22,449)	(23,535)	(22,413)	(23,481)
At 31 December	26,001	37,026	25,908	36,936

Freehold land and buildings carried at fair value

An independent valuation of the Bank's land and buildings was performed by GDA Pacific Valuers to determine the fair value of the land and buildings. The valuation, which conforms to International Valuation Standards, was determined by reference to capitalization of the notional income stream approach on the Market Value basis. The effective date of the valuation is 26th September 2006.

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

Freehold land	4,564
Buildings	37,692
	42,256

Notes to the Financial Statements

For the year ended 31 December 2006

15(c) Assets subject to operating lease	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
(i) Carrying value				
Aircraft	103,326	-	103,326	-
Accumulated depreciation	(4,185)	-	(4,185)	-
	99,141	-	99,141	-
(ii) Future minimum lease payments				
Not later than one year	11,434	-	11,434	-
Later than 1 year and not later than 5 years	40,080	-	40,080	-
Later than 5 years	-	-	-	-
	51,514	-	51,514	-
16 Investment Securities				
Securities - held to-maturity				
Inscribed stock - issued by Bank of Papua New Guinea	1,141,355	828,925	1,141,355	828,925
Movement for the year in investment securities:				
At 1 January	828,925	435,786	828,925	435,786
Additions	312,430	393,139	312,430	393,139
Disposals (redemptions)	-	-	-	-
At 31 December	1,141,355	828,925	1,141,355	828,925

Notes to the Financial Statements

For the year ended 31 December 2006

17 Deferred Tax Asset

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 30% applicable from 1 January 2006 (2005: 30%). Deferred income taxes are recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable. At 31 December 2006, the net benefit reflects the estimated future tax benefits at applicable income tax rates of the following:

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Specific allowance for losses on loans and advances	5,922	4,507	5,922	4,507
General allowance for losses on loans and advances	4,030	4,329	4,030	4,329
Employee related provisions	4,908	5,035	4,908	5,035
Prepaid expenses	(250)	(239)	(250)	(238)
Other provisions	2,375	863	2,375	863
Depreciation and amortisation	(12,705)	(7,106)	(12,705)	(7,109)
Unrealised foreign exchange gains	(1,060)	174	(1,060)	174
Deferred expenditure	108	120	84	120
	3,328	7,683	3,304	7,681

The movements on the deferred income tax accounts are as follows:

At 1 January	7,681	2,062	7,681	2,062
Specific allowance for losses on loans and advances	1,415	61	1,415	61
General allowance for losses on loans and advances	(299)	394	(299)	394
Employee related provisions	(127)	894	(127)	894
Depreciation and amortisation	(5,596)	7	(5,596)	8
Prepaid expenses	(12)	137	(12)	137
Other provisions	1,512	3,110	1,512	3,107
Unrealised foreign exchange gains	(1,234)	1,070	(1,234)	1,070
Deferred expenditure	(12)	(52)	(36)	(52)
At 31 December	3,328	7,683	3,304	7,681
Represented by:				
Future income tax benefit	17,260	14,738	17,236	14,736
Deferred tax liability	(13,932)	(7,055)	(13,932)	(7,055)
At 31 December	3,328	7,683	3,304	7,681

Notes to the Financial Statements

For the year ended 31 December 2006

17 Deferred Tax Asset (continued)

Taxable & deductible temporary differences arise from the following:

All amounts are expressed in K'000

	Consolidation						
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	Closing balance
2006							
Gross deferred tax liabilities	(7055)	311	(724)	(6,491)	27	-	(13,932)
Gross deferred tax assets	14,738	1,135	1,387	-	-	-	17,260
	7,683	1,446	663	(6,491)	27		3,328

	Consolidation						
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	Closing balance
2005							
Gross deferred tax liabilities	(11,185)	3,479	(2)	-	653	-	(7,055)
Gross deferred tax assets	13,247	1,487	4	-	-	-	14,738
	2,062	4,966	2	-	653	-	7,683

All amounts are expressed in K'000

	Bank						
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	Closing balance
2006							
Gross deferred tax liabilities	(7055)	311	(724)	(6,491)	27	-	(13,932)
Gross deferred tax assets	14,736	1,135	1,365	-	-	-	17,236
	7,681	1,446	641	(6,491)	27	-	3,304

	Bank						
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	Closing balance
2005							
Gross deferred tax liabilities	(11,185)	3,479	(2)	-	653	-	(7,055)
Gross deferred tax assets	13,247	1,487	2	-	-	-	14,736
	2,062	4,966	-	-	653	-	7,681

Notes to the Financial Statements

For the year ended 31 December 2006

18 Other assets	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Items in transit and other assets	459,541	27,824	53,844	21,593
Accrued income	32,621	17,819	32,621	17,819
Intercompany account	-	-	2,414	2,497
Computer Development Costs	1,810	1,525	1,810	1,525
Prepayments	2,925	2,688	2,925	2,688
Accounts receivable	4,359	4,257	656	82
	501,256	54,113	94,270	46,204
19 Amounts due to other banks				
Items in the course of collection	2,908	5,866	2,908	5,866
20 Amounts due to customers				
Demand / current	2,907,444	2,017,755	2,907,444	2,020,577
Term	868,936	515,649	868,936	515,649
Client funds held in trust	400,680	9,531	-	-
	4,177,060	2,542,935	3,776,380	2,536,226
21 Other liabilities				
Creditors and Accruals	17,745	9,987	16,104	9,673
Items in transit and all other liabilities	54,170	41,172	54,170	36,048
	71,915	51,159	70,274	45,721
22 Other provisions				
Staff related	16,463	14,229	16,362	14,229
Provision for Non Lending Loss	1,753	1,025	1,753	1,025
Provision for Dividend Payable	2	2	2	2
Provision for Offshore Creditors' GST	2,887	2,334	2,887	2,334
	21,105	17,590	21,004	17,590
Staff related provisions				
At 1 January	14,229	13,804	14,229	13,804
Provisions charge	4,648	3,221	4,307	3,221
Payouts	(2,414)	(2,796)	(2,174)	(2,796)
At 31 December	16,463	14,229	16,362	14,229

Notes to the Financial Statements

For the year ended 31 December 2006

23 Ordinary Shares – Bank

<i>Number of shares in '000s, Book value in K'000</i>	Number of shares	Book value
At 31 December 2004 / 1 January 2005	431,965	191,131
Issue of shares – employees' bonus shares	491	1,581
Dividend Re-investment Plan	5,809	17,410
Exercise of EMSOP	225	720
Share buy-back	(8,000)	(25,600)
At 31 December 2005 / 1 January 2006	430,490	185,242
Dividend Re-investment Plan	7,190	23,156
Exercise of EMSOP	1,121	3,808
At 31 December 2006	438,801	212,206

The shareholders on 16 July 2006, took part in the Dividend Re-Investment Plan to invest their dividends to purchase shares in the Bank and the Group. The staff also exercised their options during the year when the 2004 EMSOP had expired on 30 June 2006.

The issued capital of Bank of South Pacific Limited comprises ordinary shares. Following is a summary of principal shareholders as at 31 December 2006 and their respective percentage holdings.

Major shareholders: % shareholding	2006	2005
Independent Public Business Corporation	24.41	24.88
Motor Vehicles Insurance Limited	12.08	12.31
POSF Limited	11.10	11.56
Petroleum Resources Kutubu Limited	10.52	10.72
Credit Corporation (PNG) Limited	10.03	10.17
National Superannuation Fund Limited	8.49	10.32
PNG Sustainable Development Program Limited	5.37	2.32
Teachers Savings & Loans Society Limited	4.22	4.50
Defence Force Retirement Benefits Fund	3.74	3.92
Sir George Constantinou	1.01	1.03
	90.97	91.73
All Others	9.03	8.27
	100.00	100.00

Share Options - Executive Management Share Option Plan (EMSOP)

An Executive Management Share Option Plan was established at the Annual General Meeting of 27 May 2004. The first options of 1,121,818 were exercised on 30 June 2006. These options were valued at Mark to Market.

On 12 December 2006, the Board under this plan, granted the third options dated back to 1 July 2006 over ordinary shares of Bank of South Pacific Limited and the Group to the executives only. These options were issued for nil consideration, are not transferable, and cannot be quoted on any stock exchange.

At balance date, there are 600,000 of these options issued, with a vesting date of 1 July 2008, and an exercise price of K3.38. The overriding exercise conditions of these options are performance hurdles.

Notes to the Financial Statements

For the year ended 31 December 2006

23 Ordinary Shares (continued)

At balance date there are now 1,481,818 of the second options remaining, with a vesting date of July 1 2007, and an exercise price of K3.13. The overriding exercise conditions of these options are performance hurdles.

The 2005 and 2006 share options have been revalued in compliance with IFRS 2 and classified as equity on the balance sheet.

Options 2006	Opening balance	Issued	Exercised	Forfeited	Others	Closing Balance
2004	1,121	-	(1,121)	-	-	-
2005	1,657	-	-	(175)	-	1,482
2006	-	600	-	-	-	600
Total	2,778	600	(1,121)	(175)	-	2,082
Weighted average exercise price	2.31	3.38	1.10	3.05	-	3.20

Options 2005	Opening balance	Issued	Exercised	Forfeited	Others	Closing Balance
2004	1,501	-	(225)	(155)	-	1,121
2005	-	1,657	-	-	-	1,657
Total	1,501	1,657	(225)	(155)	-	2,778
Weighted average exercise price	1.10	3.38	1.10	1.10	-	2.31

24 Reserves and retained earnings

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Reserves comprise:				
Revaluation reserve	32,165	16,333	32,165	16,333
Capital reserve	635	635	635	635
Options Reserve	726	2,523	726	2,523
General reserve	2,971	2,848	2,875	2,848
	36,497	22,339	36,401	22,339

Movement in reserves for the year:

Revaluation reserve

At 1 January	16,333	16,986	16,333	16,986
Adjustment for deferred tax liability	(6,491)	-	(6,491)	-
Disposal of properties	(27)	(653)	(27)	(653)
Net gains from changes in fair value of owned properties	22,350	-	22,350	-
At 31 December	32,165	16,333	32,165	16,333

Capital reserve

At 1 January	635	635	635	635
No movement for the year	-	-	-	-
At 31 December	635	635	635	635

Notes to the Financial Statements

For the year ended 31 December 2006

24 Reserves and retained earnings (continued)	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Options reserve				
At 1 January	2,523	2,906	2,523	2,906
Movement for the year	(1,797)	(383)	(1,797)	(383)
At 31 December	726	2,523	726	2,523
General reserve				
At 1 January	2,848	2,195	2,848	2,195
Movement for the year	123	653	27	653
At 31 December	2,971	2,848	2,875	2,848
Retained earnings				
At 1 January	100,719	44,685	100,008	44,685
Net profit for the year	111,616	99,224	109,790	98,519
Dividend paid	(60,425)	(43,196)	(60,425)	(43,196)
Exchange movement reserve	-	6	-	-
Deferred Income 2005	(3,684)	-	(3,684)	-
Tax Adjustment	(634)	-	-	-
At 31 December	147,592	100,719	145,689	100,008
25 Contingent Liabilities and Commitments				
Off balance sheet financial instruments				
Standby letters of credit	25,383	4,337	25,383	4,337
Guarantees and indemnities issued	84,614	40,640	84,614	40,640
Trade letters of credit	36,470	15,040	36,470	15,040
Commitments to extend credit	470,739	333,421	470,739	333,421
	617,206	393,438	617,206	393,438
Legal Proceedings				
A number of legal proceedings against the Bank and the Group were outstanding as at 31 December 2006. 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 2006, the Bank and the Group estimates a contingent liability of K3.66 million (2005: K3.37 million) in respect of these proceedings.				
Statutory deposits with the central bank				
Cash reserve requirement - 3% of all amounts due to customers (2005: 3 %)	109,608	76,341	109,608	76,341
Commitments for capital expenditure				
Amounts with firm commitments, and not reflected in the accounts	10,998	633	10,998	633

Notes to the Financial Statements

For the year ended 31 December 2006

25 Contingent Liabilities and Commitments (continued)	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Operating lease commitments				
Not later than 1 year	2,311	9,582	2,311	9,582
Later than 1 year and not later than 5 years	6,239	8,683	6,239	8,683
Later than 5 years	1,146	1,056	1,146	1,056
	<u>9,696</u>	<u>19,321</u>	<u>9,696</u>	<u>19,321</u>

26 Cash and cash equivalents

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

Cash and balances with central bank (note 11)	271,097	211,344	268,522	211,230
Due from other banks (note 13)	144,716	179,049	144,716	179,049
Due to other banks (note 19)	(2,908)	(5,866)	(2,908)	(5,866)
	<u>412,905</u>	<u>384,527</u>	<u>410,330</u>	<u>384,413</u>

27 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 2006, balances and transactions of accounts for Directors were as follows:

<i>All amounts are expressed in K'000</i>	2006	2005
Deposits		
Opening balances	104,066	32,381
Net Movement	(55,416)	71,685
Closing Balance	<u>48,650</u>	<u>104,066</u>
Interest Paid	1,097	296
Loans and advances		
Opening balances	36,723	26,670
Loans issued	49,738	30,919
Interest	55	892
Charges	394	203
Loan Repayments	(28,219)	(21,961)
Closing Balance	<u>58,691</u>	<u>36,723</u>

Notes to the Financial Statements

For the year ended 31 December 2006

27 Related Party Transactions (continued)

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 2006, staff account balances were as follows:

Housing loans	7,428	7,886
Other loans	4,591	3,236
	<u>12,019</u>	<u>11,122</u>
Cheque accounts	2,507	1,619
Foreign currency accounts	794	65
Savings accounts	1,077	919
	<u>4,378</u>	<u>2,603</u>

Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
N. N. Beangke	Director	Credit Corporation (PNG) Ltd ³ , Bank South Pacific Limited ¹ , New Guinea Islands Produce Ltd ⁵ , PNG Coffee Exports Ltd ^{1,5} , Credit Corporation (Fiji) Ltd, Boroma Ltd ^{1,5} , General Holdings Ltd ⁵ , Credit Corporation (SI) Ltd,
	Shareholder	Credit Corporation (PNG) Ltd ⁵ , New Guinea Islands Produce ⁵ , Boroma Ltd.
T. E. Fox	Director	Kramer Group Ltd, Bank of South Pacific Limited ² , International Project Management Pty Ltd ⁵ , Teyo No. 1 Ltd ⁵ , Kramer Pacific Ltd ⁵ , PNG Sustainable Infrastructure Ltd, Capital Life Insurance Company Ltd.
	Shareholder	Bank of South Pacific Limited, International Project Management Pty Ltd, Teyo No. 1 Ltd, Kramer Pacific Ltd, Citigold Corporation Ltd, Mining Projects Group, Marengo Gold Limited.
	Trustee/member	Institute of National Affairs ⁸ , PNG Institute of Directors
G. McIlwain	Director	Bank of South Pacific Ltd ³ , Anderson Foodland Limited ⁶ , Tower Insurance Ltd, Niugini Islands Produce Co Ltd ⁵ , East New Britain Supermarkets ⁶ , Rabtrad Madang Ltd, Balimore No. 21 Ltd ⁵ , Credit Corporation (Fiji) Ltd.
	Shareholder	Bank of South Pacific Ltd.
	Treasurer	Returned Servicemen League (Port Moresby sub-branch)
J. G. Jeffery	Director	James Barnes PNG Ltd, Bank of South Pacific Ltd, National Superannuation Fund Ltd ^{1,5} , Employers Federation of PNG, Jayliss Ltd, Small Business Development Corporation Ltd ¹ , CPL Ltd .
	Shareholder	Highlands Pacific Ltd, Oil Search Ltd, Jayliss Ltd
V. Reva	Director	Bank of South Pacific Ltd, Melanesian Trustee Services Ltd ¹ , Hatumai Ltd, Melanesian Metal Corporation Ltd, Toyota Tusho Ltd, BOC (PNG) Ltd, PNG Microfinance Ltd, Metals Refining Operations ¹ .
	Shareholder	Bank of South Pacific Ltd, Marengo Mining Ltd, Hatumai Ltd.
	Consultant	British American Tobacco

Notes to the Financial Statements

For the year ended 31 December 2006

27 Related Party Transactions (continued)

Interests Register (continued)

Name	Nature of Interest	
G. Aopi	Director	Oil Search Ltd ⁷ , Bank of South Pacific Ltd, Steamships Trading Co Ltd, POMSoX Ltd, Marsh Ltd, Hiram Ltd, Wahinemo Ltd, FM Morobe Ltd, National Roads Authority, Telikom PNG Ltd ¹ , CDI Foundation, Kumuls Hotels Ltd.
	Shareholder	Oil Search Ltd ⁷ , Hiram Ltd, Wahinemo Ltd, Lihir Gold Ltd, Highlands Pacific Ltd, Melanesian Trustees (ICPNG).
	Member	Institute of National Affairs, Business Council of PNG, National Events Council,
Dr I Temu	Director	Bank of South Pacific Ltd, Tipi Enterprise Ltd, BSP Capital Limited ¹ .
	Shareholder	Telstra
	Employee Committee member	Barrick Gold Limited. Divine Word University
Sir N. Bogan	Director	Bank of South Pacific Ltd, Public Officers Superannuation Fund Ltd ^{1,5} , In Touch Media Ltd ¹ , Coprez Communications Ltd ¹ , Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory, Ahi Holdings Ltd.
	Shareholder	In Touch Media Ltd, Coprez Holdings Ltd, Inventive Nook Ltd, James Cook Ltd, Niugini Cocoa Factory
	Member	Evangelical Lutheran Church Finance Committee
C. C. Procter	Director	Bank of South Pacific Ltd, Sun Hung Kai Ltd, Quality Health Care Asia Ltd
J. K. Natto	Director	Petroleum Resources Kutubu Ltd ¹ , Kutubu Security Services Ltd ³ , Welgris Fuel Distributors Ltd, Hekari Security Services Ltd, Hekari Properties Ltd, Namo'aporo Landowners Association Inc. ¹ , Bank of South Pacific,
	Member	Australian Institute of Company Directors

¹Chairman, ²Deputy Chairman, ³Managing Director, ⁴Executive Director, ⁷General Manager, ⁸Councillor

⁵Company is shareholder of Bank of South Pacific Limited, or shareholder of company that is shareholder

⁶Company has commercial banking facilities with Bank of South Pacific Limited

28 Directors and executive remuneration

Directors remuneration

Directors of the company received remuneration including benefits during 2006 as detailed below:

All amounts are in K

Name of Director	Meetings attended / total held	Appointed/ (Resigned)	Base emolument	Bonus shares	Other compensation	Total remuneration	
						2006	2005
N. N. Beangke	8/8	-	96,773	-	-	96,773	94,660
T. E. Fox	8/8	-	90,773	-	-	90,773	86,604
Dr. I. Temu	7/8	-	69,864	-	-	69,864	68,660
C. C. Procter	8/8	-	90,667	-	-	90,667	89,833
Sir N. Bogan	7/8	-	64,364	-	-	64,364	63,662

Notes to the Financial Statements

For the year ended 31 December 2006

28 Directors and executive remuneration (continued)

Name of Director	Meetings attended / total held	Appointed/ (Resigned)	Base emolument	Bonus shares	Other compensation	2006	2005
G. McIlwain *	8/8	- -	-	-	-	-	-
J. G. Jeffery	8/8	- -	80,409	-	-	80,409	70,547
G. Aopi	7/8	- -	74,090	-	-	74,090	70,547
V. Reva	8/8	- -	75,909	-	-	75,909	69,604
J K Natto	6/6	26/05/2006	34,454	-	-	34,454	-

Directors V. Reva & G. 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 26th May 2006 Annual General Meeting. They were subsequently re-elected as directors.

Dr Ila Temu also received an allowance of K60,300 as the Board of Directors chairman of the BSP Capital Limited which forms part of the Group.

* Managing Director receives no fees for his services as director during the year.

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	2006 No.	2005 No.	Remuneration K'000	2006 No.	2005 No.	Remuneration K'000	2006 No.	2005 No.
100-110	2	-	310-320	1	2	490-500	-	-
110-120	-	3	320-330	1	1	500-510	1	-
120-130	2	2	330-340	1	-	510-520	1	2
130-140	1	-	340-350	1	1	530-540	-	-
140-150	1	1	350-360	-	-	540-550	1	-
150-160	2	-	360-370	2	1	560-570	1	1
160-170	-	-	370-380	2	4	580-590	1	-
180-190	1	-	380-390	1	1	590-600	-	-
190-200	-	-	390-400	6	2	660-680	1	1
210-220	1	-	400-410	2	4	750-790	1	1
220-240	1	1	410-420	-	2	790-800	-	1
240-250	-	-	420-430	1	3	810-830	1	-
250-260	-	-	430-440	2	2	830-850	-	-
260-269	-	-	440-450	-	1	850-860	-	-
270-280	1	-	450-460	1	-	920-930	-	1
280-290	1	-	460-470	-	1	930-1,020	1	-
290-300	-	-	470-480	-	-	1,250-1,260	-	1*
300-310	-	-	480-490	1	1	1,530-1,540	1	-
Total							45	41

During 2006, a total of 600,000 share options over ordinary shares were issued to executives only under the Executive Management Share Option Plan referred to in Note 23. The options are outstanding as at 31 December 2006. * This remuneration includes payout from termination of employment.

Notes to the Financial Statements

For the year ended 31 December 2006

28 Directors and executive remuneration (continued)

The specified executives during the year were:

Garth McIlwain	Robin Fleming
Johnson Kalo	Brian Storm
Kevin McCarthy	John Pascoe
Aho Baliki	Giau Duruba

Specified executives' remuneration in aggregate (K'000)

	Primary			Post-employment			Equity options	Other benefits	Total
	Salary	Bonus	Non-monetary	Super	Pre-scribed benefits	Other			
2006	3,989	301	65	213	-	-	1,197	494	6,259
2005	4,365	220	73	334	-	-	-	886	5,878

29 Reconciliation of operating cash flow

	Consolidated		Bank	
	2006	2005	2006	2005
<i>All amounts are expressed in K'000</i>				
Reconciliation of operating profit/(loss) after tax to operating cash flow before changes in operating assets				
Operating profit/(loss) after tax	111,616	99,224	109,790	98,519
Add: Tax Expense	52,902	43,006	52,373	42,953
Operating Profit before income tax	164,518	142,230	162,163	141,472
Major Non Cash amounts				
Depreciation	30,356	26,844	30,320	26,829
Amortisation of deferred acquisition and computer development costs	602	-	602	-
Net (profit)/loss on sale of fixed assets	(336)	(169)	(336)	(169)
Write off of fixed assets		724	-	724
Write off of goodwill	1,755		1,755	
Write off of other income	91	-	-	-
Gain on property revaluation	(3,021)	-	(3,021)	-
Movement in forex income accrual	(611)	(620)	(611)	(620)
Movement in provision for doubtful debts	(1,311)	(3,968)	(1,311)	(3,968)
Movement in payroll provisions	2,234	(425)	2,132	(425)
Net effect of other accruals	6,548	5,209	5,202	2,699
Operating cash flow before changes in operating assets	200,825	169,825	196,895	166,542

Notes to the Financial Statements

For the year ended 31 December 2006

30 Earnings Per Share

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.

Net Profit attributable to shareholders (K'000)	111,616	99,224	109,790	98,519
Weighted average number of ordinary shares in use ('000)	438,801	435,778	438,801	435,778
Basic and diluted earning /(loss) per share (expressed in toea)	25.4	22.8	25.0	22.6

31 Segment Reporting – Bank

Business segments

The Bank of South Pacific Limited and group comprises two segments, this being the provision of banking services and products and stock broking services. This determination is based on the risks involved with the provision of services and products and the bank and group's management reporting system.

Geographical segments

The Bank of South Pacific Limited and group's business segment operates in Papua New Guinea and has a branch in the country of Niue since 2004 and has just opened a branch in Fiji on 15 December 2006. Both branch's results are immaterial to warrant reporting by geographical segments. Refer to Note 8 regarding acquisition of the Fiji Branch.

Independent audit report to the members of Bank of South Pacific Limited and its Subsidiaries

Scope

We have audited the accompanying consolidated financial statements of Bank of South Pacific Limited and its subsidiaries, which comprises the consolidated balance sheet as at 31 December 2006 and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statements for the year then ended and a summary of significant accounting policies and other explanatory notes in order to express an opinion on them to the members of the Bank of South Pacific Limited and its subsidiaries.

Management's Responsibility for the Financial Statements

Management is responsible for preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes designing and implementing and maintaining internal controls relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our audit has been conducted in accordance with International Standards on Auditing to provide reasonable assurance as to whether the consolidated financial statements are free of material misstatement. Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the consolidated financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material aspects, the consolidated financial statements are presented fairly in accordance with generally accepted accounting practice (which requires, amongst other things, compliance with International Financial Reporting Standards and Statements of Accounting Standards of the Certified Practising Accountants of Papua New Guinea) and other statutory requirements, so as to present a view which is consistent with our understanding of the company and its subsidiaries financial position and the results of its operations, changes in equity and its cash-flows.

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

Audit Opinion

In our opinion, the consolidated financial statements of Bank of South Pacific Limited and its subsidiaries are drawn up as required by the Companies Act, 1997 so as to give a true and fair view of the company and its subsidiaries affairs as at 31 December 2006, and of the results of its operations, cash flows and the changes in equity for the year then ended in accordance with generally accepted accounting practice (which requires, amongst other things, compliance with International Financial Reporting Standards and Statements of Accounting Standards of the Certified Practising Accountants of Papua New Guinea) and other statutory requirements.

Other Information

We do not provide any other services to Bank of South Pacific Limited and its subsidiaries.

Port Moresby, this *14th* day of *March* 2007.



By: Paul Barber
Partner
Registered under the Accountants Act 1996

DELOITTE TOUCHE TOHMATSU
Deloitte Touche Tohmatsu

Member of
Deloitte Touche Tohmatsu