

Bank of South Pacific Limited and Subsidiaries

Financial Statements

For the year ended

31 December 2010



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Directors' Report

for the Year Ended 31 December 2010

The Directors take pleasure in presenting the Financial Statements of the Bank of South Pacific Limited and its subsidiaries (Company and the Group) for the year ended 31 December 2010. In order to comply with the provision of the Companies Act 1997, the directors report as follows:

Principal activities

The principal activity of the Bank of South Pacific Limited (BSP) is the provision of commercial banking and finance services. The Group's activities includes the provision of commercial banking and finance services, stock broking, fund management and insurance businesses 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 Bank and the Group are licensed to operate in the Solomon Islands, Fiji Islands and Niue. The registered office is at Douglas Street, Port Moresby.

Review of operations

For the year ended 31 December 2010, the Company's profit after tax was K276.570 million (2009: K257.738 million profit). The Group's profit after tax was K283.147 million (2009: K257.118 million).

Dividends

Interim dividend of K65.585 million was declared and paid on 15th November 2010 by the Company in respect of the half year ended 30 June 2010 (2009: K182.374 million full and final dividend was paid on 8th July 2010 in respect of the year ended 31 December 2009).

Directors and officers

The following were directors of the Bank of South Pacific Limited during the year ended 31 December 2010:

Mr. K Constantinou	Sir. N Bogan	Mr. J G Jeffery	Dr. I Temu
Mr. G Aopi	Mr I B Clyne	Mr. J K Natto	
Mr. N N Beangke	Mr. T E Fox	Mr. C C Procter	

Details of directors' tenure and directors and executives' remuneration during the year are provided in Note 32 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 48. 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 Group during the year amounted to K316,983 (2009: K282,976).

Directors' Report

for the Year Ended 31 December 2010

Interests Register

Transactions recorded in the Interests Register are disclosed in Note 31 of the Notes to the Financial Statements.

Change in accounting policies

No changes in accounting policies occurred during the year.

For, and on behalf of, the Directors.

Dated and signed in accordance with a resolution of the directors in Port Moresby this 04th day of March 2011.



Kostas Constantinou
Chairman



Ian B Clyne
Chief Executive Officer/Director

Statement by the Directors

for the Year Ended 31 December 2010

The directors declare that:

- (a) in the directors' opinion, there are reasonable grounds to believe that the Company and the Group will be able to pay their debts as and when they become due and payable; and
- (b) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the PNG Companies Act 1997, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the Company and the Group.

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.

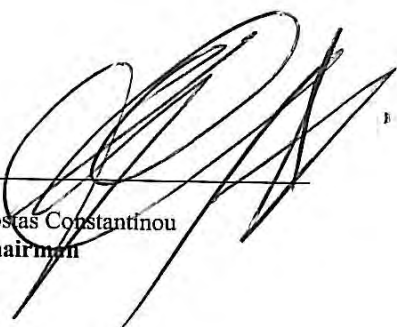
In the opinion of the Directors, no circumstances have arisen that make adherence to the existing method of valuation of assets or liabilities of the Company and the Group misleading or inappropriate.

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 04th day of March 2011.



Kostas Constantinou
Chairman



Ian B Clyne
Chief Executive Officer/Director

Statement of Comprehensive Income

for the Year Ended 31 December 2010

	Note	Consolidated		Bank	
		2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>					
Interest income	1	646,044	582,862	576,481	576,954
Interest expense	1	(102,042)	(108,893)	(80,390)	(106,746)
Net interest income		544,002	473,969	496,091	470,208
Fee and commission income	2	152,058	108,809	145,581	106,030
Other income	3	258,915	142,934	155,075	125,623
Net operating income		954,975	725,712	796,747	701,861
Bad and doubtful debts (expense)/recovery	4	(20,581)	(15,020)	(19,112)	(16,376)
Other operating expenses	5	(522,827)	(335,146)	(375,173)	(308,684)
Operating profit		411,566	375,546	402,462	376,801
Impairment of non-current assets		-	2,372	-	2,372
Share of loss from associates accounted for using the equity method	14(a)	(762)	225	(364)	(1,209)
Profit before tax		410,804	378,143	402,097	377,964
Income tax expense	6(a)	(127,657)	(121,025)	(125,527)	(120,226)
Operating profit/(loss) from ordinary activities after tax		283,147	257,118	276,570	257,738
Other comprehensive income					
Exchange difference on translation of foreign operations/subsidiaries	28	2,739	(7,076)	2,242	(6,862)
Net value gain on revaluation of share options	28	657	(249)	657	(249)
Net movement in asset revaluation	28	-	37,623	-	37,628
Other comprehensive income for the year, net of tax		3,398	30,298	2,900	30,517
Total comprehensive income for the year		286,545	287,416	279,470	288,255
Earnings per share - basic & diluted (in toea per share)					
	34	5.9	5.6	5.8	5.7

The attached notes form an integral part of these financial statements

Statement of Financial Position

As at 31 December 2010

	Note	Consolidated		Bank	
		2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>					
ASSETS					
Cash and balances with Central Bank	15	1,042,029	996,393	744,280	796,197
Treasury & Central Bank bills	16	2,280,816	2,325,713	2,280,816	2,305,708
Amounts due from other banks	17	302,061	191,888	295,028	186,655
Loans and advances to customers	18	4,091,297	3,638,562	3,276,747	2,860,022
Properties held for sale	19(a)	-	9,011	-	-
Property, plant and equipment	19(b)	364,154	282,246	312,024	243,302
Assets subject to operating lease	19(c)	77,480	86,024	77,480	86,024
Other financial assets	20	1,521,915	1,512,569	1,318,174	1,331,311
Investment in associates	14	54,456	47,733	12,563	1,417
Investment in subsidiaries		-	-	215,517	226,201
Intangible asset	13	16,158	21,333	-	-
Investment properties	19(d)	74,816	70,990	-	-
Deferred tax assets	21	64,968	52,603	52,569	41,210
Other assets	22	137,140	162,756	80,114	88,680
Total assets		10,027,290	9,397,821	8,665,312	8,166,727
LIABILITIES					
Amounts due to other banks	23	23,638	26,594	29,497	12,202
Amounts due to customers	24	7,984,657	7,493,779	7,185,575	6,759,626
Subordinated debt securities	25(b)	75,525	75,525	75,525	75,525
Other liabilities	25(a)	683,993	670,955	150,424	202,260
Provision for income tax	6(b)	30,484	109,691	28,513	103,377
Deferred tax liabilities	21	30,166	31,881	31,792	31,881
Other provisions	26	64,430	55,299	54,642	45,778
Total liabilities		8,892,893	8,463,724	7,555,968	7,230,649
SHAREHOLDERS EQUITY					
Ordinary shares	27	461,633	318,014	461,633	318,014
Retained earnings	28	588,977	553,912	578,372	551,625
Other reserves	28	83,787	62,171	69,339	66,439
Total shareholders' equity		1,134,397	934,097	1,109,344	936,078
Total equity and liabilities		10,027,290	9,397,821	8,665,312	8,166,727

The attached notes form an integral part of these financial statements

Statement of Changes in Shareholders Equity

As at 31 December 2010

Bank	Notes	Share capital	Reserves	Retained earnings	Total
<i>All amounts are expressed in K'000</i>					
Balance as at 1 January 2009	27 & 28	318,014	35,922	394,461	748,397
Final dividend paid for 2008	28	-	-	(100,305)	(100,305)
Deferred income 2009		-	-	(269)	(269)
Net profit	28	-	-	257,738	257,738
Other comprehensive income		-	30,517	-	30,517
Balance at 31 December 2009	27 & 28	318,014	66,439	551,625	936,078
Dividend paid	28	-	-	(247,959)	(247,959)
Deferred income 2010		-	-	(1,864)	(1,864)
Issue of ordinary shares	27	143,619	-	-	143,619
Net profit	28	-	-	276,570	276,570
Other comprehensive income		-	2,900	-	2,900
Balance at 31 December 2010	27 & 28	461,633	69,339	578,372	1,109,344
Consolidated					
Balance at 31 December 2009	27 & 28	318,014	62,171	553,912	934,097
Dividend paid	28	-	-	(247,959)	(247,959)
Deferred income 2010		-	-	(1,864)	(1,864)
Prior year Adjustments		-	-	1,741	1,741
Issue of ordinary shares	27	143,619	-	-	143,619
Equity component of convertible notes		-	18,218	-	18,218
Net profit	28	-	-	283,147	283,147
Other comprehensive income		-	3,398	-	3,398
Balance at 31 December 2010	27 & 28	461,633	83,787	588,977	1,134,397

The attached notes form an integral part of these financial statements

Statement of Cash Flow

As at 31 December 2010

	Notes	Consolidated		Bank	
		2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>					
CASH FLOW FROM OPERATING ACTIVITIES					
Interest received		645,728	584,859	573,599	579,318
Fees and other income		437,135	249,399	300,015	232,578
Interest paid		(109,337)	(116,142)	(80,807)	(101,732)
Amounts paid to suppliers and employees		(482,970)	(327,522)	(323,839)	(300,651)
Operating cash flow before changes in operating assets	33	490,556	390,594	468,968	409,513
Decrease/(increase) in loans		(429,305)	(535,954)	(435,838)	(532,554)
Decrease/(increase) in bills receivable and other assets		866	28,679	866	(26,047)
(Decrease)/increase in deposits		488,179	920,295	425,949	961,889
(Decrease)/increase in bills payable and other liabilities		8,192	(125,729)	(26,886)	62,175
Net cash flow from operations before income tax		558,488	677,067	433,059	874,976
Income taxes paid		(220,415)	(101,403)	(213,771)	(101,372)
Net cash flow from operating activities		338,073	575,664	219,288	773,604
CASH FLOW FROM INVESTING ACTIVITIES					
Decrease/(increase) in government securities		176	(281,094)	38,029	(273,963)
Expenditure on property, plant & equipment		(136,744)	(32,747)	(104,118)	(27,822)
Proceeds from disposal of property, plant & equipment		6,020	2,472	1,987	1,184
Proceeds from disposal of interest in former associate		100	-	100	-
Proceeds from other Investments		34,338	-	-	-
Movement in share trading activities		749	3,575	-	-
Additional funding in associate		-	(800)	-	(800)
Additional funding in subsidiary		641	-	(10,000)	-
Net cash flow on acquisition of subsidiary		(371)	8,622	(371)	(180,100)
Net cash flow from investing activities		(95,091)	(299,972)	(74,373)	(481,501)
CASH FLOW FROM FINANCING ACTIVITIES					
Issue of share capital	28	143,983	-	143,619	-
Proceeds from subordinated debt securities/convertible notes	25 & 11	22,395	75,525	-	75,525
Client management trust		(4,795)	(6,746)	-	-
Dividends paid	28	(247,959)	(100,305)	(247,959)	(100,305)
Net cash flow from financing activities		(86,376)	(31,934)	(104,340)	(24,780)
Net Increase/(decrease) in cash and cash equivalents		156,606	244,167	40,575	267,323
Effect of exchange rate movements on cash and cash equivalents		2,159	(3,135)	(1,414)	(3,135)
Cash and cash equivalent at the beginning of the period-subsiary		-	213,466	-	-
Cash and cash equivalents at the beginning of the year		1,161,687	707,189	970,650	706,462
Cash and Cash Equivalents at the end of the year	30	1,320,452	1,161,687	1,009,811	970,650

The attached notes form an integral part of these financial statements

Accounting Policies

For the year ended 31 December 2010

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 its subsidiaries 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 2010, 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 statement of comprehensive income;
- 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 profits or losses are recognised in the statement of comprehensive income.

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 statement of comprehensive income.

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

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

Accounting Policies

For the year ended 31 December 2010

E Revenue

Interest income and expense

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

Interest income includes coupons earned on inscribed stock, accrued discount and premium on central bank bills and treasury bills.

Short term insurance contracts

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

These contracts protect the Group's customers from the consequences of events such as death, medical emergency or loss on travel. Guaranteed benefits paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder. There are no maturity or surrender benefits.

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

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

Long Term Insurance Contracts

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

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

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

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The statutory liability is based on LPS 3.04 Capital Adequacy Standard issued by the Australian Prudential Regulation Authority and is calculated in a two-step process.

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

Accounting Policies

For the year ended 31 December 2010

E Revenue (continued)

The base policy liability is then recalculated to arrive at a statutory policy liability, based on assumptions which anticipate more adverse experience than the best estimate experience. Allowance is made for future bonuses (if any) in line with these adverse assumptions. The statutory policy liability is calculated as follows:

For policies with a Discretionary Participation Feature the maximum of:

- the base policy liability calculated on adverse assumptions and with the use of discretions
- the base policy liability calculated on best estimate assumptions including policyholder retained earnings
- the current surrender value

For other businesses the maximum of:

- the base policy liability calculated on adverse assumptions and with the use of discretions
- the current surrender value, or unearned premium reserve

The statutory policy liability is then increased by the solvency margin required under the applicable insurance act.

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 statement of comprehensive income 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 statement of comprehensive income.

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

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 statement of financial position as an intangible asset.

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

Accounting Policies

For the year ended 31 December 2010

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.

K Property, plant and equipment

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

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

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

Depreciation is provided on property, plant and equipment, including freehold buildings but excluding land. Depreciation is calculated on a straight line basis so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter, using the straight line method. The estimated useful 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 statement of comprehensive income reflecting the pattern of benefits derived from the leased assets.

Bank is lessor

Finance leases are included in Loans and Advances to Customers (Note 18) and are accounted for under the finance method whereby income is taken to account over the life of the lease in proportion to the outstanding investment balance.

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

Accounting Policies

For the year ended 31 December 2010

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.

N Provisions

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

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

O Employee benefits

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

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

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

Post employment benefits - defined contribution plans

A defined contribution plan is a pension plan under which the 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. The contributions are at the current rate of employees' gross salary. Once the contributions have been paid, the Bank and the Group have no further payment obligations for post-employment benefits from the date an employee ceases employment with the Bank and the Group.

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

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

Accounting Policies

For the year ended 31 December 2010

P Income tax (continued)

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

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

Current and deferred tax for the period

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

Q Investments

Investments are classified into the following categories: financial assets carried at fair value through profit and loss, held-to-maturity and available-for-sale. Trading reflects active and frequent buying and selling, and financial assets carried at fair value through profit and loss 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. Financial assets carried at fair value through profit and loss 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 financial assets carried at fair value through profit and loss are included in the statement of comprehensive income in the period in which they arise.

R Foreign Currency

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

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

Foreign operations

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

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.

Accounting Policies

For the year ended 31 December 2010

S Share capital (continued)

Dividends on ordinary shares

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

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

Share options

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

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 Non-current assets held for sale

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

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

V 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 2010

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 2010, the Bank and the Group's total capital adequacy ratio and leverage capital ratio satisfied the capital adequacy criteria for well-capitalised. The minimum capital adequacy requirements set out under the standard are: Tier 1 8%, total risk base capital ratio 14% and the leverage ratio 6%.

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

Financial Risk Management

For the year ended 31 December 2010

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	
	2010	2009	2010	2009
Balance sheet assets (net of provisions)				
Currency	1,042,029	999,683	-	-
Loans and advances	4,091,297	3,638,562	3,977,693	3,239,995
Investments and short term securities	3,802,731	3,838,282	-	-
All other assets	1,091,233	921,294	863,830	692,030
Off balance sheet items	1,220,614	1,200,968	503,154	416,132
Total	11,247,905	10,598,789	5,344,677	4,348,157

Capital Ratios		Capital (K'000)		Capital Adequacy Ratio (%)	
		2010	2009	2010	2009
a) Before YTD profits included in Tier 1 Capital	Tier 1 capital	768,769	598,310	14.4%	12.6%
	Tier 1 + Tier 2 capital	1,261,714	1,054,789	23.6%	22.1%
b) After YTD profits included in Tier 1 Capital	Tier 1 capital	1,051,916	855,428	19.7%	18.0%
	Tier 1 + Tier 2 capital	1,261,714	1,054,789	23.6%	22.1%
c) Leverage Capital Ratio – Before YTD profits included in Tier 1 Capital				7.7%	6.4%
d) Leverage Capital Ratio – After YTD profits included in Tier 1 Capital				10.5%	9.1%

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 Chief Risk Officer) is responsible for the development and implementation of credit policy and loan portfolio review methodology. The Credit Committee is the final arbiter of risk management and loan risk concentration.

As indicated in Accounting Policy 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 2010

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 2010, the 25 largest exposures totaled K1.410 billion, accounting for over 62.9% of the Bank and the Group's total loan portfolio (2009: K997 million, accounting for over 58.1%).

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	2010	%	2009	%
Commerce, finance and other business	1,661,184	41	1,855,439	51
Private households	882,512	22	463,963	13
Government and public authorities	116,041	3	8,214	-
Agriculture	334,157	8	260,051	7
Transport & communication	426,733	10	276,230	8
Manufacturing	261,464	6	397,624	11
Construction	409,206	10	377,041	10
Net loan portfolio balance	4,091,297	100	3,638,562	100

Financial Risk Management

For the year ended 31 December 2010

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 2010

The maturity profile of material Assets and Liabilities as at 31 December 2010 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. The requirement to hold a minimum of 25% of the value of total customer deposits in the form of prescribed liquid assets is now reduced to zero percent in accordance with Bank of Papua New Guinea (“BPNG”) monetary policy statement issued in September 2010. As at 31 December 2010, the Bank and the Group’s Liquid Asset Ratio was approximately 42.96% (2009: 50.14%).
- The CRR specifies that a bank must hold an amount equal to 4% 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 15, Cash and Balances with Central Bank, and Note 30, Cash & Cash Equivalents.

Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2010	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Assets						
Cash and balances with Central Bank	1,042,029	-	-	-	-	1,042,029
Treasury & Central Bank bills	645,146	736,200	899,470	-	-	2,280,816
Due from other banks	302,061	-	-	-	-	302,061
Loans and advances	759,077	415,204	604,353	1,477,824	834,839	4,091,297
Investments	-	-	238,103	349,642	934,170	1,521,915
Total assets	2,748,313	1,151,404	1,741,926	1,827,466	1,769,009	9,238,118

Financial Risk Management

For the year ended 31 December 2010

D Liquidity risk (continued)

Maturity of assets and liabilities

All amounts are expressed in K'000

As at 31 December 2010	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Liabilities						
Due to other banks	23,638	-	-	-	-	23,638
Due to customers	6,366,940	960,024	539,647	35,471	82,575	7,984,657
Other liabilities	679,884	30,587	-	-	75,525	785,996
Other provisions	18,239	34,451	-	-	27,136	79,826
Total liabilities	7,088,701	1,025,062	539,647	35,471	185,236	8,874,117
Net liquidity gap	(4,279,009)	126,343	1,140,899	1,791,996	1,583,772	364,001
As at 31 December 2009	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Total assets	3,574,405	619,864	1,072,174	1,856,863	1,541,819	8,665,125
Total liabilities	6,840,446	989,886	443,656	23,799	165,937	8,463,724
Net liquidity gap	(3,266,041)	(370,022)	628,518	1,833,064	1,375,886	201,401

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 operational risk management function is responsible for the maintenance of these policies, procedures practices and monitoring the organization's compliance with them.

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 2010

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 2010	USD	AUD	EURO	PGK	Other	Total
Assets						
Cash and balances with Central Bank	1,458	1,168	38	735,408	303,957	1,042,029
Treasury & Central Bank bills	-	-	-	2,280,816	-	2,280,816
Due from other banks	35,389	227,480	956	26,120	12,116	302,061
Loans and advances	47,249	2,376	-	3,227,122	814,550	4,091,297
Investments	-	-	-	1,318,174	203,741	1,521,915
Other assets	-	-	-	751,187	37,985	789,172
Total assets	84,096	231,024	994	8,338,827	1,372,349	10,027,290
Liabilities						
Due to other banks	-	-	-	(29,497)	5,859	(23,638)
Due to customers	(107,559)	(157,174)	(2,099)	(6,916,467)	(801,358)	(7,984,657)
Other liabilities	-	-	-	(322,664)	(561,934)	(884,598)
Total liabilities	(107,559)	(157,174)	(2,099)	(7,268,628)	(1,357,433)	(8,892,893)
Net on-balance sheet position	(23,463)	73,850	(1,105)	1,070,198	14,917	1,134,397
Off-balance sheet net notional position						
	24,946	8,491	6,133	-	5,714	45,284
Credit commitments	-	-	-	1,220,614	-	-
31 December 2009						
Total Assets	66,725	93,605	4,135	7,890,756	1,342,600	9,397,821
Total Liabilities	(117,692)	(120,373)	(789)	(6,945,999)	(1,278,871)	(8,463,724)
Net on-balance sheet position	(50,967)	(26,768)	3,346	944,757	63,729	934,097
Off-balance sheet net notional position	16,648	9,269	7,105	-	10,237	43,259
Credit commitments	-	-	-	1,111,273	-	-

Financial Risk Management

For the year ended 31 December 2010

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 2010 and prevailing rates of interest, a 1% increase in rates will result in a K0.297 million decrease in net interest income, whilst a 1% decrease in rates will result in a K0.274 million increase in net interest income.

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

All amounts are expressed in K'000

As at 31 December 2010	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non interest bearing
Assets						
Cash & Balances with Central Bank	-	-	-	-	-	1,042,029
Treasury & Central Bank bills	645,146	736,200	899,470	-	-	-
Due from other banks	302,061	-	-	-	-	-
Loans and advances	1,989,354	510,339	740,327	565,058	286,215	4
Investments	-	-	238,103	349,642	934,170	-
Other assets	-	-	-	-	-	789,172
Total assets	2,936,561	1,246,539	1,877,900	914,700	1,220,385	1,831,205
Liabilities						
Due to other banks	23,638	-	-	-	-	-
Due to customers	4,669,132	642,114	339,147	33,471	5	2,300,788
Other liabilities	-	-	-	-	75,525	809,073
Total liabilities	4,692,770	642,114	339,147	33,471	75,530	3,109,861
Interest sensitivity gap	(1,756,209)	604,425	1,538,753	881,229	1,144,855	(1,278,656)

Financial Risk Management

For the year ended 31 December 2010

G Interest rate risk (continued)

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

As at 31 December 2009	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non interest bearing
Assets						
Cash and balances with Central Bank	-	-	-	-	-	996,393
Treasury and Central Bank bills	1,731,100	187,543	407,070	-	-	-
Due from other banks	191,888	-	-	-	-	-
Loans and advances	1,599,968	401,010	697,185	576,658	363,737	4
Investments	-	35,000	87,349	567,150	823,070	-
Other assets	-	-	-	-	-	732,696
Total assets	3,522,956	623,553	1,191,604	1,143,808	1,186,807	1,729,093
Liabilities						
Due to other banks	26,594	-	-	-	-	-
Due to customers	4,575,913	574,476	309,656	23,799	76,100	1,933,835
Other liabilities	-	-	-	-	75,525	867,826
Total liabilities	4,602,507	574,476	309,656	23,799	151,625	2,801,661
Interest sensitivity gap	(1,079,551)	49,077	881,948	1,120,008	1,035,185	-

Effective interest rates as at 31 December

Amounts are expressed in % p.a.

Assets	2010	2009
Cash and Central Bank assets	7.00	7.00
Treasury & Central Bank bills	3.50	7.05
Due from other banks	7.00	7.00
Loans and advances	12.50	13.30
Investments	9.70	9.50
Liabilities		
Due to other banks	7.00	7.00
Due to customers	3.00	3.00

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.

Financial Risk Management

For the year ended 31 December 2010

H Fair values of financial assets and liabilities (continued)

Forward exchange contracts outstanding at 31 December 2010 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 2010		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	16,795	-	-	4,760	-	21,555
	Kina	43,855	-	-	19,716	-	63,571
Buying	FCY	(15,742)	(29,013)	(400)	(3,200)	(82,975)	(131,329)
	Kina	(43,376)	(75,030)	(1,487)	(2,030)	(4,160)	(126,083)
As at 31 December 2009		USD	AUD	EURO	GBP	Other	Total
Selling	FCY	1,831	15,874	100	4,500	1,287	-
	Kina	5,504	38,279	368	7,353	2,497	54,001
Buying	FCY	(45,382)	(32,500)	(20)	(5,161)	-	-
	Kina	(120,585)	(29,631)	(77)	(22,501)	-	(172,794)

I Policy liabilities

Key assumptions used in determining this liability are as follows:

(i) Discount Rates

For contracts which have a DPF, the discount rate used is linked to the assets which back those contracts. For 2010 this was 5.49% per annum (30 June 2010: 5.41% per annum), based on 5 year government bond rate and expected earnings from the investment portfolio. For contracts without DPF, a rate of 4.04% per annum was used at 31 December 2010 (30 June 2010: 3.85% per annum). For Accident business a rate of 3.98% per annum was used at 31 December 2010 (30 June 2010: 5.62% per annum). These rates were based on the 5 year government bond rate.

(ii) Investment and Maintenance Expenses

Future maintenance and investment expenses have been derived from budgeted expenses. Future inflation has been assumed to be 3.5% per annum (30 June 2010: 3.5% per annum) for determining future expenses.

(iii) Taxation

The rates of taxation enacted or substantially enacted at the date of the valuation (i.e. 31%) are assumed to continue into the future.

The reduction in tax rates from financial year 2010 would have an immaterial impact on policy liabilities with any reduction in the liability materially offset by an increase in bonus rate.

(iv) Mortality and Morbidity

Projected future rates of mortality for insured lives are based on the Fiji Mortality Statistics performed in 1998. These are then adjusted by comparing with the Group's own experience. For 2010 the mortality rates used was 85% of the Mortality statistics. Assumptions are reviewed based on annual experience studies. There have been no changes to mortality assumptions for the current period.

(v) Rates of Discontinuance

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

	31 December 2010	30 June 2010
Whole of Life and Endowment Insurance	14%	14%
Term Insurance	16%	16%
Accident Insurance	13%	13%

Financial Risk Management

For the year ended 31 December 2010

I Policy liabilities (continued)

(vi) Basis of Calculation of Surrender Values

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

(vii) Discretionary Participating Business

For most participating business, bonus rates are set such that, over long periods, the returns to contract holders are commensurate with the investment returns achieved on the pool of assets which provide security for the contract, together with other sources of profit arising from this business. Distributions are split between contract holders and shareholders with the valuation allowing for shareholders to share in distributions at a maximum allowable rate of 20% (30 June 2010: 20%). For business written between 1995 and 1998 the shareholder receives 11% of distributions.

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

Assumed future bonus rates included in the liability for the long term insurance contracts were set such that the present value of the liabilities equates to the present value of assets supporting the business together with assumed future investment returns, allowing for the shareholder's right to participate in distributions.

Assumed future bonus rates per annum for the major classes of participating businesses range from 1.35% to 3.25% per annum (30 June 2010: 1.05% to 2.00% per annum).

Reinsurance

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

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

Reinsurance recoveries for claims are recognised as Reinsurance recoveries.

Notes to the Financial Statements

For the year ended 31 December 2010

1	Net Interest income	Consolidated		Bank	
		2010	2009	2010	2009
	<i>All amounts are expressed in K'000</i>				
	Interest income				
	Cash and short term funds	1,339	1,167	1,339	1,167
	Treasury bills, Central Bank bills and other financial assets	228,619	282,801	223,061	282,406
	Loans and advances	412,260	298,196	351,531	293,106
	Other	3,826	698	550	275
		646,044	582,862	576,481	576,954
	Less:				
	Interest expense				
	Customer deposits	90,202	103,555	68,550	101,408
	Other banks	32	1,666	32	1,666
	Subordinated debt securities	9,278	3,664	9,278	3,664
	Other borrowings	2,530	8	2,530	8
		102,042	108,893	80,390	106,746
		544,002	473,969	496,091	470,208
2	Net fee and commission income				
	Fee and commission income				
	Credit related	49,167	38,941	44,639	38,561
	Trade and international related	143	165	143	165
	Electronic banking related	13,449	8,735	13,449	8,735
	Brokerage and fee income	1,957	1,996	-	-
	Other	87,725	59,293	87,733	58,890
		152,441	109,130	145,964	106,351
	Less:				
	Fee and commission expenses				
	Agencies	383	321	383	321
		383	321	383	321
		152,058	108,809	145,581	106,030

Notes to the Financial Statements

For the year ended 31 December 2010

3 Other income	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Foreign exchange related	139,260	104,338	132,566	104,338
Net insurance premium income	89,074	6,621	-	-
Other	30,581	31,975	22,509	21,285
	258,915	142,934	155,075	125,623
Included in other income:				
Profit/(loss) on sale of fixed assets	1,166	1,184	498	1,184
Change in fair value of assets held through profit and loss	10,119	2,755	-	-
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	34,479	29,498	31,690	29,584
Net charge to doubtful debts provision	(55,060)	(44,518)	(50,802)	(45,960)
	(20,581)	(15,020)	(19,112)	(16,376)
5 Other operating expenses				
Administration	171,520	74,508	99,548	73,291
Auditors remuneration	1,893	1,178	1,597	1,153
Computing	22,234	16,332	22,234	16,332
Depreciation	53,499	37,371	43,261	36,556
Amortization of computer development	645	1,684	645	1,684
Non-executive Directors costs	1,533	886	1,533	886
Non-lending losses	5,812	25,683	4,292	24,900
Fixed Asset write off (write back)	645	1,397	645	1,397
Premises and equipment	33,069	37,953	30,331	37,953
Increase/(decrease) in policy liabilities	2,576	7,556	-	-
Insurance commissions	5,106	4,782	-	-
	298,532	209,330	204,086	194,152
Staff costs				
Defined contribution plans	7,836	4,236	5,011	4,236
Statutory benefit contributions	10,841	5,808	8,016	5,467
Wages and salaries	164,413	89,056	125,784	86,662
Other	41,205	26,716	32,276	18,167
	224,295	125,816	171,087	114,532
	522,827	335,146	375,173	308,684

Notes to the Financial Statements

For the year ended 31 December 2010

6(a) Income tax expense

	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Current tax	142,609	128,170	142,328	127,783
Deferred tax	(20,438)	(13,463)	(20,607)	(14,045)
Current year	122,171	114,707	121,721	113,739
Prior year adjustments	5,486	6,318	3,806	6,487
	127,657	121,025	125,527	120,226
Tax calculated at 30% of profit before tax (2010: 30%)	119,473	113,052	120,629	113,389
Tax calculated at 29% of profit before tax - subsidiary	3,828	842	-	-
Expenses not deductible for tax	2,601	2,050	1,092	1,398
Deductible expenses not recognized for accounting purposes	-	(1,049)	-	(1,049)
Net insurance income not subject to tax	2,211	2,974	-	-
Tax benefit not brought to account - subsidiary	(5,942)	(3,162)	-	-
Prior year under provision	5,486	6,318	3,806	6,487
	127,657	121,025	125,527	120,226

Further information about deferred taxes is presented in note 21.

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

Recoverable / (provision) comprise:

At 1 January	(109,691)	(68,416)	(103,377)	(68,355)
Opening balance - subsidiary	-	(5,898)	-	-
Income tax provision	(142,609)	(128,170)	(142,328)	(127,784)
Tax benefit not bought to account – subsidiary	(5,942)	-	-	-
Expenses not deductible for tax	3,922	(1,398)	-	(1,398)
Deductible expenses not recognized for accounting purposes	-	1,049	-	1,049
Prior year over / (under) provision	12,890	(8,261)	12,890	(8,261)
Foreign tax paid	6,644	4,866	-	4,866
Tax payments made	204,302	96,537	204,302	96,506
At 31 December	(30,484)	(109,691)	(28,513)	(103,377)

Notes to the Financial Statements

For the year ended 31 December 2010

7 Discontinued Operations

Colonial Fiji Life Limited (CFL) is no longer available for sale (available for sale in 2009). A full consolidation has been performed in 2010.

8 Acquisition of Associate/Available for Sale Investment

In November 2010, the Bank acquired 50% interest of Suva Central Limited from Colonial Fiji Life Limited (CFL) a 100% subsidiary of Bank of South Pacific Ltd for a consideration of K12.563m (Fiji dollars \$8.5m). Suva Central Limited a company incorporated in the Fiji Islands, CFL transferred the form of shares to Bank South Pacific. These shares were transferred at fair value and the carrying value of the investment is recorded at acquisition cost.

9 Acquisition of Subsidiary

In March 2010, the Group acquired EMWAL Nominees Limited, a duly registered company incorporated in the Republic of Fiji Islands for a consideration of 2 Fiji Dollars (FJD). The EMWAL Nominees Limited was incorporated on 27 October 2006 as a shelf company. After the acquisition, it was renamed as BSP Convertible Notes Limited (BSP CN).

BSP CN is a special purpose vehicle incorporated in Fiji with limited powers under its memorandum and articles to facilitate the issue of convertible notes, BSP Fiji Class Shares and the loan to BSP, Fiji Branch of funds raised. 100% of the ordinary shares of BSP CN are beneficially owned by Bank of South Pacific Limited.

During the period, BSP CN issued convertible notes and raised FJD 16.090 million (K23.5 million) at FJD5.25 per note. The notes attract a half yearly coupon of 7% and at maturity on 20 April 2013 will convert to Fiji Class Shares at the ratio of 10 shares for 1 Note. (see note 11)

In May 2010, BSP Rural, a wholly owned subsidiary of Bank of South Pacific Limited was incorporated. At 31 December 2010 it operated branches/agencies in three locations. These branches/agencies are operated on the Bank's core banking system and the cash used and deposits mobilized are the assets and liabilities of BSP. In this regard BSP Rural acts as an agent of Bank of South Pacific Limited.

10 Borrowings

On 23 June 2010, the Group signed a loan agreement with International Finance Corporation (IFC), a member of the World Bank Group to obtain a floating rate loan to the amount of US\$30 million. As at 31 December 2010, the balance of the undrawn borrowing was US\$30 million.

11 Convertible Notes

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

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

	<u>K'000</u>
Proceeds of issue	<u>22,394</u>
Liability component of issue (note 25(a))	4,176
Equity component (note 28)	18,218

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

The liability component is measured at amortized cost. Interest payment of 7% per annum is payable twice yearly on 20 April and 20 October for a maximum of three (3) years. The accrued interest expense for the half-year for the two-month period since the loan notes were issued was FJD220,084 (K306,310).

Notes to the Financial Statements

For the year ended 31 December 2010

12 CDO Provisions

In 2008 and prior periods, BSP Capital Limited (a subsidiary of the Bank), marketed certain collateralised debt obligation investment products issued or arranged by Lehman Brothers. The value of the notes was seriously impaired following the unfolding global financial crisis, particularly the demise of Lehman Brothers, which was the primary issuer or promoter in the majority of cases. Value remains subject to great uncertainty, because of the status of the issuer/promoter, because the general level of financial asset prices have declined dramatically over the last year as the global financial crisis has developed, and because of the complex investment structures and contractual relationships causing difficulties in identifying the nature and quality of the assets underlying these instruments.

A K50 million asset impairment adjustment/provision in respect of these events was created as a prudent estimate of the cost to BSP Group of protecting against reputation risk & risk of financial loss. The balance as at 31 December 2010 is K3.226 million. (2009:K6.860 million)

As at 31 December 2010 and up to the date of the release of these financial statements, subsequent to 31 December 2010 an additional K46.7 million of these losses have been realized

13 Intangible asset

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
Gross carrying amount	16,158	21,333	-	-
Impairment adjustment	-	-	-	-
	16,158	21,333	-	-

The directors have determined that the carrying value of the goodwill arising on consolidation as a result of elimination of BSP investment in its subsidiaries is considered not materially impaired. The directors also determined that these subsidiaries continue to trade profitably and the impairment adjustment does not indicate otherwise.

14(a) Investments in Associates

Name of Associates	Principal activity	Place of incorporation and operation	Proportion of ownership and voting power held	
			2010	2009
PNG Micro Finance Limited ****	Micro finance	PNG	-	32%*
Suva Central Limited	Property rental	Fiji	50%*	50%*
Richmond Limited	Hotel operation	Fiji	61.3%**50%***	61%** , 50%***
Williams and Gosling	Freight forwarding	Fiji	27.7%*	20.4%*

both ownership and voting power held, **ownership, *voting power held, ****disposed in 2010*

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
Investment in associate	47,733	46,708	1,417	1,826
Disposal	(5,078)	-	(1,053)	-
Additional	12,563	800	12,563	800
Share of profit/(loss) for year ended 31 December 2010	(762)	225	(364)	(1,209)
Net investment in associate	54,456	47,733	12,563	1,417

Notes to the Financial Statements

For the year ended 31 December 2010

14(a) Investments in Associates (continued)

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
Summarised financial information of associate:				
Total assets	188,011	217,421	41,738	39,924
Total liabilities	(103,184)	(122,925)	(38,794)	(37,533)
Net assets	84,827	94,496	2,944	2,391
Net profit/(loss)	(1,536)	3,228	(1,138)	(3,779)
Share of associate's profit or loss:				
Share of associate's profit/(loss)	(762)	225	(364)	(1,209)

14(b) Disposal of Investments in Associate

As at 31st December 2009, the bank held a 32% interest in PNG Microfinance Limited and accounted for the investment as an associate. In May 2010, the bank disposed its full interest in the associate to a third party for the proceeds of K100,000. This transaction has resulted in the recognition of a loss in profit or loss as follows;

	Total K'000
Proceeds of disposal	100
Less: Carrying value of investment at the date of sale	(1,053)
Loss recognised on disposal of associate interest	(953)

15 Cash and balances with Central Bank

Notes and coins	278,484	233,722	173,626	152,762
Balances with Central Bank other than statutory deposit	258,688	401,872	155,271	378,016
Included in cash and cash equivalents	537,172	635,594	328,897	530,778
Statutory deposits with Central Bank	504,857	360,799	415,383	265,419
	1,042,029	996,393	744,280	796,197

16 Treasury & Central Bank bills

Treasury & Central Bank bills - face value	2,312,609	2,357,862	2,312,609	2,337,857
Discount for interest receivable	(31,793)	(32,149)	(31,793)	(32,149)
	2,280,816	2,325,713	2,280,816	2,305,708

Treasury & Central Bank bills are debt securities issued by the Central Bank 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.

17 Amounts due from other banks

Items in the course of collection	259,586	84,874	259,586	84,874
Placements with other banks	42,475	107,014	35,442	101,781
Included in cash and cash equivalents	302,061	191,888	295,028	186,655

Notes to the Financial Statements

For the year ended 31 December 2010

18 Loans and advances to customers	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Loans originated by the BSP Group:				
Overdrafts	680,475	614,085	615,482	566,655
Leases	174,171	182,142	174,171	182,142
Term loans	2,692,603	2,296,478	2,430,426	2,043,497
Mortgages	654,761	629,187	163,946	153,252
Policy loans	47,965	46,430	-	-
Gross loans and advances net of reserved interest	4,249,975	3,768,322	3,384,025	2,945,546
Less allowance for losses on loans and advances	(158,678)	(129,760)	(107,278)	(85,524)
	4,091,297	3,638,562	3,276,747	2,860,022
Allowance for losses on loans and advances				
Movement in allowance for losses on loans and advances:				
Balance at 1 January	129,760	50,496	85,524	50,496
Opening balance - subsidiary	-	42,382	-	-
New Provision	39,847	23,581	30,000	22,225
Loans written off against provisions / (Write back of provisions no longer required)	(10,929)	13,301	(8,246)	12,803
Balance at 31 December	158,678	129,760	107,278	85,524
Loans and advances to customers includes finance lease receivables, analysed as follows:				
Investment in finance leases receivable				
Not later than 1 year	23,522	15,061	23,522	15,061
Later than 1 year and not later than 5 years	161,773	182,142	161,773	182,142
Later than 5 years	-	-	-	-
	185,295	197,203	185,295	197,203
Unearned future finance income	(11,124)	(15,061)	(11,124)	(15,061)
Net investment in finance leases	174,171	182,142	174,171	182,142
The net investment in finance leases is analysed as follows:				
Not later than 1 year	22,984	14,580	22,984	14,580
Later than 1 year and not later than 5 years	151,187	167,562	151,187	167,562
Later than 5 years	-	-	-	-
	174,171	182,142	174,171	182,142
19(a) Properties held for sale				
Premises	9,011	9,011	-	-
Disposal	(9,011)	-	-	-
	-	9,011	-	-

Notes to the Financial Statements

For the year ended 31 December 2010

19(b) Property, plant and equipment

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
(i) Carrying value				
Capital Work in Progress	94,061	58,347	77,816	46,284
Premises	241,073	209,859	216,212	200,378
Accumulated depreciation	(59,398)	(32,781)	(41,357)	(32,107)
	181,675	177,078	174,855	168,271
Equipment	305,623	200,349	231,421	182,134
Accumulated depreciation	(217,205)	(153,528)	(172,067)	(153,387)
	88,418	46,821	59,354	28,747
	364,154	282,246	312,024	243,302
(ii) Reconciliations				
Capital WIP				
At 1 January	58,347	38,787	46,284	38,787
Opening balance – subsidiary	-	13,135	-	-
Additions	115,669	38,194	100,908	35,989
Transfers	(79,955)	(31,769)	(69,376)	(28,492)
At 31 December	94,061	58,347	77,816	46,284
Premises				
At 1 January	177,078	113,577	168,271	113,577
Opening balance – subsidiary	-	9,120	-	-
Additions	14,697	3,383	13,859	2,726
Disposals	(330)	(2,052)	(20)	(1,756)
Adjustments-prior year	1,895	2,354	1,895	2,354
Revaluation increases	-	57,141	-	57,141
Depreciation expense	(11,665)	(6,445)	(9,150)	(5,771)
At 31 December	181,675	177,078	174,855	168,271
Equipment				
At 1 January	46,821	22,684	28,747	22,684
Opening balance – subsidiary	-	17,614	-	-
Additions	76,672	25,652	55,517	24,494
Disposals	(5,330)	(3,157)	(2,888)	(2,600)
Adjustments prior year	3,545	6,410	3,545	6,410
Depreciation expense	(33,290)	(22,382)	(25,567)	(22,241)
At 31 December	88,418	46,821	59,354	28,747

Notes to the Financial Statements

For the year ended 31 December 2010

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

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 9th October 2009.

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

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
Freehold land	11,467	11,461	11,467	11,461
Buildings	89,561	75,906	89,561	75,906
At 31 December	101,028	87,367	101,028	87,367

19(c) Assets subject to operating lease

(i) Carrying value

Aircraft	115,041	115,041	115,041	115,041
Accumulated depreciation	(37,561)	(29,017)	(37,561)	(29,017)
	77,480	86,024	77,480	86,024

Reconciliations

Aircraft

At 1 January	86,024	94,568	86,024	94,568
Depreciation	(8,544)	(8,544)	(8,544)	(8,544)
At 31 December	77,480	86,024	77,480	86,024

(ii) Future minimum lease payments

Not later than one year	7,509	13,164	7,509	13,164
Later than 1 year and not later than 5 years	3,461	9,240	3,461	9,240
	10,970	22,404	10,970	22,404

19(d) Investment Properties

Opening net book value	70,990	-	-	-
Opening net book value – subsidiary	-	79,703	-	-
Additions and adjustments	5,038	298	-	-
Gain/loss on revaluation	(1,212)	-	-	-
Transfer to properties held for sale	-	(9,011)	-	-
At 31 December	74,816	70,990	-	-

Notes to the Financial Statements

For the year ended 31 December 2010

20 Other financial assets

<i>All amounts are expressed in K'000</i>	Consolidated		Bank	
	2010	2009	2010	2009
Securities - held to-maturity:				
Inscribed stock - issued by central bank	1,499,615	1,491,431	1,318,174	1,331,311
Financial assets carried at fair value through profit and loss:				
Equity securities	22,300	21,138	-	-
At 31 December	1,521,915	1,512,569	1,318,174	1,331,311

21 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 2010 (2009: 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 2010, the net benefit reflects the estimated future tax benefits at applicable income tax rates of the following:

Specific allowance for losses on loans and advances	8,173	15,332	7,951	9,760
General allowance for losses on loans and advances	24,543	19,669	24,233	15,897
Employee related provisions	11,896	9,531	10,336	7,878
Prepaid expenses	(253)	-	(253)	-
Other provisions	24,770	4,005	6,147	3,693
Depreciation and amortization	(24,916)	(23,542)	(26,030)	(22,566)
Unrealised foreign exchange gains	(5,509)	(9,314)	(5,509)	(9,314)
Deferred expenditure	(3,902)	5,041	3,902	3,982
	34,802	20,722	20,777	9,329

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

At 1 January	20,722	10,052	9,329	9,800
Specific allowance for losses on loans and advances	(7,159)	8,136	(1,809)	2,564
General allowance for losses on loans and advances	4,874	11,799	8,336	8,027
Employee related provisions	2,365	3,220	2,458	1,663
Depreciation and amortization	(1,374)	(10,274)	(3,464)	(9,302)
Prepaid expenses	(253)	30	(253)	20
Other provisions	12,961	(1,786)	2,454	(1,929)
Unrealised foreign exchange gains	3,805	(5,455)	3,806	(5,455)
Deferred expenditure	(1,139)	5,000	(80)	3,941
At 31 December	34,802	20,722	20,777	9,329
Represented by:				
Future income tax benefit	64,968	52,603	52,569	41,210
Deferred tax liability	(30,166)	(31,881)	(31,792)	(31,881)
At 31 December	34,802	20,722	20,777	9,329

Notes to the Financial Statements

For the year ended 31 December 2010

21 Deferred Tax Asset (continued)

Taxable & deductible temporary differences arise from the following:

All amounts are expressed in K'000

	Consolidation						Closing balance
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	
2010							
Gross deferred tax liabilities	(31,881)	9,767	(6,018)	5,915	(7,949)	-	(30,166)
Gross deferred tax assets	52,603	10,671	1,694	-	-	-	64,968
	20,722	20,438	(4,324)	5,915	(7,949)	-	34,802

	Consolidation						Closing balance
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	
2009							
Gross deferred tax liabilities	(17,094)	(271)	2,625	(17,141)	-	-	(31,881)
Gross deferred tax assets	27,146	13,734	-	-	-	11,723	52,603
	10,052	13,463	2,625	(17,141)	-	11,723	20,722

All amounts are expressed in K'000

	Bank						Closing balance
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	
2010							
Gross deferred tax liabilities	(31,881)	9,767	(6,018)	4,289	(7,949)	-	(31,792)
Gross deferred tax assets	41,210	10,840	519	-	-	-	52,569
	9,329	20,607	(5,499)	4,289	(7,949)	-	20,777

	Bank						Closing balance
	Opening balance	Current period P&L Movements	Adjustment brought forward	Revaluation & net addition	Disposal	Others	
2009							
Gross deferred tax liabilities	(17,081)	(284)	2,625	(17,141)	-	-	(31,881)
Gross deferred tax assets	26,881	14,329	-	-	-	-	41,210
	9,800	14,045	2,625	(17,141)	-	-	9,329

Notes to the Financial Statements

For the year ended 31 December 2010

22 Other Assets	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Items in transit and other assets	34,701	46,143	16,504	34,765
Accrued income	51,317	51,777	48,024	44,161
Intercompany account	-	-	2,896	-
Computer Development Costs	2,387	2,934	2,387	2,934
Outstanding premiums	25,710	23,566	-	-
Inventory	4,033	4,676	-	-
Prepayments	10,459	6,409	10,127	6,409
Accounts receivable	8,533	28,251	176	411
	137,140	162,756	80,114	88,680

23 Amounts due to other banks

Items in the course of collection	23,638	26,594	29,497	12,202
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24 Amounts due to customers

Demand / current	6,141,624	5,471,424	5,747,076	5,106,154
Term	1,843,033	2,022,355	1,438,499	1,653,472
	7,984,657	7,493,779	7,185,575	6,759,626

25(a) Other liabilities

Creditors and Accruals	65,817	36,672	27,730	27,760
Items in transit and all other liabilities	138,265	186,071	122,694	174,500
Interest payable- convertible notes	4,176	-	-	-
Policy liabilities	446,754	423,258	-	-
Premiums received in advance	4,961	4,432	-	-
Outstanding claims	7,644	5,451	-	-
Claims incurred but not reported (IBNR)	1,678	1,624	-	-
Borrowings	14,698	13,447	-	-
	683,993	670,955	150,424	202,260

25(b) Subordinated debt securities

At 31 December, there are K75.525 million of debt securities outstanding, expected to be settled more than 12 months after the balance sheet date. The notes were issued during 2009, with a maturity date in 2019, and interest is payable semi-annually at 11% per annum. They are valued at amortised cost. The Group has not had any defaults of interest or other breaches with respect to its debt securities in 2010.

Notes to the Financial Statements

For the year ended 31 December 2010

26 Other provisions	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Staff related	43,746	34,461	34,568	26,708
Provision for Non Lending Loss	17,505	12,539	16,896	10,771
Provision for Offshore Creditors' GST	3,179	8,299	3,178	8,299
	64,430	55,299	54,642	45,778
Staff related provisions:				
At 1 January	34,461	21,865	26,708	20,979
Provisions charge	62,168	17,202	57,613	7,440
Payouts	(52,883)	(4,606)	(49,753)	(1,713)
At 31 December	43,746	34,461	34,568	26,708

27 Ordinary Shares – Bank

	Number of shares	Book value
<i>Number of shares in '000s, Book value in K'000</i>		
At 31 December 2008 / 1 January 2009	4,559,328	318,014
Movement during the year	-	-
At 31 December 2009	4,559,328	318,014
Issuance during the year	227,967	143,619
At 31 December 2010	4,787,295	461,633

On 30 July 2010, the Group issued to IFC Capitalisation Fund 227,966,436 shares at 63 toea per share for a total of subscription price of K143,618,855.

The issued capital of Bank of South Pacific Limited comprises ordinary shares. Following is a summary of principal shareholders as at 31 December 2010 and their respective percentage holdings.

Major shareholders: % shareholding	2010	2009
Independent Public Business Corporation	17.61	23.49
Nominees Niugini Limited	11.07	11.63
Nambawan Super Limited	9.98	10.49
Petroleum Resources Kutubu Limited	9.64	10.12
Credit Corporation (PNG) Limited	8.04	8.43
National Superannuation Fund Limited	6.79	7.13
PNG Sustainable Development Program Limited	6.12	6.43
IFC Capitalization(Equity) Fund LP	4.76	-
International Finance Corporation	4.76	-
Teachers Savings & Loans Society Limited	3.73	4.01
Comrade Trustee Services Limited	3.20	3.42
Tropicana Limited	1.04	1.09
	86.74	86.24
All Others	13.26	13.76
	100.00	100.00

Notes to the Financial Statements

For the year ended 31 December 2010

27 Ordinary Shares – Bank (continued)

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 tranche of options of 1,121,818 were exercised on 30 June 2006. These options were valued at mark to market. The second tranche of options of 1,481,818 were exercised on 30 June 2007.

On 1 July 2008, the Board under this plan, granted options over ordinary shares of Bank of South Pacific Limited to the executives only. These options were issued for nil consideration, are not transferable, and cannot be quoted on any stock exchange.

On July 2010, when the 2008 EMSOP expired, the executive management forfeited their right to exercise their options.

On July 2010, the Board granted 18,250,000 options over ordinary shares of Bank of South Pacific Limited to the executives only. The options had a vesting period of 1 July 2012, and an exercise price of K0.65. The overriding exercise conditions of these options are performance hurdles.

The 2010 share options have been valued in compliance with IFRS 2 and classified as equity on the balance sheet.

Options 2010 ('000)	Opening balance	Share split	Issued	Exercised	Forfeited	Others	Closing Balance
2008	8,000	-	-	-	8,000	-	-
2009	-	-	-	-	-	-	-
2010	18,250	-	18,250	-	-	-	18,250
Total	26,250	-	18,250	-	8,000	-	-
Weighted average exercise price	1.26		0.65		1.26	-	0.65

Options 2009 ('000)	Opening balance	Share Split	Issued	Exercised	Forfeited	Others	Closing Balance
2007	7,000	-	-	-	7,000	-	-
2008	8,000	-	-	-	-	-	8,000
2009	-	-	-	-	-	-	-
Total	15,000	-	-	-	7,000	-	8,000
Weighted average exercise price	0.91	-	-	-	0.505	-	1.26

Notes to the Financial Statements

For the year ended 31 December 2010

28 Reserves and retained earnings

	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Retained earnings				
At 1 January	553,912	394,367	551,625	394,461
Net profit for the year	283,147	257,118	276,570	257,738
Dividend paid	(247,959)	(100,305)	(247,959)	(100,305)
Deferred income and prior year adjustments	(123)	2,732	(1,864)	(269)
At 31 December	588,977	553,912	578,372	551,625
Reserves comprise:				
Revaluation reserve	68,776	68,776	68,776	68,776
Capital reserve	635	635	635	635
Equity component of convertible notes (note 11)	18,218	-	-	-
Options reserve	1,968	1,311	1,967	1,311
Exchange reserve	(8,685)	(11,424)	(4,914)	(7,156)
General reserve	2,875	2,875	2,875	2,875
	83,787	62,171	69,339	66,439
Movement in reserves for the year:				
Revaluation reserve				
At 1 January	68,776	31,146	68,776	31,146
Asset revaluation	-	54,769	-	54,769
Deferred tax on asset revaluation	-	(17,139)	-	(17,139)
At 31 December	68,776	68,776	68,776	68,776
Capital reserve				
At 1 January	635	635	635	635
At 31 December	635	635	635	635
Options reserve				
At 1 January	1,311	1,560	1,311	1,560
Movement during the year	657	(249)	656	(249)
At 31 December	1,968	1,311	1,967	1,311
General reserve				
At 1 January	2,875	2,875	2,875	2,875
At 31 December	2,875	2,875	2,875	2,875
Exchange reserve				
At 1 January	(11,424)	(4,348)	(7,156)	(294)
Movement during the year	2,739	(7,076)	2,242	(6,862)
At 31 December	(8,685)	(11,424)	(4,914)	(7,156)

Notes to the Financial Statements

For the year ended 31 December 2010

29 Contingent Liabilities and Commitments	Consolidated		Bank	
	2010	2009	2010	2009
<i>All amounts are expressed in K'000</i>				
Off balance sheet financial instruments				
Standby letters of credit	28,671	41,641	27,470	41,641
Guarantees and indemnities issued	286,409	(34,932)	281,407	(34,932)
Trade letters of credit	17,814	24,538	17,815	24,538
Commitments to extend credit	887,720	1,080,026	863,938	1,080,026
	1,220,614	1,111,273	1,190,630	1,111,273

Legal Proceedings

A number of legal proceedings against the Bank and the Group were outstanding as at 31 December 2010. 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 2010, the Bank and the Group estimates a contingent liability of K73.833 million (2009: K65.689 million) in respect of these proceedings.

Statutory deposits with the Central Bank

Cash reserve requirement - 4% of all amounts due to customers (2009: 3 %)

	363,680	360,799	274,206	265,419
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Commitments for capital expenditure

Amounts with firm commitments, and not reflected in the accounts

	37,691	7,145	29,759	7,145
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Operating lease commitments

Not later than 1 year	11,449	7,991	7,578	7,991
Later than 1 year and not later than 5 years	20,718	60	7,049	60
Later than 5 years	20,904	92	-	92
	53,071	8,143	14,627	8,143

30 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 15)	1,042,029	996,393	744,280	796,197
Due from other banks (note 17)	302,061	191,888	295,028	186,655
Due to other banks (note 23)	(23,638)	(26,594)	(29,497)	(12,202)
	1,320,452	1,161,687	1,009,811	970,650

Notes to the Financial Statements

For the year ended 31 December 2010

31 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 2010, balances and transactions of accounts for Directors were as follows:

<i>All amounts are expressed in K'000</i>	2010	2009
Deposits		
Opening balances	21,758	14,623
Net movement	22,681	7,135
Closing balance	44,439	21,758
Interest paid	2,461	3,365
Loans and advances		
Opening balances	65,795	29,262
Loans issued	24,954	48,399
Interest	61	580
Charges	6,925	5,065
Loan repayments	(14,164)	(17,511)
Closing balance	83,571	65,795

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 2010, staff account balances were as follows:

<i>All amounts are expressed in K'000</i>	2010	2009
Housing loans	10,385	10,560
Other loans	14,381	10,503
	24,766	21,063
Cheque accounts	5,023	3,791
Foreign currency accounts	-	4
Savings accounts	3,338	2,725
	8,361	6,520

Notes to the Financial Statements

For the year ended 31 December 2010

31 Related Party Transactions (continued)

Interests Register

The following are transactions recorded in the interests register:

Name	Nature of Interest	
N. N. Beangke	Director	Credit Corporation (Fiji) Ltd, PNG Coffee Exports Ltd ^{1,5} , BSP Capital Ltd ¹ , Boroma Ltd, Bank of South Pacific Ltd ¹ , General Holdings Ltd ⁵ , Credit Corporation (SI) Ltd.
	Shareholder	Credit Corporation (PNG) Ltd ⁵ , New Guinea Islands Produce ⁵ , Boroma Ltd, Credit Corporation (Vanuatu) Ltd.
T. E. Fox	Director	Bank of South Pacific Limited ² , Teyo No. 1 Ltd ⁵ , Capital Life Insurance Company Ltd, BSP Capital Ltd.
	Shareholder	Bank of South Pacific Limited, Teyo No. 1 Ltd, Citigold Corporation Ltd, Marengo Gold Limited, New Guinea Energy Ltd.
	Trustee/Member	Institute of National Affairs ⁸ , PNG Institute of Directors
Ian B. Clyne	Director	Bank of South Pacific Limited ⁹ , BSP Capital Ltd, Capital Life Insurance Company Ltd, BSP Convertible Notes Ltd, BSP Rural Ltd.
	Member	Commercial Bankers Association.
J. G. Jeffery	Director	Bank of South Pacific Ltd, National Superannuation Fund Ltd ^{1,5} , Employers Federation of PNG, Jayliss Ltd, City Pharmacy Ltd. Airlines PNG Ltd.
	Shareholder	Highlands Pacific Ltd, Oil Search Ltd, Jayliss Ltd ¹ .
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, Telikom PNG Ltd ¹ , CDI Foundation, Kumuls Hotels Ltd, BSP Capital Ltd, Independent Public Business Corporation ¹ .
	Shareholder	Oil Search Ltd ⁷ , Hiram Ltd, Wahinemo Ltd, Lihir Gold Ltd, Highlands Pacific Ltd, Melanesian Trustees (ICPNG), Bank South Pacific Ltd, Kumul Asset Management.
	Member/Trustee	Institute of National Affairs, Business Council of PNG.
Dr I. Temu	Director	Bank of South Pacific Ltd, Tipi Enterprise Ltd, BSP Capital Limited, PNG Ports ¹ .
	Shareholder	Telstra Limited, Nautilus Minerals Niugini Ltd.
	Employee	Barrick Gold Limited.
	Member	Divine Word University, Chamber of Mining & Petroleum.
C. C. Procter	Director	Bank of South Pacific Ltd, Sun Hung Kai Ltd, BSP Capital Ltd, Allied Overseas Ltd.
Sir N. Bogan	Director	Bank of South Pacific Ltd, Nambawan Super 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.

Notes to the Financial Statements

For the year ended 31 December 2010

31 Related Party Transactions (continued)

Interests Register (continued)

Name	Nature of Interest	
K. Constantinou	Director	Bank of South Pacific Ltd, BSP Capital Ltd, Airways Hotel & Apartment Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Hebou Constructions Ltd, Heritage Park Hotel Ltd, Gazelle International Hotel Ltd, Airlines PNG Ltd, Oil Search Ltd
	Shareholder	Airways Hotel & Apartment Ltd, Lamana Hotel Ltd, Lamana Development Ltd, Hotel Technical Services Ltd, Heritage Park Hotel Ltd, C.G.A Properties, Fairhaven No. 57, Gazelle International Hotel, City Centre Development Ltd, Coastwatchers Court Ltd, Alotau International Hotel Ltd, Kimbe Bay Hotel Limited.
	Member	Australian Institute of Company Directors, PNG Institute of Directors.
J. K. Natto	Director	Petroleum Resources Kutubu Ltd ¹ , Kutubu Security Services Ltd ³ , Welgris Fuel Distributors Ltd, Maxpro Security Services Ltd, Hekari Properties Ltd, Namo'aporo Landowners Association Inc. ¹ , Bank of South Pacific Ltd, BSP Capital Ltd, Hevi Lift Ltd.
	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, ⁹Chief Executive Officer

32 Directors and executive remuneration

Directors remuneration

Directors of the company received remuneration including benefits during 2010 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	
						2010	2009
N. N. Beangke	9/10		102,259	-	-	102,259	94,500
T. E. Fox	9/10		99,109	-	-	99,109	91,350
Dr. I. Temu	8/10		74,097	-	-	74,097	67,200
C. C. Procter	9/10		96,300	-	-	96,300	88,800
Sir N. Bogan	4/10		65,210	-	-	65,210	60,900
Ian B. Clyne*	10/10		-	-	-	-	-
J. G. Jeffery	9/10		87,300	-	-	87,300	79,800
G. Aopi	7/10		76,384	-	-	76,384	70,350
J K Natto	4/10		66,072	-	-	66,072	60,900
K Constantinou	10/10		69,521	-	-	69,521	60,900

Directors Thomas Edova Fox, Sir Nagora and John Gordon Jeffery 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 21st May 2010 Annual General Meeting.

Notes to the Financial Statements

For the year ended 31 December 2010

32 Directors and executive remuneration (continued)

Bank of Papua New Guinea deemed Mr Constantinou a Fit & Proper Person in accordance with the Prudential Standards and the provisions of the Banks & Financial Institutions Act 2000.

Non Executive Board Members of the Board – Beangke, Fox, Temu, Procter, Constantinou, Aopi and Kapi Natto will receive an allowance of K46,324 as Board of Directors of BSP Capital Ltd which forms part of the Group.

* Managing Director / Chief Executive Officer receives no fees for his services as director during the year.

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 <i>K'000</i>	2010 No.	2009 No.	Remuneration <i>K'000</i>	2010 No.	2009 No.	Remuneration <i>K'000</i>	2010 No.	2009 No.
100-110	16	12	310-320	-	1	490-500	2	1
110-120	14	3	320-330	-	1	500-510	2	1
120-130	3	3	330-340	1	3	510-520	1	-
130-140	2	3	340-350	-	1	530-540	5	1
140-150	2	9	350-360	-	-	540-550	1	-
150-160	3	4	360-370	1	-	560-570	4	2
160-170	9	1	370-380	1	1	570-590	1	-
180-190	8	4	380-390	2	2	590-670	5	1
190-200	4	1	390-400	-	1	670-700	3	1
210-220	1	2	400-410	1	1	750-790	2	-
220-240	5	-	410-420	2	2	790-800	-	-
240-250	-	-	420-430	-	3	810-830	2	1
250-260	-	1	430-440	1	-	830-850	-	1
260-269	2	-	440-450	2	2	850-860	-	-
270-280	-	-	450-460	-	3	920-930	-	1
280-290	2	-	460-470	2	1	930-1,020	2	2
290-300	1	-	470-480	1	2	1,220-1,260	-	-
300-310	-	-	480-490	1	-	1,540-3,230	2	1
Total							119	80

Executives' remuneration stated includes exercised options (refer to Note 27).

The specified executives during the year were:

Ian B Clyne	Robin Fleming	Hans Abma
Johnson Kalo	Peter Dixon	Frans Kootte
Aho Baliki	Giau Duruba	Chris Beets

Notes to the Financial Statements

For the year ended 31 December 2010

32 Directors and executive remuneration (continued)

	Salary	Primary Bonus	Non-monetary	Super	Post-employment Prescribed benefits	Other	Equity options	Other benefits	Total
2010	6,944	1,825	224	135	-	-	-	396	9,525
2009	4,778	1,539	100	130	-	-	-	133	6,680

33 Reconciliation of operating cash flow

	Consolidated		Bank	
<i>All amounts are expressed in K'000</i>	2010	2009	2010	2009
Reconciliation of operating profit/(loss) after tax to operating cash flow before changes in operating assets				
Operating profit/(loss) after tax	283,147	257,118	276,570	257,738
Add: Tax Expense	127,657	121,025	125,527	120,226
Operating Profit before income tax	410,804	378,143	402,097	377,964
Major Non Cash amounts				
Depreciation	53,499	37,371	43,261	36,556
Amortisation of deferred acquisition and computer development costs	645	1,684	645	1,684
Net (profit)/loss on sale of fixed assets	1,855	(1,184)	1,987	(1,184)
Gain on property revaluation	-	(2,372)	-	(2,372)
Sundry write off	-	32,372	-	32,372
Bonds buy-back provision	-	-	-	-
Movement in forex income accrual	(2,760)	(3,135)	(1,414)	(3,135)
Movement in provision for doubtful debts	(17,739)	(16,645)	(19,112)	(16,376)
Movement in payroll provisions	7,731	(5,345)	7,731	(5,232)
Net effect of other accruals	44,257	(30,295)	33,710	(10,764)
Operating cash flow before changes in operating assets	490,556	390,594	468,968	409,513

34 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)	283,147	257,118	276,570	257,738
Weighted average number of ordinary shares in use ('000)	4,787,295	4,559,328	4,787,295	4,559,328
Basic and diluted earnings /(loss) per share (expressed in toea)	5.9	5.6	5.8	5.7

Notes to the Financial Statements

For the year ended 31 December 2010

35 Segment Information

Bank of South Pacific Limited and Group comprises two segments, these being the provision of banking services and products and stock broking services. For management purposes, segment information determination is based on the risks involved with the provision of core banking services and products and the Bank and Groups management reporting system. The four main divisions for management purposes are core banking services of Retail Banking, Paramount Banking, Corporate and International and Others non core banking (stock broking, rentals and other non-core banking activities). The Bank of South Pacific Limited and Group's business segments operates in Papua New Guinea and has branches in Niue, Fiji and Solomon Islands. Inter segment adjustments reflects elimination entries in respect of inter segment income and expense allocations including funds transfer pricing.

All amounts are expressed in K'000

Analysis by business segments:

Year ended 31 December 2010

	Retail	Wholesale	Fiji Subsidiary Bank	Insurance	BSP Capital	Others	Adjust Inter Segments	Total
Revenue	365,498	524,599	91,893	89,074	3,772	336,957	88,886	1,500,679
Costs	(349,594)	(194,463)	(89,836)	(77,531)	(7,338)	(154,798)	(216,315)	(1,089,875)
Operating results	15,904	330,136	2,057	11,543	(3,566)	182,159	(127,429)	410,804
Income tax expense								(127,657)
Profit after tax								283,147

Year ended 31 December 2009

	Retail	Wholesale	Fiji Subsidiary Bank	Insurance	BSP Capital	Others	Adjust Inter Segments	Total
Revenue	285,946	525,756	8,712	15,891	4,288	488,707	162,803	1,492,103
Costs	(298,797)	(277,597)	(6,441)	(15,259)	(7,012)	(112,556)	(396,298)	(1,113,960)
Operating results	(12,851)	248,159	2,271	632	(2,724)	376,151	(233,495)	378,143
Income tax expense								(121,025)
Profit after tax								257,118

Notes to the Financial Statements

For the year ended 31 December 2010

36 Events occurring after Balance Sheet Date

Subsequent to balance date, on 4 February 2011, the government of Fiji passed a Decree enabling the change in legislation of Fiji National Bank Ltd, to a branch of Bank of South Pacific Limited. Any date before June 2011, maybe elected as the effective date. The Board and management is yet to determine the effective date.

On 4 February 2011, the Bank of South Pacific Limited (National Bank of Fiji Limited) Decree 2011 was gazetted.

The Decree provides for the vesting of National Bank of Fiji Limited t/a Colonial National Bank's (CNB) business and undertakings in Bank of South Pacific Limited (BSP), assignment and vesting of all of CNB's contracts, assets and liabilities to BSP, transfer of all CNB customer relationships to BSP and assumption of responsibility by BSP of all CNB employees.

The Decree also provides for the release and discharge of CNB from all further actual or contingent liabilities and obligations in respect of the business to any person, deemed consent for the vesting of any CNB property, any transfer or security given to CNB, or any other right or benefit of CNB to BSP, continuation of any legal action by or against CNB, in the name of BSP and use of information given by any customer or any other person to CNB for its use in the business to be deemed to be information given to BSP for the same purpose.

It further provides for various other consequential matters, including admission of evidence by BSP, continued application of the Bankers' Books Evidence Act, directions to registrars to record entries and memorials in any relevant instrument, continuity of legal rights or accrued losses and taxation consequences.

The effective date of the Decree is yet to be gazetted.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF BANK OF SOUTH PACIFIC LIMITED AND ITS SUBSIDIARIES

We have audited the accompanying consolidated financial statements of Bank of South Pacific Limited and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2010, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flow statement for the year then ended on that date and notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration.

Management's Responsibility for the Financial Statements

The management of Bank of South Pacific Limited and its subsidiaries is responsible for the preparation and true and fair presentation of the consolidated financial statements in accordance with the International Financial Reporting Standards and other applicable laws and regulations. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, 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 responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion, and we have obtained all information required by us.

Independent Audit Report

For the year ended 31 December 2010

Audit Opinion

In our opinion,

- (a) the consolidated financial statements give a true and fair view of the financial position of Bank of South Pacific Limited and its subsidiaries as at 31 December 2010, and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards and applicable laws and regulations,
- (b) proper accounting records have been kept by Bank of South Pacific Limited and its subsidiaries.

Other Information

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

Port Moresby, this 9th day of March 2011.

Deloitte Touche Tohmatsu
DELOITTE TOUCHE TOHMATSU



By: Suzaan Theron

Partner

Registered under the Accountants Act 1996

