

Bank of South Pacific Limited

Financial Statements

For the year ended 31 December 2002

Contents of Financial Statements

				Page
Annual Report				33
Statement by the Directors				34
Income Statement				35
Balance Sheet				36
Statement of Changes in Shareholders' Equity				37
Cash Flow Statement				38
Accounting Policies				39-41
Note	page	Note	page	
A Basis of presentation and general accounting policies	39	K Cash and cash equivalents	40	
B Derivative financial instruments and acceptances	39	L Provisions	40	
C Interest income and expense	39	M Employee benefits	40	
D Fee and commission income	39	N Deferred income taxes	40	
E Borrowing expenses	39	O Borrowings and related costs	41	
F Loans and provisions for loan impairment	39	P Investments	41	
G Goodwill	39	Q Foreign currency	41	
H Computer systems development costs	40	R Share capital	41	
I Property, plant and equipment	40	S Fiduciary activities	41	
J Leases	40	T Comparatives	41	
Financial Risk Management				42-48
Note	page	Note	page	
A Bank operations, risks and strategies	42	E Foreign exchange risk	46	
B Capital adequacy	43	F Operational risk	46	
C Credit risk and asset quality	44	G Interest rate risk	47	
D Liquidity risk	45	H Fair values	48	
Notes to the Financial Statements				49-61
Note	page	Note	page	
1 Net interest income	49	15 Other assets	54	
2 Net fee and commission income	49	16 Amounts due to other banks	54	
3 Other income	49	17 Amounts due to customers	54	
4 Bad and doubtful debts expense	49	18 Other borrowed funds	55	
5 Other operating expenses	50	19 Other liabilities	55	
6 Income tax expense	50	20 Other provisions	55	
7 Abnormal items	51	21 Ordinary shares	55	
8 Cash and balances with Central Bank	51	22 Reserves & retained earnings	56	
9 Treasury bills	52	23 Contingencies & commitments	57	
10 Amounts due from other banks	52	24 Cash and cash equivalents	57	
11 Loans and advances to customers	52	25 Related party transactions	58	
12 Property, plant and equipment	53	26 Remuneration	60	
13 Investment securities	53	27 Subsequent events	61	
14 Deferred tax asset	54	28 Reconciliation of operating cash flow	61	
Independent Auditors Report				62

Annual Report

The Directors take pleasure in presenting the Financial Statements for the year ended 31 December 2002.

Principal activities

The principal activity of the Bank of South Pacific Limited (BSP) is the provision of commercial banking and finance services throughout the country. BSP is a company 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. Its registered office is at Douglas Street, Port Moresby.

Operating profit

For the year ended 31 December 2002, the loss after tax and after the write of goodwill on acquisition of PNGBC Limited was K85.830 million (2001: K18.971 million profit).

The operating profit after tax before abnormal items, was K54.727 million (2001: K18.971 million).

Dividends

Full and final dividend of K18.059 million was declared subsequent to year end and is payable in respect of the year ended 31 December 2002 (2001: K13.270 million full dividend)

Directors and officers

The following were directors of the Bank of South Pacific Limited during the year ended 2002:

Mr. N N Beangke	Mr. J G Jeffery
Mr. T E Fox	Mr. G McIlwain
Mr. G Aopi	Mr. V Reva
Mr. B A Flynn	Mr. N R Smith
Mr. B J Hanson	

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

Auditors

Details of amounts paid to the auditors for audit and other services are shown in note 5 of the financial statements.

Donations

Donations made by the company during the year amounted to K58,371.

Interests Register

Transactions recorded in the Interests Register are disclosed in note 26 of the financial statements

For, and on behalf of, the Directors. Dated and signed in Port Moresby this 8th day of May 2003.

N.N. Beangke BA. Econ.
Chairman

N.R. Smith MBE, FAIBF
Managing Director & CEO

Statement by Directors

In the opinion of the Directors of Bank of South Pacific Limited:

- a) The Income Statement is drawn up so as to exhibit a true and fair view of the results of the business of the Company for the year ended 31 December 2002.
- b) The Balance Sheet is drawn up so as to exhibit a true and fair view of the state of affairs of the Company as at 31 December 2002.
- c) The Statement of Cash Flows is drawn up so as to exhibit a true and fair view of the movements in cash of the Company for the year ended 31 December 2002.
- d) The Statement of Changes in Equity is drawn up so as to exhibit a true and fair view of the changes in equity for the year ended 31 December 2002.

Additional Statutory Information

The results of the Company'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 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 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 in its ability to meet obligations as and when they fall due.

Dated and signed at Port Moresby this 8th day of May 2003.

N.N. Beangke
Chairman

N.R. Smith MBE, FAIBF
Managing Director & CEO

Income Statement

Year Ended 31 December	Note	2002 K'000	2001 K'000
Interest income	1	154,417	83,314
Interest expense	1	(37,958)	(42,329)
Net interest income		116,459	40,985
Fee and Commission income	2	20,759	8,429
Other income	3	59,803	8,786
Net Operating income		197,021	58,200
Bad and doubtful debts (expense)/recovery	4	3,823	(2,433)
Other operating expenses	5	(139,227)	(29,948)
Operating profit /(loss) before tax and abnormal items		61,617	25,819
Abnormal items net of applicable tax	7	(140,557)	-
Operating profit /(loss) before tax and after abnormal items		(78,940)	25,819
Income tax expense	6	(6,890)	(6,848)
Operating profit/(loss) from ordinary activities after tax		(85,830)	18,971

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

Balance Sheet

Year Ended 31 December	Note	2002 K'000	2001 K'000
Assets			
Cash and balances with central banks	8	173,615	44,613
Treasury bills	9	496,113	297,193
Amounts due from other banks	10	133,359	68,403
Loans and advances to customers	11	702,635	285,238
Property, plant and equipment	12	171,834	55,804
Investment securities	13	20,286	-
Deferred tax assets	14	12,128	540
Income tax recoverable		5,314	-
Other assets	15	63,855	14,100
Total assets		1,779,139	765,891
Liabilities			
Amounts due to other banks	16	1,807	14,561
Amounts due to customers	17	1,552,161	656,134
Other borrowed funds	18	15,000	-
Other liabilities	19	47,875	11,042
Provision for income tax		-	3,630
Other provisions	20	15,800	3,090
Total liabilities		1,632,643	688,457
Shareholders Equity			
Ordinary shares	21	182,422	17,919
Retained earnings/(accumulated losses)	22	(43,913)	49,234
Other reserves	22	7,987	10,281
Total shareholders' equity		146,496	77,434
Total equity and liabilities		1,779,139	765,891

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

Statement of Changes in Shareholders' Equity

	<u>Note</u>	Share Capital	Reserves	Retained Earnings (Accumulated Losses)	Total
		K'000	K'000	K'000	K'000
Balance as at 1 January 2001		17,919	10,281	39,771	67,971
Net profit		-	-	18,971	18,971
Final dividend for 2000		-	-	(3,555)	(3,555)
Interim dividend for 2001		-	-	(5,953)	(5,953)
Balance at 31 December 2001		17,919	10,281	49,234	77,434
Tax effect transfer to deferred income tax liability - revaluation reserve		-	(2,294)	-	(2,294)
Net profit/(loss)		-	-	(85,830)	(85,830)
Final dividend paid for 2001		-	-	(7,317)	(7,317)
Issue of ordinary shares		164,503	-	-	164,503
Balance at 31 December 2002	22, 23	182,422	7,987	(43,913)	146,496

Proposed dividend for 2002

Subsequent to 31 December 2002, the Directors declared a dividend for 2002. Details of the dividend are disclosed in note 27 of these financial statements.

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

Cash Flow Statement

Year ended 31 December	Note	2002 K'000	2001 K'000
Cash Flow from Operating Activities			
Interest received		165,251	83,314
Fees and other income		76,563	17,415
Interest paid		(40,515)	(42,329)
Amounts paid to suppliers and employees		(105,788)	(34,145)
Operating cash flow before changes in operating assets		95,511	24,255
Decrease/(increase) in loans		(8,767)	3,964
Decrease/(increase) in bills receivable and other assets		(13,389)	(18,767)
(Decrease)/increase in deposits		(293,880)	145,416
(Decrease)/increase in bills payable and other liabilities		(11,320)	(1,910)
Net cash flow from operations before income tax		(231,845)	152,958
Income Taxes paid		(4,216)	-
Net cash flow from operating activities		(236,061)	152,958
Cash Flow from Investing Activities			
Decrease/(increase) in Government securities		318,097	(109,519)
Expenditure on property, plant & equipment		(78,512)	(15,651)
Proceeds from disposal of property, plant & equipment		2,009	162
Acquisition of PNGBC - net cash inflow	7	96,956	-
Net cash flow from investing activities		338,550	(125,008)
Cash Flow from Financing Activities			
Issue of share capital		94,775	-
Proceeds from borrowings		15,000	-
Dividends paid		(7,317)	(9,508)
Net cash flow from financing activities		102,458	(9,508)
Effect of exchange rate movements on cash and cash equivalents		1,765	-
Net Increase/(decrease) in cash and cash equivalents		206,712	18,442
Cash and cash equivalents at the beginning of the year		98,455	80,013
Cash and Cash Equivalents at the end of the year	24	305,167	98,455

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

Accounting Policies

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

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 financial statements of the Bank of South Pacific Limited are prepared in accordance with International Financial Reporting Standards and interpretations of these standards issued by the Standards 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.

On 9 April 2002, the Bank of South Pacific Limited acquired Papua New Guinea Banking Corporation Limited following its successful bid, when it was privatised by the Government of Papua New Guinea in December 2001. The assets and liabilities of the acquired bank were amalgamated with the assets and liabilities of the Bank of South Pacific Limited from the date of acquisition using the purchase method of accounting. Goodwill arising on acquisition was expensed in the Income Statement. The results from the date of acquisition reflect the result of the amalgamated operations.

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

B Derivative financial instruments and acceptances

Forward foreign exchange contracts entered into for trading purposes are initially recognised at cost and subsequently re-measured based upon the exchange rates applicable at balance sheet date. Gains and losses on such contracts are taken to the Income Statement.

Acceptances comprise undertakings by the bank to pay bills of exchange drawn on customers. The bank 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 does not actively enter into or trade in complex forms of derivative financial instruments such as currency and interest rate swaps and options.

C 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.

D Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. All non-refundable front-end loan fees and other risk related fees that constitute cost recovery are taken to income when levied.

E Borrowing expenses

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

F 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 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 non-identifiable possible losses and latent risks inherent 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.

G Goodwill

Goodwill represents the excess of the cost of any acquisition over the fair value of the share of net assets acquired at the date of acquisition. Goodwill is reported in the balance sheet as an intangible asset and is amortised using the straight line method over its estimated useful life.

In determining the estimated useful life of goodwill, management considers various factors including 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.

During the year, a significant amount of goodwill arose on a major acquisition, the recoverable amount of which was determined to be materially lower than its book value. Accordingly, the amount was taken to the Income Statement. Note 7 to these Financial Statements provides further details on the transaction.

Accounting Policies (continued)

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

H Computer systems development costs

Costs incurred to develop and enhance the bank'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.

I Property, plant and equipment

All property is stated at both cost and revalued amount less accumulated depreciation. Plant and equipment is stated at cost less accumulated depreciation. Depreciation is assessed from the month of acquisition. The Directors have determined that all bank properties will be revalued within a cycle of 3 years. Revaluation increments are credited to the premises revaluation reserve, whilst revaluation decrements are debited to the Income Statement unless they relate to the reversal of a pre-valuation revaluation increment of the same property.

The following basis and method of depreciation are 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

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.

J Leases

Bank is lessee

All leases entered into by the bank 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 11) 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.

K Cash and cash equivalents

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

L 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.

Long service leave entitlements represent the pro-rata statutory entitlement for all existing staff members based on length of service up to balance sheet date.

Provision for annual leave, leave fares and other entitlements are based upon the bank's personnel policies, contractual obligations and services rendered by employees up to balance sheet date.

M Employee benefits

Post employment benefits - defined contribution plans

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

The bank 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 seven per cent of employees' gross salary. Once the contributions have been paid, the bank has no further payment obligations for post-employment benefits once an employee ceases employment with the bank.

N Deferred income taxes

The liability method is used to account for deferred income tax arising from temporary differences between the tax bases of assets and liabilities and their carrying values in the financial statements.

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

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 Papua New Guinea Income Tax Act, 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.

O Borrowings (subordinated debt) and related borrowing costs

Certain interest bearing liabilities arising from sources other than depositors and other banks, are subordinated in respect of repayment, to all other classes of liabilities, including depositors' funds and other banks funds, and are classified as borrowings on the balance sheet. These borrowings are in the form of unsecured, subordinated fixed term debt, with interest payable half-yearly and principal repayable in full on or before maturity. They are carried on the balance sheet at their principal amount. The interest on unsecured debt is recognised in the income statement as interest expense in the period it is incurred.

P Investments

Investments are classified into the following categories : trading, held-to-maturity and available-for-sale. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments. During the period the bank did not hold any investments in this category. 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 and re-evaluates such designation on a regular basis.

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

Q Foreign currency

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.

R Share capital

Share issue costs

External costs directly attributable to the issue of new shares, other than on a business combination, are deducted from equity net of any related income taxes.

Dividends on ordinary shares

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

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

S Fiduciary activities

The bank acts in a fiduciary capacity to the central bank in respect of the disbursement and collection of funds relating to the central bank's agricultural support scheme loans. The bank returns all funds and income to the central bank. Accordingly, all transactions pursuant to these arrangements are excluded from these financial statements.

T Comparatives

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

Interpretation of comparative figures

The business combination that occurred with the bank's acquisition of Papua New Guinea Banking Corporation during the year has significant implications for comparisons between the current and prior year balances. The transaction added about K1.218 billion of assets and K1.221 billion of liabilities or funds onto the balance sheet of the bank. Capital raising prior to the transaction increased its share capital by K164.395 million. After acquisition, the size and operational capacity of the bank increased significantly. As stated in Note A, Basis of Presentation, the results for the current year incorporate, from the date of acquisition, the returns from a significantly larger pool of banking assets and funds. This is reflected in the exceptional disparity between the figures for the current year and the prior year comparatives.

Financial Risk Management

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'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 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 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 also enters into guarantees and other commitments such as letters of credit, performance bonds, and other bonds.

The bank also enters into transactions denominated in foreign currencies. This activity generally requires the bank 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 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 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 as a whole. The limits are delegated from the Board of Directors to executive management and thence 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 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 and Compliance Committee of the Board, and ultimately to the Board of Directors.

B Capital adequacy

The Bank 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 minimum ratio of base capital to risk weighted assets set by the BPNG during the year ended 31 December 2002, is 10% and the bank satisfies this requirement.

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.

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's capital adequacy level is as follows:

	Balance sheet / notional amount		Risk-weighted amount	
	2002	2001	2002	2001
	K'000	K'000	K'000	K'000
Balance sheet assets (net of provisions)				
Currency	56,980	10,082	360	216
Loans and advances	836,873	323,394	609,856	231,206
Investments and short term securities	516,398	297,193	68	-
All other assets	381,651	142,650	260,283	84,003
Off balance sheet items				
Credit related commitments	273,710	101,167	23,441	45,510
Other contingent liabilities	99,781	10,186	499	10,186
Total risk-weighted assets	2,165,393	884,672	894,507	371,121
Capital Ratios				
		Capital (K'000)	Capital Adequacy Ratio (%)	
	2002	2001	2002	2001
a) Before Dividend				
Tier 1 capital	122,911	66,729	13.74%	17.98%
Tier 1 + Tier 2 capital	154,445	75,574	17.26%	20.36%
b) After Dividend				
Tier 1 capital	104,852	59,412	11.72%	16.01%
Tier 1 + Tier 2 capital	136,386	68,257	15.25%	17.98%

Financial Risk Management (continued)

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 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, approved by the Credit and Business Risk sub-committee of the Board and implemented. 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 F - Loans and provision for loan impairment, the bank 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 assigns quality indicators to its credit exposures to determine the asset quality profile.

Large credit exposures are also monitored as part of credit risk management. These are classified as balances of individual accounts or groups of related counter-parties that exceed 10% of the capital base. Included in large exposures are significant exposures to the Government and statutory bodies. As at 31 December 2002, the three largest exposures totaled K53.708 million, accounting for over 90% of the exposure to the sector.

Credit related commitments

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

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

Year ended 31 December	K'000	%
Commerce, finance and other business	344,246	49
Private households	128,292	18
Government and public authorities	58,035	8
Agriculture	55,807	8
Transport & communication	50,538	7
Manufacturing	36,034	5
Construction	29,683	5
Net loan portfolio balance	702,635	100

D Liquidity risk

Liquidity risk is the risk of being unable to meet financial obligations as they fall due. Liquidity policy is set by the Board, through the Asset and Liability Committee, to ensure that the bank 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 2002

The maturity profile of material Assets and Liabilities as at 31 December 2002 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 does not impair the ability of the bank to meet its financial obligations as they fall due. The Directors are also of the view that the bank is able to meet its financial obligations as they fall due for the following additional reasons:

- The bank 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, the bank's Liquid Asset Ratio was approximately 38%, significantly in excess of the minimum requirement (2001: 51%). The CRR specifies that a bank must hold an amount equal to 5% of its total customer deposits in the form of cash in an account maintained at the BPNG. The bank complies with this daily requirement on an ongoing basis. The balance of the CRR account is shown in Note 8, Cash and Balances with Central Bank, and Note 23, Contingent Liabilities and Commitments.

Maturity of assets and liabilities

As at 31 December 2002	Up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Total
	K'000	K'000	K'000	K'000	K'000	K'000
Assets						
Cash and central bank assets	97,058	-	-	76,557	-	173,615
Treasury bills	447,288	46,846	1,979	-	-	496,113
Due from other banks	116,145	17,214	-	-	-	133,359
Loans and advances	173,548	24,270	73,382	237,297	194,138	702,635
Investments	-	-	20,285	-	-	20,285
Total assets	834,039	88,330	95,646	313,854	194,138	1,526,007
Liabilities						
Due to other banks	1,807	-	-	-	-	1,807
Due to customers	1,375,490	135,974	39,228	1,469	-	1,552,161
Other borrowings	-	-	-	15,000	-	15,000
Other liabilities	9,950	37,925	-	-	-	47,875
Other provisions	499	-	4,899	-	10,402	15,800
Total liabilities	1,387,746	173,899	44,127	16,469	10,402	1,632,643
Net liquidity gap	(553,707)	(85,569)	51,519	297,385	183,736	(106,636)
As at 31 December 2001			0-12 months	1-5 years	over 5 years	Total
Total assets			539,535	111,624	76,607	727,766
Total liabilities			684,632	197	-	684,829
Net liquidity gap			(145,097)	111,427	76,607	42,937

Financial Risk Management (continued)

E 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 is to minimise the impact on earnings of any such movement.

The bank accepts foreign currency denominated transactions and therefore has exposure to movements in foreign currency. The bank 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 material loss is not envisaged.

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

As at 31 December 2002	USD	AUD	EURO	PGK	Other	Total
	K'000	K'000	K'000	K'000	K'000	K'000
Assets						
Cash and central bank assets	923	826	32	171,699	135	173,615
Treasury bills	-	-	-	496,113	-	496,113
Due from other banks	59,115	63,418	982	6,026	3,818	133,359
Loans and advances	17,186	1,207	-	684,029	213	702,635
Investments	-	-	-	20,285	-	20,285
Other assets	-	-	-	253,132	-	253,132
Total assets	77,224	65,451	1,014	1,631,284	4,166	1,779,139
Liabilities						
Due to other banks	-	-	-	1,807	-	1,807
Due to customers	8,950	50,658	-	1,492,507	46	1,552,161
Other borrowings	-	-	-	15,000	-	15,000
Other liabilities	545	1,026	-	62,104	-	63,675
Total liabilities	9,495	51,684	-	1,571,418	46	1,632,643
Net on-balance sheet position	67,729	13,767	1,014	59,866	4,120	146,496
Off-balance sheet net notional position	11,976	1,171	62,654	-	5,797	81,598
Credit commitments	-	-	-	198,960	-	198,960

F Operational risk

Operational risk is the potential exposure to unexpected financial or non-financial losses arising from the way in which the bank and its subsidiaries 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.

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 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. 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.

Shown in the following tables are the balance sheet structure and contractual maturity profile of assets and liabilities as at 31 December 2002 and the effective ruling rates. Given this information, an immediate and sustained 1% change in market interest rates would change net interest income by K0.799 million in the succeeding year.

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

As at 31 December 2002

	Up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Non interest bearing
	K'000	K'000	K'000	K'000	K'000	K'000
Assets						
Cash and central bank assets	173,615	-	-	-	-	-
Treasury bills	496,113	-	-	-	-	-
Due from other banks	-	133,359	-	-	-	-
Loans and advances	632,372	70,263	-	-	-	-
Investments	-	-	20,286	-	-	-
Other assets	-	-	-	-	-	253,131
Total assets	1,302,100	203,622	20,286	-	-	253,131
Liabilities						
Due to other banks	-	1,807	-	-	-	-
Due to customers	1,552,161	-	-	-	-	-
Other borrowings	-	-	15,000	-	-	-
Other liabilities	-	-	-	-	-	63,675
Total liabilities	1,552,161	1,807	15,000	-	-	63,675
Interest sensitivity gap	(250,061)	201,815	5,286	-	-	-

Effective interest rates as at 31 December 2002

Amounts are expressed in % p.a.

Assets		%
Cash and central bank assets		12.00
Treasury Bills		14.97
Due from other banks		12.00
Loans and advances		12.66
Investments		11.28
Liabilities		%
Due to other banks		12.00
Due to customers		3.22
Other borrowed funds		16.97

Financial Risk Management (continued)

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.

Derivative financial instruments

In the normal course of trading, the bank enters into forward exchange contracts. The bank 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 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 2002, stated at the face value of the respective contracts are:

As at 31 December 2002		USD	AUD	EURO	GBP	Other	Total
Selling	FCY '000	18,314	5,233	277	135	81,539	
	Kina '000	73,846	11,976	1,170	8,721	4,068	99,781
Buying	FCY '000	(2,775)	-	-	(717)	(69,100)	
	Kina '000	(11,191)	-	-	(4,635)	(2,357)	(18,183)

Notes to the Financial Statements

	2002	2001
	K'000	K'000
1 Net Interest income		
Interest income		
Cash and short term funds	1,699	532
PNG Public Securities: Treasury bills and inscribed stock	60,106	27,624
Loans and advances	92,415	54,954
Other	197	204
	154,417	83,314
Less:		
Interest expense		
Customer deposits	36,683	42,027
Other banks	926	302
Other borrowings	349	-
	37,958	42,329
	116,459	40,985
2 Net fee and commission income		
Fee and commission income		
Credit related	7,273	4,086
Trade and international related	3,871	563
Electronic banking related	2,582	379
Other	7,184	3,467
	20,910	8,495
Less:		
Fee and commission expenses		
Agencies	66	-
Other	85	66
	151	66
	20,759	8,429
3 Other income		
Dividend income - available for sale securities	8	-
Foreign exchange related	53,872	8,406
Other	5,923	380
	59,803	8,786
Included in other income:		
Profit on sale of fixed assets	11	67
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	1,486	134
Bad debts written off	(710)	(324)
Net credit / (charge) to doubtful debts provision	3,047	(2,243)
	2,337	(2,567)
	3,823	(2,433)

Notes to the Financial Statements (continued)

	2002	2001
	K'000	K'000
5 Other operating expenses		
Administration		
Electronic banking related	162	255
Other general administration	26,959	4,422
	27,121	4,677
Auditors remuneration	543	275
Computing		
Electronic banking related	1,194	18
Other	6,022	1,739
	7,216	1,757
Depreciation	17,067	2,706
Amortisation of deferred expenditure	1,739	-
Non-executive Directors costs	403	208
Loss on sale of fixed assets	1,522	11
Non-lending losses	5,946	360
Premises and equipment	14,453	4,167
Staff costs		
Defined contribution plans	1,818	365
Statutory benefit contributions	3,300	616
Wages and salaries	48,818	12,315
Other	9,281	2,491
	63,217	15,787
	139,227	29,948
6 Income tax expense		
Current tax	(2,856)	7,580
Deferred tax	10,999	(732)
Current year	8,143	6,848
Prior year adjustments	334	-
Tax credit in respect of settlement of PNGBC tax obligations at acquisition	(1,587)	-
	6,890	6,848
Tax calculated at 25% of profit before tax	(19,735)	6,455
Expenses not deductible for tax	35,432	393
Deductible expenses not recognised for accounting purposes	(132)	-
Adjustment to deferred taxes for change in tax rate	(2,404)	-
Tax credit in respect of Community Service Obligations Act	(5,018)	-
Tax credit in respect of settlement of PNGBC tax obligations at acquisition	(1,587)	-
Prior year under provision	334	-
	6,890	6,848

Further information about deferred taxes is presented in note 16.

	2002	2001
	K'000	K'000
7 Abnormal items		
Write off of goodwill on acquisition of PNGBC Limited	140,557	-
Tax applicable	-	-
	140,557	-

Acquisition of Papua New Guinea Banking Corporation Limited

In December 2001, the Corporation under the Papua New Guinea Government's privatisation program, accepted a bid by the Bank of South Pacific Limited for the purchase from it, of Papua New Guinea Banking Corporation Limited. On April 9 2002, the Bank effected the settlement transaction for the purchase of Papua New Guinea Banking Corporation Limited from the Government of Papua New Guinea. The goodwill represents the excess of the consideration paid over the net assets acquired. A summary of the acquisition transaction is shown below:

Assets and liabilities acquired and goodwill arising:

	2002	2001
	K'000	K'000
Cash and cash equivalents	179,418	-
Loans and advances to customers	403,606	-
Other assets	771,293	-
Amounts due to customers	(1,194,255)	-
Other liabilities	(69,715)	-
Goodwill arising on acquisition	140,557	-
Total purchase consideration (discharged by cash, shares and assets)	230,904	-

The directors have determined that reliable assessments of the future economic benefits flowing from the goodwill cannot be made because of the high levels of risk and uncertainty surrounding the critical decision factors. Accordingly, the amount has been written off as allowed in these circumstances, by the relevant accounting standards, IFRS 22: Business Combinations and IFRS 36: Impairment of Assets.

Net cash flow on acquisition

	2002	2001
	K'000	K'000
Portion of consideration discharged by cash	(82,462)	-
Cash acquired	179,418	-
Net cash inflow on acquisition	96,956	-

8 Cash and balances with central bank

	2002	2001
	K'000	K'000
Notes and coins	57,890	11,426
Money market placements	22,000	-
Balances with central bank other than statutory deposit	17,168	24
Included in cash and cash equivalents	97,058	11,450
Statutory deposits with central bank	76,557	33,163
	173,615	44,613

Notes to the Financial Statements (continued)

	2002	2001
	K'000	K'000
9 Treasury bills		
Treasury bills - face value	500,000	300,000
Discount for interest receivable	(3,887)	(2,807)
	<u>496,113</u>	<u>297,193</u>
Treasury bills are debt securities issued by the Bank of Papua New Guinea for a term of three months, six months or a year. Treasury Bills are classified as assets held for trading and carried at fair value.		
10 Amounts due from other banks		
Items in the course of collection	34,442	599
Placements with other banks	98,917	67,804
Included in cash and cash equivalents	<u>133,359</u>	<u>68,403</u>
11 Loans and advances to customers		
Loans originated by the bank		
Overdrafts	163,406	68,131
Leases	13,174	6,755
Term loans	491,001	191,545
Mortgages	98,239	28,647
Gross loans and advances net of reserved interest	765,820	295,078
Less allowance for losses on loans and advances	(63,185)	(9,840)
	<u>702,635</u>	<u>285,238</u>
Allowance for losses on loans and advances		
Movement in allowance for losses on loans and advances:		
Balance at 1 January	9,840	7,597
Balance of provisions acquired on amalgamation	56,392	-
Provision for loan impairment	1,508	2,567
Loans written off during the year as uncollectible	(4,555)	(324)
Balance at 31 December	<u>63,185</u>	<u>9,840</u>
Loans and advances to customers includes finance lease receivables, analysed as follows:		
Investment in finance leases receivable		
Not later than 1 year	6,127	
Later than 1 year and not later than 5 years	8,597	
Later than 5 years	2,325	
	<u>17,049</u>	
Unearned future finance income	(3,875)	
Net investment in finance leases	<u>13,174</u>	
The net investment in finance leases is analysed as follows:		
Not later than 1 year	5,018	
Later than 1 year and not later than 5 years	6,419	
Later than 5 years	1,737	
	<u>13,174</u>	

12 Property, plant and equipment

	Capital WIP	Premises	Equipment	Total
	K'000	K'000	K'000	K'000
At 31 December 2001				
Cost	18,204	25,014	23,837	67,055
Accumulated depreciation	-	(3,440)	(7,811)	(11,251)
Net book amount	18,204	21,574	16,026	55,804
Year ended December 2002				
Opening net book amount	18,204	21,574	16,026	55,804
Net book amount of assets acquired on amalgamation	1,620	55,993	22,261	79,874
Additions	18,451	19,814	40,246	78,511
Disposals/transfers	(21,768)	(3,383)	(137)	(25,288)
Depreciation charge	-	(3,165)	(13,902)	(17,067)
Closing net book amount	16,507	90,833	64,494	171,834
At 31 December 2002				
Cost	16,507	103,064	104,979	224,550
Accumulated depreciation	-	(12,231)	(40,485)	(52,716)
Net book amount	16,507	90,833	64,494	171,834

	2002	2001
	K'000	K'000
13 Investment securities		
Securities - held-to-maturity		
Inscribed stock - issued by Bank of Papua New Guinea	20,286	-
Movement for the year in investment securities:		
At 1 January	-	-
Securities acquired on amalgamation	14,970	-
Additions	15,000	-
Disposals (redemptions)	(9,970)	-
	20,000	-
Interest receivable	286	-
At 31 December	20,286	-

Notes to the Financial Statements (continued)

14 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 2003 (2001: 25%). 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, the net benefit reflects the estimated future tax benefits at applicable income tax rates of the following:

	2002	2001
	K'000	K'000
Specific allowance for losses on loans and advances	12,807	1,233
General allowance for losses on loans and advances	5,425	1,227
Employee related provisions	4,738	750
Prepaid expenses	(281)	(151)
Other provisions	34	-
Depreciation and amortisation	(7,669)	(2,519)
Revalued assets	(2,294)	-
Deferred expenditure	(197)	-
Other	(435)	-
	12,128	540
The movements on the deferred income tax accounts are as follows:		
At 1 January	540	(191)
Deferred tax balances acquired on acquisition of PNGBC	18,379	-
Tax expense - change in tax rate	2,404	-
Tax losses utilised during the year	(11,128)	-
Specific allowance for losses on loans and advances	(837)	1,217
General allowance for losses on loans and advances	75	(656)
Employee related provisions	964	118
Depreciation	(2,315)	40
Prepaid expenses	(84)	12
Other provisions	(5)	-
Deferred expenditure	(73)	-
Revalued assets	4,208	-
Other	-	-
At 31 December	12,128	540
15 Other assets		
Items in transit and other assets	38,196	8,295
Accrued income	8,991	2,191
Deferred acquisition costs	4,400	2,360
Prepayments	12,258	1,254
Accounts receivable	10	-
	63,855	14,100
16 Amounts due to other banks		
Items in the course of collection	1,807	14,561
17 Amounts due to customers		
Demand / current	1,128,950	221,419
Term	423,211	434,715
	1,552,161	656,134

	2002	2001
	K'000	K'000
18 Other borrowed funds		
Loan capital		
Subordinated loan	15,000	-
<p>The loan capital qualifies as tier 2 capital under current capital adequacy guidelines issued by the Bank of Papua New Guinea. The indebtedness is subordinated to all other classes of liabilities, and is repayable on or before maturity on 30 September 2007. Interest is payable every six months on 1 April and 1 October each year.</p> <p>Interest rate: actual rate for 182-day treasury bills issued by Bank of Papua New Guinea at the commencement of the interest period + 2%</p>		
19 Other liabilities		
Creditors and Accruals	10,299	5,074
Items in transit and all others	37,576	5,968
	47,875	11,042
20 Other provisions		
Staff related	15,687	3,000
Other	113	90
	15,800	3,090

21 Ordinary Shares

	Number of shares	Book value
	'000	K'000
At 31 December 2001 /1 January 2002	17,016	17,919
Issue of shares - capital raising	14,581	94,775
Issue of shares - consideration for business acquisition	10,711	69,620
Issue of shares - remuneration of employees	45	108
At 31 December 2002	42,353	182,422

The issued capital of Bank of South Pacific Limited comprises ordinary shares. Following is a summary of principal shareholders as at 31 December 2002 and their respective percentage holdings.

Major shareholders: % shareholding	2002	2001
	%	%
Privatisation Commission	25.29	-
Motor Vehicles Insurance Limited	12.52	22.04
Credit Corporation (PNG) Limited	11.47	25.61
Petroleum Resources Kutubu Limited	10.90	-
Public Officers Superannuation Fund Board	10.90	-
National Superannuation Fund Limited	10.03	11.46
Teachers Savings & Loans Society Limited	5.78	8.51
Defence Force Retirement Benefits Fund Board	4.87	9.18
Sir George Constantinou	0.82	0.95
Lamin Trust Fund	0.72	1.79
Evangelical Lutheran Church of PNG Superannuation Board	0.49	7.08
	93.79	86.62
All others	6.21	13.38
	100.00	100.00

Notes to the Financial Statements (continued)

	2002	2001
	K'000	K'000
22 Reserves and retained earnings/(accumulated losses)		
<i>Reserves comprise:</i>		
Revaluation reserve	5,352	7,646
Capital reserve	635	635
General reserve	2,000	2,000
	7,987	10,281
<i>Movement in reserves for the year:</i>		
Revaluation reserve		
At 1 January	7,646	7,600
Adjustment for deferred tax liability	(2,294)	-
Net gains from changes in fair value of property, plant and equipment	-	46
At 31 December	5,352	7,646
Capital reserve		
At 1 January	635	635
No movement for the year	-	-
At 31 December	635	635
General reserve		
At 1 January	2,000	2,000
No movement for the year	-	-
At 31 December	2,000	2,000
<i>Movement in retained earnings for the year:</i>		
Retained earnings/(losses)		
At 1 January	49,234	39,771
Net profit/(loss) for the year	(85,830)	18,971
Dividend for prior year	(7,317)	(3,555)
Interim dividend for current year	-	(5,953)
At 31 December	(43,913)	49,234

	2002	2001
	K'000	K'000
23 Contingent liabilities and commitments		
Off balance sheet financial instruments		
Standby letters of credit	12,195	-
Guarantees and indemnities issued	42,618	4,934
Trade letters of credit	19,937	2,360
Commitments to extend credit	198,960	37,453
Forward exchange contracts	99,780	-
	373,490	44,747
Legal Proceedings		
A number of legal proceedings against the bank were outstanding as at 31 December 2002. 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 2002, the bank estimates a contingent liability of K0.464 million in respect of these proceedings.		
Statutory deposits with the central bank		
Cash reserve requirement - 5% of all amounts due to customers	76,557	33,163
Commitments for capital expenditure		
Amounts with firm commitments, and not reflected in the accounts	27,079	-
Operating lease commitments		
Not later than 1 year	3,481	441
Later than 1 year and not later than 5 years	1,214	-
Later than 5 years	1,497	-
	6,192	441
24 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 9)	173,615	44,613
Due from other banks (note 11)	133,359	68,403
Due to other banks (note 17)	(1,807)	(14,561)
	305,167	98,455

Notes to the Financial Statements (continued)

25 Related party transactions

Related parties are considered to be enterprises or individuals with whom the bank 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, by virtue of being able to control, dominate or participate in a fiduciary capacity, in decision-making functions or processes. The bank 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.

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 2002, staff account balances were as follows:

	2002
	K'000
Housing loans	17,514
Other loans	2,374
Leases	663
	20,551
Cheque accounts	2,321
Foreign currency accounts	1,197
Savings accounts	1,101
Term deposits	133
	4,752

25 Related party transactions (continued)

Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
N. N. Beangke	Director	Oil Search Limited ² , New Guinea Islands Produce Ltd ⁵ , PNG Coffee Exports Ltd ¹ , Credit Corporation (PNG) Ltd ^{3,5} , Baibua Ltd, Demakuri Ltd ⁵ , Bank of South Pacific Limited ¹
	Shareholder	New Guinea Islands Produce Ltd ⁵ , Credit Corporation (PNG) Ltd ⁵
	Family Trust	Niugini Nominees Ltd ⁵
T. E. Fox	Director	Kramer Group Ltd ⁴ , Kramer Consultants Ltd ⁴ , Kramer Pacific Ltd, PNG Institute of Directors, Teyo No. 1 Ltd, Port Moresby City Mission, Bank of South Pacific Limited ²
	Shareholder	Kramer Consultants Ltd, Teyo No. 1 Ltd, Bank of South Pacific Limited
N. R. Smith	Director/shareholder	Bank of South Pacific Limited ³ , N & R Smith Ltd ⁵
	Committee member	Commercial Bankers Association ¹ , Consultative Implementation and Monitoring Council, Institute of National Affairs ⁸
G Mcllwain	Director	Anderson Foodland ^{6,1} , Tower Insurance Ltd, New Guinea Islands Produce Ltd ⁵ , Finance Pacific Superannuation Fund, East New Britain Supermarkets ^{1, 6} , Rabtrad Madang Ltd, Balimore No. 21 Ltd ⁵ , Demakuri Ltd ⁵ , Bank of South Pacific Limited ⁴
	Shareholder	Bank of South Pacific Limited, Niugini Islands Produce Ltd ⁵
	Family Trust	Niugini Nominees Ltd ⁵
	Committee member	Papua Club, Returned Servicemen's League (Port Moresby sub-branch)
J. G. Jeffery	Director	James Barnes (PNG) Ltd ³ , NasFund ¹ , Crocodile Catering (PNG) Ltd ¹ , The Tower Ltd ¹ , Bank of South Pacific Limited
	Committee member	Employers Federation of PNG
V. Reva	Director	Motor Vehicles Insurance ¹ , Pacific Re Ltd ¹ , Pacific MMI Ltd, Bank of South Pacific Limited
	Employee	British American Tobacco (PNG) Ltd ⁷
G. Aopi	Director	Bank of South Pacific Limited, Steamships Trading Company ⁶ , Turanet Ltd, POMSoX Ltd, Hiram Ltd, Niu Marsh Ltd ¹ , Kumul Hotels ⁶ , MRDC Ltd, Endeavour Properties Ltd, Vaio Investments Ltd, Wahinemo Ltd, Tahali Consultants Ltd, Ezytok Ltd
	Shareholder	Oil Search Ltd, POMSoX Ltd, Hiram Ltd, Endeavour Properties Ltd, Vaio Investments Ltd, Wahinemo Ltd, Tahali Consultants Ltd, Lihir Gold Ltd, Investment Corporation of PNG
	Employee	Oil Search Ltd ⁷
	Committee member	Institute of National Affairs, Business Council of PNG, National Events Council, Ela United Church Fundraising, Society of Petroleum Engineers

¹Chairman, ²Deputy Chairman, ³Managing Director, ⁴Executive Director,

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, ⁷General Manager, ⁸Councillor

Notes to the Financial Statements (continued)

26 Directors and executive remuneration

Directors remuneration

Directors of the company received remuneration including benefits during 2002 as detailed below:

Total remuneration

Name of Director	Meetings attended /total held	Appointed/ (Resigned)	Base emolument	Bonus shares	Other compensation	2002	2001
N. N. Beangke	6 / 8	-	37,500	-	2,000	39,500	32,858
T. E. Fox	8 / 8	-	30,000	-	2,000	32,000	27,854
P. Auru	-	(20/4/01)	-	-	-	-	4,693
B. A. Flynn	1 / 8	(2/4/02)	31,250	-	3,750	35,000	24,104
B. J. Hanson	1 / 8	(2/4/02)	31,250	-	3,750	35,000	22,229
N. R. Smith	8 / 8	-	809,256	318,868	1,446,644	2,574,768	2,178,241
J. G. Jeffery	7 / 8	-	30,000	-	2,000	32,000	-
G. Aopi	6 / 8	4/4/02	13,750	-	1,000	14,750	-
V. Reva	6 / 8	4/4/02	13,750	-	1,000	14,750	-
G. McIlwain	6 / 8	4/4/02	440,861	106,132	166,813	713,806	-

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	2002 No.	2001 No.	Remuneration K'000	2002 No.	2001 No.	Remuneration K'000	2002 No.	2001 No.
100-110	1	-	320-330	1	2	480-490	1	-
120-130	4	1	330-340	1	1	490-500	2	-
130-140	1	-	340-350	2	-	500-510	1	-
190-200	1	1	350-360	5	1	510-520	2	-
230-240	-	1	360-370	3	-	570-580	1	-
240-250	-	1	370-380	4	-	580-590	-	1
250-260	-	2	380-390	4	1	590-600	-	1
260-269	2	2	390-400	3	1	610-620	1	-
270-280	1	1	400-410	3	-	660-670	1	-
280-290	-	3	410-420	1	-	730-740	1	-
290-300	1	2	420-430	-	1	760-770	1	-
300-310	1	1	430-440	2	-	790-800	1	-
310-320	2	4	440-450	1	-			
Total							56	28

27 Post balance sheet date events

Dividends

Subsequent to 31 December 2002 and prior to the authorised release of these financial statements, the Board of Directors declared that a full and final dividend of K18.059 million, representing 42.64 toea per share, be paid to shareholders for the year ended 31 December 2002.

Proposed new prudential standard: Capital Adequacy

In 2002, the Bank of Papua New Guinea invited submissions from the commercial banks in respect of a revised prudential standard for capital adequacy. The main thrust of the revisions was to bring the capital adequacy requirements closer to the guidelines promulgated by the Bank of International Settlements Basel Committee, currently being adopted by banks around the world. A major development in the new capital adequacy standard is the independent compliance requirement for tier 1 capital, in addition to the overall capital adequacy requirements. Submissions were made prior to the end of 2002, and discussions are continuing between the Bank of Papua New Guinea and the commercial banks on various aspects of the proposed standard. It is anticipated that the new prudential standard will be applied from 30 June 2003.

Proposed new prudential standard: Asset Quality

In 2002, the Bank of Papua New Guinea invited submissions from the commercial banks in respect of a revised prudential standard for asset quality. The new asset quality standards specify more detailed criteria for the classification of loans into various grades of default risk and corresponding loss provision levels as a consequence. These developments are aimed at bringing the asset quality monitoring and reporting requirements closer to the guidelines promulgated by the Bank of International Settlements Basel Committee, which are currently being adopted by banks around the world. Submissions were made prior to the end of 2002, and discussions are continuing between the Bank of Papua New Guinea and the commercial banks on various aspects of the proposed standard. It is anticipated that the new prudential standard will be applied from 30 June 2003.

Change in Corporate Income Tax Rate

The Papua New Guinea Government released its 2003 national budget in November 2002. New fiscal measures announced in the budget included a change in the corporate income tax rate from 25% to 30% per annum. This change has been incorporated in the carrying amount of deferred tax accounts as at 31 December 2002.

Debits Tax

The Papua New Guinea Government released its 2003 national budget in November 2002. New fiscal measures announced in the budget included the proposed introduction in 2003, of a 0.01% tax on withdrawals from savings, transaction and current accounts of bank customers (debits tax). The concept of the debits tax was for the banks to charge and collect the tax from their respective customers and periodically remit it to the Internal Revenue Commission. At the time of publication of these accounts the debits tax has not yet been implemented, as the relevant legislation is still being finalised, and the government (through the Internal Revenue Commission) and the commercial banks are still deliberating on the administrative aspects of the debits tax.

28 Reconciliation of operating cash flow

	2002	2001
	K'000	K'000
Reconciliation of operating profit/(loss) after tax to operating cash flow before changes in operating assets		
Operating profit/(loss) after tax	(85,830)	18,971
Adjustments to reconcile operating profit/(loss) after income tax to operating cash flow before changes in operating assets:		
Abnormal non-cash expense - goodwill on acquisition	140,557	-
Depreciation and amortisation	18,806	2,706
Net (profit)/loss on sale of fixed assets	1,511	(57)
Net effect of accruals	20,467	2,635
Operating cash flow before changes in operating assets	95,511	24,255

Independent Audit Report

Scope

We have audited the financial statements of Bank of South Pacific Limited for the year ended 31 December 2002. The financial report includes the Company's balance sheet as at 31 December 2002 and the related statements of income, cash flows and changes in equity for the year then ended. The Company's Directors are responsible for the financial statements. Our responsibility is to express an opinion on the financial report based on our audit to the members of the Company.

Our audit has been conducted in accordance with International Standards on Auditing. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial report is free of material misstatement. Our procedures include an assessment of the accounting principles used and significant accounting estimates made by the directors, as well as evaluating the overall financial report presentation. These procedures have been undertaken to form an opinion whether, in all material respects, the financial report is presented fairly in accordance with International Financial Reporting Standards and other generally accepted accounting practice and statutory requirements in Papua New Guinea, so as to present a view which is consistent with our understanding of the Company's financial position and performance as represented by the results of their operations and their cash flows.

We have obtained all the information and explanations we have required. We believe that our audit provides a reasonable basis for our opinion.

The audit opinion expressed in this report is formed on the above basis.

Unqualified Audit Opinion

In our opinion, the financial report of Bank of South Pacific Limited has been prepared in accordance with the PNG Companies Act (1997) including:

- a) giving a true and fair view of the Company's financial position as at 31 December 2002 and the results of its operations and cash flows statements for the year then ended in accordance with International Financial Reporting Standards, and comply with generally accepted accounting practice and statutory requirements Papua New Guinea; and
- b) proper accounting records have been kept by the Company as far as appears from our examination of those records.

Other information

In addition to providing audit services, we also provide Bank of South Pacific Limited taxation advice.

Dated this 8th day of May 2003.

DELOITTE TOUCHE TOHMATSU

By: Paul Barber

Registered under the Accountants Act 1996