KINA FINANCE LIMITED

Leasing Term Deposits EsiLoan Commercial Loans Term Deposits
Insurance Premium Funding Cash Management EsiLoan

# Financial Statements for the year ended 31 December 2003

Personal Loans Leasing Insurance Premium Funding Commercial Loans
Term Deposits Cash Management Personal Loans

2003

KINA FINANCE LIMITED
Annual Report

# Contents

# CEO's Report

The 2003 year was a period of consolidation and steady growth for Kina Finance, and we have continued to drive our business with both new products and best practice customer service.

For the year ending 31 December 2003, Kina Finance posted a net profit of K671,561. This was higher than last year's profit of K653,948, and continues Kina Finance's period of strong growth over the last five years.

The strong profit is a result of continued strong performances from our key areas of Commercial Lending and Personal Lending, EsiLoans, Fixed Term Deposits and Cash Management.

Our continued growth can also be attributed to Kina Finance's ongoing commitment to customer service, best practice standards and meeting customers' needs by continuously improving and refining services.

We are investing heavily in this program to ensure the benefits flow to our whole staff team, our clients and our future clients.

This year we have continued to improve our EsiLoans service for customers, with 24 hour processing of loan applications, the provision of arrears incentives, and the implementation of a new School Loan Promotion.

Our new products will continue to be customer focused to meet the real needs of the people of PNG.

In 2003 we were also pleased to launch our new EsiLoan rates and EsiShares facility. The EsiShares program is a major initiative by Kina which allows customers to obtain finance through EsiLoans to purchase shares from the Port Moresby Stock Exchange (POMSoX) listed companies.

The program aims to further promote investment in the POMSoX and foster an investment culture, and is just another way Kina is helping PNG citizens to manage and grow their wealth.

Kina Finance also continues to implement continuous improvement policies and training with all our staff, with the aim of ensuring we are able to meet and exceed the business expectations of our customers.

In line with our program of continuous improvement, this year Kina Finance further refined its customer focus strategy, setting new higher standards and working constructively to meet the 21st century needs of our clients and new customers.

Our approach is across the organisation, with every staff member and management involved. Our desire is to improve our performance and delivery for all our products above the previous benchmark, and by continuous improvement, continuously measure the outcomes regularly.

To all our staff at Kina Finance, I would like to thank you for all your hard work and effort this year - our achievements and ongoing success would not be possible without your dedication and commitment.

To all our valued customers, I would like to thank you for your patronage this year, and we look forward to continuing to helping you manage and grow your wealth in 2004 and beyond.

**Syd Yates** MBE

Chief Executive Officer

# Company Products & Services

## We offer our clients control of their business finance

### ASSET FINANCE

Finance for all vehicle and industrial plant and equipment, and aircraft leasing.

### COMMERCIAL LOANS

Loans for all business purposed property development and acquisition.

### INSURANCE PREMIUM FUNDING

Free up capital for greater operational and investment opportunities by tailoring your insurance payments to suit your cash flow.

### PROJECT FINANCING

Advise and assistance on structuring and financing of new and existing projects.

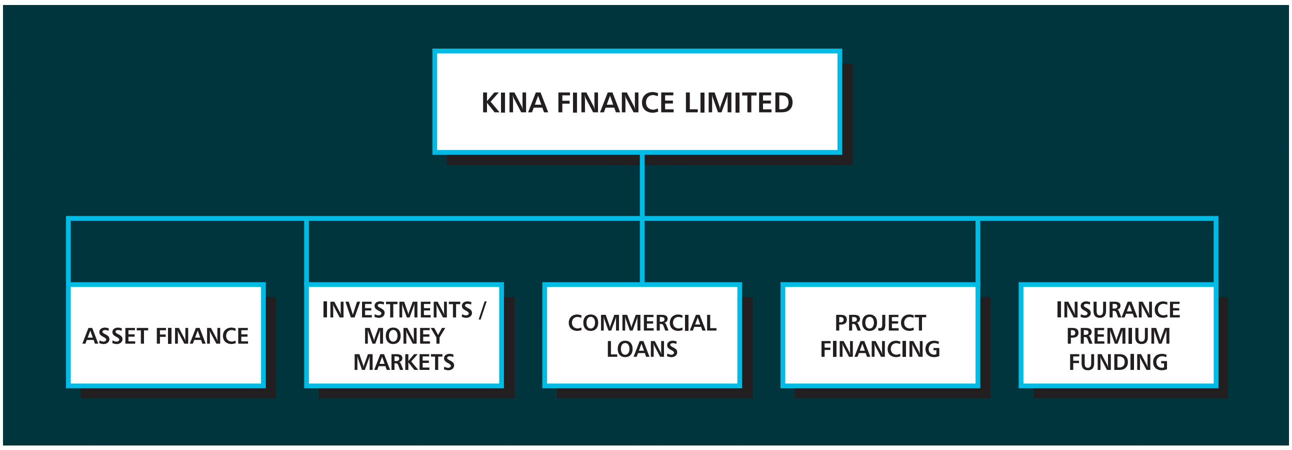
### INVESTMENTS / MONEY MARKET FACILITIES

Short and long-term deposit facilities including Term Deposits, Treasury Bills and Cash Management Accounts.

### ESILOAN

Enables members from Approved Employee Groups to obtain loans from K500 to K3,500. Loans from K500 to K2,900 are repayable over a period of 5 to 14 fortnights, over K2,900 is over 5 - 17 fortnights.

Shares from the listed companies on the Port Moresby Stock Exchange can also be purchased through EsiLoans on the newly introduced EsiShares.



# Annual Report

The Directors have pleasure in submitting their annual report and the audited financial statements of the Company for the year ended 31 December 2003.

## PRINCIPAL ACTIVITIES

The principal continuing activities of the Company during the year were the asset financing, provision of personal and commercial loans and money market operations.

The directors consider there are no unusual or other matters that warrant their comments and the Company's financial position and results from operations are properly reflected in these financial statements.

## ACCOUNTING POLICIES

Details of changes in accounting policies are shown in accounting policies (note n) to the accounts.

## DIRECTORS AND SECRETARY

The names of the directors of the Company in office during the accounting period are:

H. Wong (Chairman)
S. G. Yates MBE (also Company Secretary)
W. Golding
T. K. Lee
J. Lau
Y. A Hii
I. Temu
P. G. Gure (elected 15.05.03)

## DIVIDENDS

Directors advise that no dividends are paid or proposed during the year (31.12.02: Knil).

## RESULTS

The Group operating profit attributable to shareholders for the year was K671,561 (31.12.02: K653,948).

## DIRECTORS REMUNERATION AND OTHER BENEFITS

During the year the following remuneration and other benefits were provided to directors:

| | **2003** | 2002 |
|---|---|---|
| | **K** | K |
| W. Golding | **Nil** | Nil |
| J. Lau | **Nil** | Nil |
| T. K. Lee | **Nil** | Nil |
| Y. A Hii | **Nil** | Nil |
| P. G. Gure | **3,000** | Nil |
| H. Wong | **Nil** | Nil |
| R. Kaul (ceased 30.04.02) | **Nil** | 2,667 |
| S. G. Yates MBE | **Nil** | Nil |
| I. Temu | **3,750** | 9,000 |

## REMUNERATION OF EMPLOYEES

During the year, no employees or former employees (not being directors of the Company), received remuneration in excess of K100,000 per annum from the Company.

## DONATIONS

During the year the Company made donations totaling K6,910 (31.12.02: K3,378).

## SOLICITORS

The Company's legal advisers during the year are as follows:

1. Blake Dawson Waldron
   Level 4 Mogoru Motu Building Champion Parade
   PO Box 850 Port Moresby NCD
2. Allens Arthur Robinson
   Level 5 Pacific Place Musgrave Street
   PO Box 1178 Port Moresby

## BANKS

The Company maintains its cash and cash balances during the year to following banks:

1. Australia & New Zealand Banking Group (PNG) Limited
   Corner Champion Parade and Hunter Street
   PO Box 115 Port Moresby NCD
2. Bank of South Pacific Limited
   Corner Musgrave and Douglas Streets
   PO Box 78 Port Moresby NCD

## COUNTRY OF INCORPORATION

The Company is incorporated in Papua New Guinea and has its principal place in Papua New Guinea.

## REGISTERED OFFICE

Its registered office is at Level 2, Deloitte Tower, Douglas Street, Port Moresby, National Capital District.

## AUDITOR'S FEES

During the year fees paid to the auditor for professional services are shown in note 5 to the accounts.

Signed at **Port Moresby** on behalf of the board on the **29th** day of **June 2004**.

**Hilary Wong**
Chairman

**Sydney Yates MBE**
Director

# Corporate Governance

## CORPORATE GOVERNANCE PRINCIPLES

Kina Finance Limited ("Kina") is committed to observing the highest corporate governance and ethical standards throughout its entire operations. At Kina, we understand that success is not only determined by financial results, but also by the way we conduct our business. Kina is dedicated to maintaining the highest standards of corporate behaviour at all levels, and acting in a socially responsible manner that benefits the whole community.

Kina's mission is to improve people's lives by helping them understand, plan, manage and enhance their financial security.

We are committed to:

- Providing high quality products and services to meet customers' needs
- Maintaining the highest standards of ethics and corporate governance
- Providing opportunities for continual growth and learning for our employees
- Promoting and facilitating the ongoing economic development of Papua New Guinea ("PNG")

## COMMITMENT TO PAPUA NEW GUINEA

Kina is strongly committed to supporting the development of PNG. We have been operating within the country for more than 15 years, and pride ourselves on our unparalleled reputation for helping customers secure and grow their wealth. Kina employs a team of more than 22 staff who have been recruited from throughout PNG, and we are committed to offering our staff ongoing training and professional development opportunities.

We actively work to provide financial information and education to the people of PNG through tools such as our free weekly Kina Communique newsletter, and through the annual Money Show.

We consciously address the important issues of the day for PNG and the ongoing need for all organisations to be open, transparent, accountable and responsible in their financial and administrative procedures. Kina is proud to be an active member of the PNG community, and we will continue to contribute to the country's development by offering financial products, service and advice. We will continue to strive in our day to day activities and performance to help the people of PNG understand the importance of the global economy and their role at all levels, to carry PNG forward internationally.

## BOARD OF DIRECTORS

Key functions of the Board of Directors include:

- Setting and monitoring the overall strategic direction for the company, including operational and financial performance
- Regularly reviewing the Company's achievements against its strategic objectives
- Establishing and maintaining risk management systems to protect the Company's financial position and performance
- Ensuring the Company complies with its legal and regulatory requirements, and maintains the highest standards of financial and ethical behaviour
- Monitoring the governance performance of all Company activities

The Board is currently comprised of seven non-executive Directors, including the Chairman, and one Executive Director who is the Managing Director. The Board meets a minimum of four times a year, with regular correspondence also taking place between Board meetings. The Board is committed to maintaining an appropriate mix of skills and experience, and Board appointments are made on the basis of achieving the best possible representatives to serve the Company, its customers and stakeholders.

## EXECUTIVE MANAGEMENT

Kina combines the efforts of an experienced and dedicated management team, led by a Chief Executive Officer, Financial Controller, Finance and Administration Manager, and division team leaders. The Chief Executive Officer and management team are responsible for overseeing the day to day operations of the Company, and ensuring the Company achieves the operational and financial objectives set by the Board. A close, regular and open dialogue is maintained between the Board and senior management. Senior management are also committed to meeting regularly with all staff as a team unit, to fully enunciate Kina's governance policy and performance requirements.

Kina is committed to delivering governance standards, which are in line with global best practice in financial management, as one of our benchmark contributions to the financial services industry of PNG.

# Corporate Governance

## MANAGEMENT COMMITTEES

Kina also has a number of management committees, which are responsible for overseeing and making recommendations on key aspects of the business. Kina's three core management committees are outlined below:

***Asset and Liabilities Committee***

The Assets and Liabilities Committee meets fortnightly to discuss set agenda items, focussing on assets quality, profitability, interest rate spread, liquidity and forex issues. The Assets and Liabilities Committee is comprised of six members: The Chairman, Chief Executive Officer, Group Financial Controller, Finance and Administration Manager, Team Leader-Lending and Team Leader-Operations, Credit Manager from Kina Securities Group of Companies.

***Credit Committee***

The Credit Committee meets monthly to discuss issues relating to non-performing loans, lending limits and asset quality. The Credit Committee is made up of the Chief Executive Officer, Financial Controller, Finance and Administration Manager, and the Board of Directors.

***Audit and Risk Committee***

Kina's Audit and Risk Committee meets four times a year to discuss issues such as risk management, internal audits and control measures, and compliance. The Audit and Risk Committee is comprised of four independent directors and one director representing shareholders.

## RISK MANAGEMENT

Kina is committed to the management of risks throughout its operations, to protect its customers, employees, the community, and the Company's asset, earnings and reputation. Each year the Board reviews the budget and strategic plan put forward by management.

Certain risks occur in the normal course of the Company's business and include liquidity, interest rates, credit, asset quality and foreign exchange. These risks are reduced and managed by the Board, Executive Management, Assets and Liabilities Committee, Credit Committee, and Audit and Risk Committee.

On a day to day basis the Board ensures its risk management responsibilities are met through regular reviews and regular issues monitoring in association with Executive Management. The company also uses other risk management techniques, including insurance, to reduce the financial impact of any uncontrollable events.

## BENCHMARKING

To achieve continuous improvement in our governance and accountability standards, Kina is committed to an ongoing program of benchmarking our performances, measuring ourselves against global best practice.

Our commitment is to provide an ongoing practical demonstration to our staff, clients and all stakeholders that the PNG financial sector demonstrates measurable governance standards.

# Independent Audit Report

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers
6th Floor Credit House
Cuthbertson Street
PO Box 484
PORT MORESBY
PAPUA NEW GUINEA
Website: www.pwc.com.pg
Telephone (675) 321 1500
Facsimile (675) 321 1428

## AUDIT OPINION

In our opinion,

(a) the financial report of Kina Finance Limited ("Company"):

- presents a true and fair view of the financial position of the Company as at 31 December 2003 and of its performance for the period ended on that date, and
- is presented in accordance with the Companies Act 1997, International Financial Reporting Standards and other generally accepted accounting practices in Papua New Guinea.

(b) proper accounting records have been kept by the Company as far as appears from our examination of those records; and

(c) we have obtained all the information and explanations we have required.

This opinion must be read in conjunction with the rest of our audit report.

## SCOPE AND SUMMARY OF OUR ROLE

***The financial report and directors' responsibility***

The financial report comprises the Income Statement, Statement of Changes in Shareholders' Equity, Balance Sheet, Statement of Cash Flows and the accompanying Notes to the Financial Statements for the Company for the year ended 31 December 2003.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Companies Act 1997. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

***The auditor's role and work***

We conducted an independent audit of the financial report in order to express an opinion to the members of the Company. Our audit was conducted in accordance with International Standards on Auditing, in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Companies Act 1997, International Financial Reporting Standards and other generally accepted accounting practice in Papua New Guinea, a view which is consistent with our understanding of the Company's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

We read the other information in the Annual Report to determine whether it contained any material inconsistencies with the financial report.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls. Our audit did not involve an analysis of the prudence of business decisions made by directors or management.

## INDEPENDENCE

In conducting our audit, we followed applicable independence requirements of the Papua New Guinea Institute of Accountants and the Companies Act 1997.

PricewaterhouseCoopers

By: J C Seeto

Registered under the Accountants Act 1996

Port Moresby

29th June 2004

# Historical Financial Performance

| | 1999<br>K | 2000<br>K | 2001<br>K | 2002<br>K | **2003**<br>**K** |
|---|---|---|---|---|---|
| **Profit & Loss** | | | | | |
| Net Interest income | 1,054,569 | 1,200,653 | 1,870,204 | 2,502,984 | **2,668,190** |
| Other income | 99,779 | 110,816 | 340,205 | 665,440 | **822,560** |
| Total income | 1,154,348 | 1,311,469 | 2,210,409 | 3,168,424 | **3,490,750** |
| Operating expenses (excluding bad doubtful debts expenses) | 837,425 | 784,714 | 1,382,326 | 2,033,481 | **2,120,165** |
| Profit before tax | 196,923 | 371,454 | 515,213 | 804,335 | **794,154** |
| Net profit | 144,648 | 275,028 | 448,974 | 653,948 | **671,561** |
| **Balance Sheet** | | | | | |
| Assets | 31,218,532 | 17,687,626 | 21,357,392 | 42,548,620 | **60,256,559** |
| Loans receivable-net | 5,965,812 | 7,546,399 | 10,411,766 | 11,435,954 | **11,405,668** |
| Depositors funds | 29,349,001 | 15,452,789 | 18,673,243 | 38,886,326 | **55,436,801** |
| Shareholders' equity | 1,070,558 | 1,845,498 | 2,294,561 | 2,948,509 | **3,620,070** |
| **Other Information** | | | | | |
| Expenses to income | 73% | 60% | 63% | 64% | **61%** |
| Return on capital employed | 14% | 22% | 30% | 44% | **45%** |
| Return on shareholder equity | 14% | 19% | 22% | 25% | **20%** |
| Capital adequacy ratio | 19% | 24% | 18% | 14% | **18%** |
| Liquid assets ratio | 85% | 63% | 53% | 73% | **82%** |

*These statements are to be read in conjunction with the notes on pages 11 to 28.*

# Income Statement

| | Notes | 2003<br>K | 2002<br>K |
|---|---|---|---|
| Interest income | 1 | **9,624,717** | 5,386,517 |
| Interest expense | 1 | **(6,956,526)** | (2,883,533) |
| Net interest income | | **2,668,191** | 2,502,984 |
| Fee and commission income | | **407,110** | 326,414 |
| Dividend income | 2 | **74,516** | 48,618 |
| Gains less losses from investment securities | 13 | **66,977** | 120,398 |
| Other operating income | 3 | **273,956** | 170,010 |
| Operating income | | **3,490,750** | 3,168,424 |
| Bad and doubtful debts expenses | 4 | **(576,431)** | (330,608) |
| Other operating expenses | 5 | **(2,120,165)** | (2,033,481) |
| Profit before tax | | **794,154** | 804,335 |
| Income tax expense | 7 | **(122,593)** | (150,387) |
| **Net profit** | | **671,561** | 653,948 |

# Statement of Changes in Shareholders' Equity

| | Share Capital<br>K | Retained Earnings<br>K | Total<br>K |
|---|---|---|---|
| **Balance as at 31 December 2001** | **1,500,002** | **794,559** | **2,294,561** |
| Net Profit | - | 653,948 | 653,948 |
| **Balance as at 31 December 2002** | **1,500,002** | **1,448,507** | **2,948,509** |
| Net Profit | - | 671,561 | 671,561 |
| **Balance as at 31 December 2003** | **1,500,002** | **2,120,068** | **3,620,070** |

*These statements are to be read in conjunction with the notes on pages 11 to 28.*

# Balance Sheet

| | Notes | 2003<br>K | 2002<br>K |
|---|---|---|---|
| **Assets** | | | |
| Cash and due from other banks | **8** | **10,193,880** | 3,747,743 |
| Treasury bills | **9** | **35,366,864** | 24,516,521 |
| Loans and advances to customers | **10** | **11,405,668** | 11,435,954 |
| Income tax receivable | **11** | **141,717** | 69,478 |
| Deferred tax assets | **12** | **359,124** | 198,535 |
| Due from parent company | **20** | **117,338** | 180,995 |
| Due from related companies | **20** | **387,526** | 149,824 |
| Investment securities | **13** | **730,676** | 1,162,726 |
| Property and equipment | **14** | **780,446** | 824,484 |
| Other assets | **15** | **773,320** | 262,360 |
| | | **60,256,559** | 42,548,620 |
| **Liabilities** | | | |
| Due to customers | **16** | **55,436,801** | 38,886,326 |
| Employee provisions | **17** | **158,919** | 157,978 |
| Other liabilities | **18** | **1,040,769** | 555,807 |
| | | **56,636,489** | 39,600,111 |
| **Net Assets** | | **3,620,070** | 2,948,509 |
| | | | |
| **Shareholders' Equity** | | | |
| Issued and fully paid ordinary shares | | **1,500,002** | 1,500,002 |
| Retained earnings | | **2,120,068** | 1,448,507 |
| | | **3,620,070** | 2,948,509 |

These financial statements have been approved for issue by the board of directors and signed on its behalf by:

**Hilary Wong**
Chairman

**Sydney Yates** MBE
Director

Port Moresby 29th day of June 2004

*These statements are to be read in conjunction with the notes on pages 11 to 28.*

# Statement of Cash Flows

| | Notes | 2003<br>K | 2002<br>K |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest receipts | | **9,154,574** | 5,248,314 |
| Interest payments | | **(6,593,227)** | (2,778,308) |
| Dividend receipts | | **74,516** | 48,618 |
| Fee and commission receipts | | **407,110** | 326,414 |
| Net trading and other income | | **247,754** | 170,010 |
| Recoveries and loans previously written-off | **10** | **20,642** | 15,400 |
| Cash payment to employees and suppliers | | **(2,040,958)** | (1,942,997) |
| Income tax paid | **11** | **(355,421)** | (354,610) |
| **Cash flows from operating profits before changes in operating assets and liabilities** | | **914,990** | 732,841 |
| Changes in operating assets and liabilities: | | | |
| - Increase in loans and advances to customers | | **(555,356)** | (1,327,496) |
| - Decrease/(increase) in other assets | | **3,346** | (43,242) |
| - Increase in due to customers | **16** | **16,550,475** | 20,366,669 |
| - Increase in other liabilities | | **130,219** | 87,034 |
| Net cash provided by operating activities | | **17,043,674** | 19,815,806 |
| **Cash flows from investing activities** | | | |
| Purchase of property and equipment | **14** | **(279,221)** | (460,965) |
| Proceeds from disposal of property and equipment | | **33,000** | |
| Purchase of securities | **13** | **-** | (878,546) |
| Proceeds from sale of securities | **13** | **499,027** | 10,830 |
| **Net cash used in investing activities** | | **252,806** | (1,328,681) |
| **Net increase in cash and cash equivalents** | | **17,296,480** | 18,487,125 |
| **Cash and cash equivalents at beginning of year** | **19** | **28,264,264** | 9,777,139 |
| **Cash and cash equivalents at end of year** | **19** | **45,560,744** | 28,264,264 |

*These statements are to be read in conjunction with the notes on pages 11 to 28.*

# Accounting Policies

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

a) **Basis of presentation**

These financial statements are prepared in accordance with International Financial Reporting Standards. The financial statements are prepared under the historical cost convention.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting period. Although these estimates are based on managements' best knowledge of current events and actions, actual results ultimately may differ from those estimates.

b) **Interest income and expenses**

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. Interest income is suspended when loans become doubtful of collection, such as when overdue by more than 30 days, or, when the borrower defaults, if earlier than 90 days. Such income is excluded from interest income until received.

c) **Fee and commission income**

Fees and commissions are generally recognised on an accrual basis. Commissions and fees arising from negotiations, or participating in the negotiation of a transaction for a third party, such as acquisition of shares or loans, are recognized on completion of the underlying transaction.

d) **Lease income recognition**

Lease income is brought to account on the basis of the rule of 78 on lease rental receivable and on the straight-line basis for interest earned on lease residual amounts.

e) **Income tax**

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax. Deferred tax assets are recognised to the extent that it is probable that the future taxable profit will be available, against which the temporary differences can be utilised.

f) **Property and equipment and depreciation**

Property and equipment is stated at historical cost less accumulated depreciation. Depreciation is calculated on the basis of straight line to write-off the cost of such assets to their residual values over their estimated useful lives as follows:

| | |
|---|---|
| Furniture and fittings | 11.25% |
| Renovation | 10% |
| Motor vehicle | 30% |
| Office equipment | 15% to 30% |
| Software | 33% to 100% |

Profits and losses on disposal (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. Repairs and maintenance costs are charged to the income statement when the expenditure is incurred.

g) **Computer software development costs**

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with identifiable and unique software products controlled by the Company and will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include staff costs of the software development team and an appropriate portion of relevant overheads.

Expenditure, which enhances or extends the performance of computer software programmes beyond their original specifications is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as asset are amortised using the straight-line method over their useful lives, not exceeding a period of 3 years.

h) **Investment securities**

The Company classified its investment securities into the category of available-for-sale assets.

Investment securities 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, exchange rates, or equity prices are classified as available-for-sale. Management determines the appropriate classification of its investments at the time of the purchase.

Investment securities are initially recognised at cost (which includes transaction costs).

**h) Investment securities** continued...

Available-for-sale financial assets are subsequently re-measured at fair value based on quoted bid prices. Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised in the income statement.

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

All purchases and sales of investments are recognised at trade date, which is the date that the Company commits to purchase or sell the asset.

Dividends receivable are included separately in dividend income, when a dividend is received.

**i) Originated loan and provision for loan impairment**

Loans originated by the Company by providing money directly to the borrower are categorised as loans originated by the Company and are carried at amortised cost, which is defined as the fair value of cash consideration given to originated those loans as is determinable by references to market prices at origination date. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction.

All loans and advances are recognised when cash is advanced to borrowers. A credit risk provision for loan impairment is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original contractual terms and credits. The amount of the provision is the difference between the carrying amount and the recoverable amount.

The loan loss provision also covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate.

**j) Cash and cash equivalents**

For the purpose of the statement of cash flows, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including, cash, treasury bills and amounts due from other banks.

**k) Provisions**

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligations can be made.

A provision for annual leave is recognised and measured at the amount unpaid at the reporting date at current pay rates in respect of employee services up to that date.

A liability for long service leave is recognised taking into consideration the salary levels, experience of employees' departures and periods of service.

**l) Employee benefits**

The Company operates a defined contribution scheme, the assets of which are held in separate trustee administered funds. The pension plans are generally funded by payments from employees and by the relevant Group companies.

The Company's contributions to defined contribution pension plans are charged to the income statement in the year to which they relate.

**m) Foreign currency**

Transactions in foreign currency are converted in Papua New Guinea currency at rates ruling on the dates of the relevant transactions. At balance sheet date, amounts payable to and by the Company in foreign currencies are translated into Papua New Guinea currency at the rates of exchange ruling at that date. Exchange differences are included in the income statement in the year in which they arise.

**n) Changes in accounting policies and comparatives**

Where necessary, comparative figures have been adjusted to conform to changes in presentation and accounting policies in the current year. There have been no changes to accounting policy in year 2003.

**o) Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

# Notes to the Financial Statements

## 1. NET INTEREST INCOME

| | 2003 K | 2002 K |
|---|---|---|
| **Interest income** | | |
| Cash and short term funds | **6,749,862** | 2,641,159 |
| Loans and advances | **2,874,855** | 2,745,358 |
| | **9,624,717** | 5,386,517 |
| **Interest expense** | | |
| Due to customers | **(6,956,526)** | (2,883,533) |
| | **2,668,191** | 2,502,984 |

## 2. DIVIDEND INCOME

| | 2003 K | 2002 K |
|---|---|---|
| Available-for-sale investments | **74,516** | 48,618 |

## 3. OTHER OPERATING INCOME

| | 2003 K | 2002 K |
|---|---|---|
| Rental-parent company and related companies (note 20) | **208,892** | 145,757 |
| Gains on sale of property and equipment | **26,200** | - |
| Other | **38,864** | 24,253 |
| | **273,956** | 170,010 |

## 4. BAD AND DOUBTFUL DEBTS EXPENSES

| | 2003 K | 2002 K |
|---|---|---|
| Loans and advances to customers (note 10) | | |
| - Specific provisions for impairment | **413,295** | 271,840 |
| - General provisions for impairment | **151,705** | 16,068 |
| Other assets (note 15) | | |
| - Specific provisions for impairment | **11,431** | 42,700 |
| | **576,431** | 330,608 |

## 5. OTHER OPERATING EXPENSES

| | 2003 K | 2002 K |
|---|---|---|
| Staff cost (note 6) | **977,394** | 1,018,106 |
| Administrative expenses | **505,854** | 450,148 |
| Auditor remuneration | **30,750** | 42,478 |
| Depreciation (note 14) | **316,459** | 228,455 |
| Software costs | **22,449** | 24,719 |
| Operating lease | **127,445** | 118,390 |
| Other | **139,814** | 151,185 |
| | **2,120,165** | 2,033,481 |

## 6. STAFF COST

| | 2003 K | 2002 K |
|---|---|---|
| Salaries and wages | **616,479** | 754,469 |
| Superannuation contributions | **13,471** | 10,067 |
| Staff accommodation | **151,178** | 112,941 |
| Travelling cost | **68,224** | 47,437 |
| Other | **128,042** | 93,192 |
| | **977,394** | 1,018,106 |

As at 31 December 2003 the company had 22 (31.12.02: 17) employees.

## 7. INCOME TAX EXPENSE

The tax on the Company's profit before tax differs from the amount calculated on the operating profit. The differences are reconciled as follows:

| | 2003 K | 2002 K |
|---|---|---|
| Profit before tax | **794,154** | 804,335 |
| Prima facie tax at 30% (31.12.02: 25%) | **238,246** | 201,083 |
| Tax effect of permanent differences | **(42,851)** | (50,696) |
| Prior year over tax provision | | |
| - Change of tax rates | **(39,707)** | - |
| - Difference of depreciation per accounts and taxation | **(33,095)** | - |
| | **122,593** | 150,387 |
| Represented by: | | |
| Current (note 11) | **283,182** | 216,497 |
| Future | **(160,589)** | (66,110) |
| | **122,593** | 150,387 |

## 8. CASH AND DUE FROM OTHER BANKS

| | 2003<br>K | 2002<br>K |
|---|---|---|
| Cash in hand | **-** | 400 |
| Loans and advances to other banks | **3,690,810** | 397,343 |
| Placement with other banks | **4,280,000** | 3,330,000 |
| Loans and advances to finance companies | **2,223,070** | 20,000 |
| Included in cash and cash equivalents (note 19) | **10,193,880** | 3,747,743 |

## 9. TREASURY BILLS

| | 2003<br>K | 2002<br>K |
|---|---|---|
| Treasury bills (note 19) | **35,366,864** | 24,516,521 |

Treasury bills are debt securities issued by the Bank of Papua New Guinea ("BPNG") for a term of three months, six months, or a year. Bills are categorised as assets held for trading and carried at their fair value.

## 10. LOANS AND ADVANCES TO CUSTOMERS

| | 2003<br>K | 2002<br>K |
|---|---|---|
| Loan originated by the Group | | |
| - Individuals | **4,974,325** | 4,140,611 |
| Loan to corporate entities | | |
| - Direct commercial loan | **7,287,602** | 7,938,667 |
| Gross loan and advances | **12,261,927** | 12,079,278 |
| Less provisions for impairment | | |
| - Specific provisions | **(659,853)** | (598,623) |
| - General provisions | **(196,406)** | (44,701) |
| | **11,405,668** | 11,435,954 |

Movements in provisions for impairment are as follows:

| | | |
|---|---|---|
| **Specific provisions** | | |
| Balances at beginning of year | **598,623** | 475,738 |
| Doubtful debts expense (note 4) | **413,295** | 271,840 |
| Bad debts written off | **(372,707)** | (164,355) |
| Recoveries | **20,642** | 15,400 |
| Balances at end of year | **659,853** | 598,623 |
| **General provisions** | | |
| Balances at beginning of year | **44,701** | 28,633 |
| Doubtful debts expense (note 4) | **151,705** | 16,068 |
| Balances at end of year | **196,406** | 44,701 |

The aggregate amount of non-performing loans on which interest was not being accrued amounted to K1,684,448 (31.12.02: K1,835,714) as at 31 December 2003.

Unrecognised interest related to such loans amounted to K577,195 (31.12.02: K196,232) as at 31 December 2003. Uncollected interest accrued on impaired loans amounted to K577,195 (31.12.02: K196,232) as at 31 December 2003.

## 11. INCOME TAX RECEIVABLE

| | 2003 K | 2002 K |
|---|---|---|
| Balances at beginning of year | **69,478** | (68,635) |
| Paid during the year | **355,421** | 354,610 |
| Current provisions (note 7) | **(283,182)** | (216,497) |
| Balances at end of year | **141,717** | 69,478 |

## 12. DEFERRED TAX ASSETS

Significant components of deferred tax assets/(liabilities) are as follows:

| | 2003 K | 2002 K |
|---|---|---|
| Provisions for impairment | | |
| - Loans and advances to customers | **256,878** | 160,831 |
| - Other assets | **308** | 8,114 |
| Employee provisions | **47,675** | 39,495 |
| Accrual of audit fees | **3,697** | 5,488 |
| Difference of depreciation per accounts and taxation | **84,356** | 18,586 |
| Prepayments | **(5,684)** | (4,539) |
| Gains from changes in fair value | **(28,106)** | (29,440) |
| | **359,124** | 198,535 |

Deferred tax will only be realised if:

(i) The Company derives further assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the loss to be realised;

(ii) The Company continues to comply with the conditions for deductibility imposed by law; and

(iii) No changes in tax legislation adversely affect the company in realising the benefit from the deductions for the loss.

## 13. INVESTMENT SECURITIES

| | 2003 K | 2002 K |
|---|---|---|
| Securities available-for-sale | | |
| Equity securities - at fair value | | |
| - Listed | **649,876** | 1,081,926 |
| - Unlisted | **80,800** | 80,800 |
| | **730,676** | 1,162,726 |

The movement in investment securities available-for-sale as follows:

| | 2003 K | 2002 K |
|---|---|---|
| At beginning of year | **1,162,726** | 174,612 |
| Gains/(losses) from changes in fair value | **(24,072)** | 117,758 |
| Additions | **-** | 878,546 |
| Disposal | **(499,027)** | (10,830) |
| Gains on sale | **91,049** | 2,640 |
| At end of year | **730,676** | 1,162,726 |

## 14. PROPERTY AND EQUIPMENT

| | Furniture & Fittings K | Renovation K | Motor Vehicle K | Office Equipment K | Software K | Total K |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **Balance 31.12.02** | **67,555** | **248,739** | **116,516** | **414,436** | **546,494** | **1,393,740** |
| Additions | 6,518 | - | 90,000 | 159,221 | 23,482 | 279,221 |
| Disposal | - | (70,527) | (48,500) | (22,666) | - | (141,693) |
| **Balance 31.12.03** | **74,073** | **178,212** | **158,016** | **550,991** | **569,976** | **1,531,268** |
| **Accumulated depreciation** | | | | | | |
| Balance 31.12.02 | 27,021 | 114,518 | 39,289 | 165,870 | 222,558 | 569,256 |
| Charged in year (note 5) | 8,067 | 17,821 | 45,504 | 102,320 | 142,747 | 316,459 |
| Disposal | - | (70,527) | (41,700) | (22,666) | - | (134,893) |
| **Balance 31.12.03** | **35,088** | **61,812** | **43,093** | **245,524** | **365,305** | **750,822** |
| **Book value 31.12.03** | **38,985** | **116,400** | **114,923** | **305,467** | **204,671** | **780,446** |
| **Book value 31.12.02** | **40,534** | **134,221** | **77,227** | **248,566** | **323,936** | **824,484** |

## 15. OTHER ASSETS

| | 2003 K | 2002 K |
|---|---|---|
| Prepayments | **87,223** | 31,632 |
| Bonds | **1,300** | 4,983 |
| Accrued interest-treasury bills | **453,594** | 174,513 |
| Accrued interest-due from other banks | **196,028** | 4,965 |
| Other | **36,200** | 78,723 |
| Total | **774,345** | 294,816 |
| Less specific provisions for impairment | **(1,025)** | (32,456) |
| | **773,320** | 262,360 |
| Movements in specific provisions for impairment are as follows: | | |
| Balances at beginning of year | **32,456** | 17,300 |
| Doubtful debts expense (note 4) | **11,431** | 42,700 |
| Bad debts written off | **(42,862)** | (27,544) |
| Balances at end of year | **1,025** | 32,456 |

## 16. DUE TO CUSTOMERS

| | 2003 K | 2002 K |
|---|---|---|
| Corporate customers | | |
| - Current/settlement accounts | **2,073,475** | 2,602,013 |
| - Term deposits | **36,347,969** | 23,542,245 |
| Retail customers | | |
| - Current/settlement accounts | **221,735** | 651,451 |
| - Term deposits | **16,793,622** | 12,090,617 |
| | **55,436,801** | 38,886,326 |

## 17. EMPLOYEE PROVISIONS

| | 2003 K | 2002 K |
|---|---|---|
| Balances at beginning of year | **157,978** | 15,677 |
| Charged to profit and loss | **75,004** | 149,466 |
| Utilised during the year | **(74,063)** | (7,165) |
| Balances at end of year | **158,919** | 157,978 |
| Represented by: | | |
| Short term provisions | **87,330** | 103,586 |
| Long term provisions | **71,589** | 54,392 |
| | **158,919** | 157,978 |

## 18. OTHER LIABILITIES

| | 2003 K | 2002 K |
|---|---|---|
| Creditors | **133,376** | 98,499 |
| Accrued Interest to due to customers | **622,110** | 258,811 |
| Accruals | **101,897** | 94,531 |
| Other | **183,386** | 103,966 |
| | **1,040,769** | 555,807 |

## 19. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprises the following:

| | 2003 K | 2002 K |
|---|---|---|
| Cash and due from other banks (note 8) | **10,193,880** | 3,747,743 |
| Treasury bills (note 9) | **35,366,864** | 24,516,521 |
| | **45,560,744** | 28,264,264 |

## 20. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. The Company is controlled by Kina Securities Limited ("KSL") (incorporated in Papua New Guinea), which owns 100% of the ordinary shares, unless otherwise stated. The ultimate parent entity is Flensburg Inc. Limited (incorporated in Liberia).

A number of banking transactions are entered into with related parties in the normal course of business. These include loans and deposits transactions. These transactions were carried out on normal commercial terms and at normal market rates. The related party transactions, outstanding balances at the year-end, and related expenses and income for the year ended are as follows:

The total amount due from KSL as at 31 December 2003 was K117,338 (31.12.02: K180,995)

The total remuneration cost for employees who work for both Kina Finance Limited and KSL are shared on a time basis.

As at 31 December 2003, Directors loans and deposits account balances were are follows:

a) H. Wong, representative Director of parent company KSL is also Shareholder of W.N. Investments Limited ("WNI"). During the year, WNI had loan transactions undertaken on commercial terms and conditions and H. Wong maintained interest-bearing deposits at normal market rates on interest. The balance due as at 31 December 2003 and related income and expenses for the year ended are as follows:

| | K |
|---|---|
| **Loan:** | |
| Outstanding at 1 January 2003 | 40,152 |
| Repayments during the year | (22,054) |
| Outstanding at 31 December 2003 | 18,098 |
| Interest income earned | 4,573 |
| Average interest rate per annum | 18.50% |

**20. RELATED PARTY TRANSACTIONS** continued...

| | K |
|---|---|
| **Deposit:** | |
| At 1 January 2003 | 539,331 |
| Received during the year | 83,361 |
| At 31 December 2003 | 622,692 |
| Interest expense on deposits | 106,756 |
| Average interest rate per annum | 16.53% |

b) W. Golding, is a Director and Shareholder of KSL and also Director and Shareholder of Tanubada Dairy Products Limited ("TDPL"), Hohola Softdrinks Limited ("HSL") and Manufacturers Council of PNG ("MCP"). During the year, TDPL and HSL had loan transactions undertaken on normal commercial terms and conditions and MCP maintained interest-bearing deposits at normal market rates on interest. The balances due as at 31 December 2003 and related income and expenses for the year ended are as follows:

| | TDPL K | HSL K | Total K |
|---|---|---|---|
| **Loans:** | | | |
| Outstanding at 1 January 2003 | 13,918 | 64,500 | 78,418 |
| Issued during the year | 84,253 | - | 84,253 |
| Repayments during the year | (96,634) | (20,583) | (117,217) |
| Outstanding at 31 December 2003 | 1,537 | 43,917 | 45,454 |
| Interest income earned | 10,936 | - | 10,936 |
| Average interest rate per annum | 22.00% | 23.00% | - |

| | K |
|---|---|
| **Deposit:** | |
| At 1 January 2003 | 140,999 |
| Received during the year | 133,114 |
| Repaid during the year | (274,113) |
| At 31 December 2003 | - |
| Interest expense on deposits | 11,032 |
| Average interest rate per annum | 12.74% |

c) J. Lau, is a representative director of KSL is also Director and Shareholder of RH Trading Limited ("RTL"). During the year, RTL had loan transactions undertaken on normal commercial terms and conditions. The balance due as at 31 December 2003 and related income for the year ended are as follows:

| | K |
|---|---|
| **Loan:** | |
| Outstanding at 1 January 2003 | 289,554 |
| Repayments during the year | (151,410) |
| Outstanding at 31 December 2003 | 138,144 |
| Interest income earned | 38,051 |
| Average interest rate per annum | 18.00% |

**20. RELATED PARTY TRANSACTIONS** continued...

d) T. K Lee, is a representative Director of KSL and is also shareholder of RTL and Cold Storage Limited ("CSL") and Director of The Lotto Limited ("TLL"). During the year, RTL and CSL had loan transactions undertaken on normal commercial terms and conditions and TLL maintained interest-bearing deposits at normal market rates on interest. The balances due as at 31 December 2003 and related income and expenses for the year ended are as follows:

| | RTL<br>K | CSL<br>K | Total<br>K |
|---|---|---|---|
| **Loans:** | | | |
| Outstanding at 1 January 2003 | 289,554 | 100,000 | 389,554 |
| Repayments during the year | (151,410) | (30,581) | (181,991) |
| Outstanding at 31 December 2003 | 138,144 | 69,419 | 207,563 |
| Income earned | 38,051 | 15,067 | 53,118 |
| Average interest rate per annum | 18.00% | 17.25% | - |

| | K |
|---|---|
| **Deposit:** | |
| At 1 January 2003 | 1,954,738 |
| Received during the year | 1,575,271 |
| Repaid during the year | (3,097,339) |
| At 31 December 2003 | 432,670 |
| Interest expense on deposit | 281,698 |
| Average interest rate per annum | 15.08% |

e) S. Yates, Managing Director and Chief Executive Officer of KSL is also Director of PNG Swimming, Inc. ("PSI") and Shareholder of Kurada No. 16 ("KN"). During the year, PSI, KN and S. Yates maintained interest-bearing deposits at normal market rates on interest. The balances due as at 31 December 2003 and relating expense for the year ended are as follows:

| | PSI<br>K | KN<br>K | S. Yates<br>K | Total<br>K |
|---|---|---|---|---|
| **Deposits:** | | | | |
| At 1 January 2003 | 7,053 | - | 4,180 | 11,233 |
| Received during the year | 592 | 71,261 | 82,724 | 154,577 |
| Repaid during the year | - | (71,261) | (86,904) | (158,165) |
| At 31 December 2003 | 7,645 | - | - | 7,645 |
| Interest expense on deposits | 695 | 1,173 | 1,800 | 3,668 |
| Average interest rate per annum | 15.08% | 16.22% | 15.80% | - |

From time to time during the year, Directors and Senior Management of the parent company and related companies had deposits and loans in the Company on normal terms and conditions and market rates.

A listing of the members of the Board of Directors is shown on page 2 of the annual reports. In 2003, the total remunerations paid to the directors was K6,750 (31.12.02: K11,667)

The other subsidiaries of KSL are Kina Investments and Superannuation Services Limited ("KISS"), Kina Morgan Corporate Limited, Kina Funds Management Limited ("KFM") and Kina Nominees Limited ("KNL").

**20. RELATED PARTY TRANSACTIONS** continued...

As at 31 December 2003, deposits account balances from related companies were are follows:

| | **KSL** | **KFM** | **KISS** | **KNL** |
|---|---|---|---|---|
| | **K** | **K** | **K** | **K** |
| **Deposits:** | | | | |
| At 1 January 2003 | 38,513 | 19,780 | - | 1,730,371 |
| Received during the year | 3,965 | 32,990,721 | 50,146 | 591,780 |
| Repaid during the year | (42,478) | (30,987,431) | (50,146) | (1,031,883) |
| At 31 December 2003 | - | 2,023,070 | - | 1,290,268 |
| Interest expense on deposits | 4,006 | 397,494 | 599 | 241,325 |

KFL has acquired property and equipment, which leased to KSL and other related companies, details are as follows (note 3):

| | **2003** | 2002 |
|---|---|---|
| | **K** | K |
| KSL | **33,039** | 22,272 |
| KFM | **30,117** | - |
| KISS | **145,826** | 123,485 |
| | **208,982** | 145,757 |

The Company maintains an inter-company account with the parent company and related companies, which is interest free, unsecured and with no fixed term of repayment. The total amount due from related companies as at 31 December 2003 is:

| | **2003** | 2002 |
|---|---|---|
| | **K** | K |
| KFM | **299,409** | 4,497 |
| KISS | **88,117** | 145,327 |
| | **387,526** | 149,824 |

**21. CONTINGENT LIABILITIES**

The Company is the lessee and its future minimum lease payments under non-cancelable operating leases are as follows:

| | **2003** | 2002 |
|---|---|---|
| | **K** | K |
| Building: | | |
| Not later than 1 year | **108,445** | 108,445 |
| Later than 1 year and not later than 5 years | **36,148** | 144,593 |
| | **144,593** | 253,038 |
| Other: | | |
| Not later than 1 year | **6,650** | 9,500 |
| Later than 1 year and not later than 5 years | **2,217** | 12,667 |
| | **8,867** | 22,167 |

# Capital Adequacy

To monitor the adequacy of its capital the Company uses ratios established by BPNG. The Company is required to comply with various prudential standards issued by BPNG, the official authority for the prudential supervision of banks and similar institutions in Papua New Guinea. One of the most critical standards is the capital adequacy requirement. All banks and finance companies 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 Basel Accord. The minimum ratio of base capital to risk-weighted assets set by the BPNG in the prior year, was 10%. On 1 October 2003, the BPNG issued revised prudential standard 1/2003, Capital Adequacy, that prescribed ranges of overall capital ratios to measure whether a bank or finance company is under, adequately, or well capitalised, and also introduced the leverage capital ratio of 6% minimum (see below for details). In all months, the Company complied with the prevailing requirements for total capital, except leverage capital. As at 31 December 2003, total capital ratio was 17.98% (31.12.02: 14.15%, which satisfied the capital adequacy criteria. However, the leverage capital ratio of 4.30% (31.12.02: 4.93%) was under capitalised.

The measure of capital used for the purpose of prudential supervision is referred to as base capital. Total base capital varies from the capital shown on balance sheet and is made of tier 1 (core) and tier 2 (supplementary), after deducting the value of investments in other banks and financial institutions. Tier 1 capital is obtained by deducting from equity capital and audited retained earnings/(accumulated 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 assets revaluation reserves, un-audited profits (or losses) and a small percentage of general loan provisions. The Leverage Capital is calculated as Tier 1 Capital divided by Total Assets.

Risk-weighted assets are derived from on-balance sheet items only. On-balance sheet assets are weighted for credit risk by applying weighting (0, 20, 50 and 100 percent) according to risk classification criteria set by the BPNG. For example cash and money market instrument have zero risks weighting which means that no capital is required to support the holding of these assets.

The Company's capital adequacy level was as follows:

| | Balance sheet/ Notional amount | | Risk-weighted amount | |
|---|---|---|---|---|
| | **2003** | 2002 | **2003** | 2002 |
| | **K** | K | **K** | K |
| Cash and due from other banks | **10,193,880** | 3,747,743 | **3,817,232** | 765,469 |
| Treasury bills | **35,366,864** | 24,516,521 | **-** | - |
| Loans and advances to customers | **11,405,668** | 11,435,954 | **9,888,080** | 10,258,926 |
| Income tax receivable | **141,717** | 69,478 | **141,717** | 69,478 |
| Deferred tax assets | **359,124** | 198,535 | **-** | - |
| Due from parent company | **117,338** | 180,995 | **117,338** | 180,995 |
| Due from related companies | **387,526** | 149,824 | **387,526** | 149,824 |
| Investment securities | **730,676** | 1,162,726 | **161,429** | 160,665 |
| Property and equipment | **780,446** | 824,484 | **780,446** | 824,484 |
| Other assets | **773,320** | 262,360 | **773,320** | 262,360 |
| | **60,256,559** | 42,548,620 | **16,067,088** | 12,672,201 |

| | Capital | | BPNG % | |
|---|---|---|---|---|
| | **2003** | 2002 | **2003** | 2002 |
| | **K** | K | **%** | % |
| Tier 1 capital | **2,589,385** | 2,096,026 | **16.12** | 16.54 |
| Total capital | **2,888,105** | 1,792,614 | **17.98** | 14.15 |
| Leverage capital | **-** | - | **4.3** | 4.93 |

**a) Strategy in using financial instruments**

By its nature the Company's activities are principally related to the use of financial instruments.

The Company 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 Company also seeks to raise its interest margins by obtaining above average margins, net of provisions, through lending to commercial and retail borrowers with a range of credit standing.

**b) Credit risk**

Company takes on exposure to credit risk, which is the risk that a counter party will be unable to pay amounts in full when due. The Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers. Such risks are monitored on a revolving basis and subject to an annual review or more frequent review.

Comprehensive credit standards and approval limits have been formulated, approved by the Credit Committee and implemented. The Credit Committee (which reports to the Board) is responsible for the development and implementation of credit policy and loan portfolio review methodology.

Exposure to credit risk is managed through daily review of the ability of the borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. This is the responsibility of the Senior Loan Officer. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees, but a significant portion is personal lending where no such facilities can be obtained.

Large credit exposures are also monitored as part of credit risk management. These are the 25 largest loan relationships or loan balances, which exceed the 10% of the capital base.

From October 2003, the BPNG introduced a revised prudential standard for asset quality. The revised standard specifies more detailed criteria for the classification of loans into various grades of default risk and corresponding provision levels as a consequence of those grading. As at 31 December 2003, the Company complied with the new requirement.

**c) Interest rate risk**

The Company takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. 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 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 positions and cash flow of the Company that may be undertaken.

Shown in the following tables are the balance sheet structure and contractual maturity profile of assets and liabilities as at 31 December 2003.

Interest sensitivity of assets and liabilities - re-pricing analysis.

| | Less than One year K | One to two years K | Three to five years K | Over five years K | Non interest bearing K | Total K |
|---|---|---|---|---|---|---|
| **31.12.03** | | | | | | |
| **Assets** | | | | | | |
| Cash and due from other banks | 10,193,880 | - | - | - | - | 10,193,880 |
| Treasury bills | 35,366,864 | - | - | - | - | 35,366,864 |
| Loans and advances to customers | 7,214,839 | 1,394,484 | 883,091 | 1,913,254 | - | 11,405,668 |
| Income tax receivable | - | - | - | - | 141,717 | 141,717 |
| Deferred tax assets | - | - | - | - | 359,124 | 359,124 |
| Due from parent company | - | - | - | - | 117,338 | 117,338 |
| Due from related companies | - | - | - | - | 387,526 | 387,526 |
| Investment securities | - | - | - | - | 730,676 | 760,676 |
| Other assets | - | - | - | - | 773,320 | 773,320 |
| | **52,775,583** | **1,394,484** | **883,091** | **1,913,254** | **2,509,701** | **59,476,113** |
| **Liabilities** | | | | | | |
| Due to customers | (55,398,995) | (27,703) | (10,103) | - | - | (55,436,801) |
| Employee provisions | - | - | - | - | (158,919) | (158,919) |
| Other liabilities | - | - | - | - | (1,040,769) | (1,040,769) |
| | **(55,398,995)** | **(27,703)** | **(10,103)** | **-** | **(1,199,688)** | **(56,636,489)** |
| **Interest sensitivity gap** | **(2,623,412)** | **1,366,781** | **872,988** | **1,913,254** | **1,310,013** | **2,839,624** |
| **31.12.02** | | | | | | |
| **Assets** | | | | | | |
| Cash and due from other banks | 3,747,743 | - | - | - | - | 3,747,743 |
| Treasury bills | 24,516,521 | - | - | - | - | 24,516,521 |
| Loans and advances to customers | 7,876,164 | 2,135,481 | 1,228,197 | 196,112 | - | 11,435,954 |
| Income tax receivable | - | - | - | - | 69,478 | 69,478 |
| Deferred tax assets | - | - | - | - | 198,535 | 198,535 |
| Due from parent company | - | - | - | - | 180,995 | 180,995 |
| Due from related companies | - | - | - | - | 149,824 | 149,824 |
| Investment securities | - | - | - | - | 1,162,726 | 1,162,726 |
| Other assets | - | - | - | - | 262,360 | 262,360 |
| | **36,140,428** | **2,135,481** | **1,228,197** | **196,112** | **2,023,918** | **41,724,136** |
| **Liabilities** | | | | | | |
| Due to customers | (38,842,177) | (44,149) | - | - | - | (38,886,326) |
| Employee provisions | - | - | - | - | (157,978) | (157,978) |
| Other liabilities | - | - | - | - | (555,807) | (555,807) |
| | **(38,842,177)** | **(44,149)** | **-** | **-** | **(713,785)** | **(39,600,111)** |
| **Interest sensitivity gap** | **(2,701,749)** | **2,091,332** | **1,228,197** | **196,112** | **1,310,133** | **2,124,025** |

Table below summarises the effective annual interest rate for monetary financial instrument:

| | 2003 % | 2002 % |
|---|---|---|
| **Assets** | | |
| Cash and due from other banks | **13.54** | 8.51 |
| Treasury bills | **18.33** | 11.82 |
| Loans and advances to customers | **28.50** | 27.47 |
| **Liability** | | |
| Due to customers | **14.22** | 8.97 |

**d) Liquidity risk**

The Company is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawn downs. Liquidity policy is set up by the Board, through ALCO to ensure the Company has sufficient funds available to meet all its known and potential obligations, such that they are able to cover withdrawals at unexpected levels of demand.

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

The maturity profile of assets and liabilities as at 31 December 2003 is shown in the following schedule. The mismatching of maturity assets and liabilities and the ability to replace, at an acceptable cost, interest- bearing liabilities as they mature, are important factors in assessing the liquidity of the Company and its exposure to changes in interest rates and exchange rates. Accordingly this mismatched maturity position is considered manageable by the Company, and does not impair the ability of the Company to meet its financial obligations as they fall due. The Directors are also the view that the Company is able to meet its financial obligations as they fall due, due to liquid assets ratio as at 31 December 2003 of approximately 86% (31.12.02: 73%).

| | Less than One year K | One to two years K | Three to five years K | Over five years K | Total K |
|---|---|---|---|---|---|
| **31.12.03** | | | | | |
| **Assets** | | | | | |
| Cash and due from other banks | 10,193,880 | - | - | - | 10,193,880 |
| Treasury bills | 35,366,864 | - | - | - | 35,366,864 |
| Loans and advances to customers | 7,214,839 | 1,394,484 | 883,091 | 1,913,254 | 11,405,668 |
| Income tax receivable | 141,717 | - | - | - | 141,717 |
| Deferred tax assets | 359,124 | - | - | - | 359,124 |
| Due from parent company | 117,338 | - | - | - | 117,338 |
| Due from related companies | 387,526 | - | - | - | 387,526 |
| Investment securities | 730,676 | - | - | - | 730,676 |
| Other assets | 773,320 | - | - | - | 773,320 |
| | **55,285,284** | **1,394,484** | **883,091** | **1,913,254** | **59,476,113** |
| **Liabilities** | | | | | |
| Due to customers | (55,398,995) | (27,703) | (10,103) | - | (55,436,801) |
| Employee provisions | (87,330) | - | (71,589) | - | (158,919) |
| Other liabilities | (1,039,169) | (913) | (687) | - | (1,040,769) |
| | **(56,525,493)** | **(28,616)** | **(82,379)** | **-** | **(56,636,489)** |
| **Net liquidity gap** | **(1,240,209)** | **1,365,868** | **800,712** | **1,913,254** | **2,839,624** |

| | Less than One year K | One to two years K | Three to five years K | Over five years K | Total K |
|---|---|---|---|---|---|
| **31.12.02** | | | | | |
| **Assets** | | | | | |
| Cash and due from other banks | 3,747,743 | - | - | - | 3,747,743 |
| Treasury bills | 24,516,521 | - | - | - | 24,516,521 |
| Loans and advances to customers | 7,876,164 | 2,135,481 | 1,228,197 | 196,112 | 11,435,954 |
| Income tax receivable | 69,478 | - | - | - | 69,478 |
| Deferred tax assets | 198,535 | - | - | - | 198,535 |
| Due from parent company | 180,995 | - | - | - | 180,995 |
| Due from related companies | 149,824 | - | - | - | 149,824 |
| Investment securities | 1,162,726 | - | - | - | 1,162,726 |
| Other assets | 262,360 | - | - | - | 262,360 |
| | **38,164,346** | **2,135,481** | **1,228,197** | **196,112** | **41,724,136** |
| **Liabilities** | | | | | |
| Due to customers | (38,842,177) | (44,149) | - | - | (38,886,326) |
| Employee provisions | (103,586) | - | (54,392) | - | (157,978) |
| Other liabilities | (555,000) | (807) | - | - | (555,807) |
| | **(39,500,763)** | **(44,956)** | **(54,392)** | **-** | **(39,600,111)** |
| **Net liquidity gap** | **(1,336,417)** | **2,090,525** | **1,173,805** | **196,112** | **2,124,025** |

**e) Foreign exchange risk**

The Company undertakes transactions denominated in foreign currencies from time to time and resulting from these activities, exposures in foreign currencies arise. Though there are no specific hedging activities to mitigate any currency risk, this exposure is monitored by management on an ongoing basis.

**f) Fair values of financial assets and liabilities**

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Company's balance sheet at their fair value. Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

| | Carrying value | | Fair value | |
|---|---|---|---|---|
| | **2003** | 2002 | **2003** | 2002 |
| | **K** | K | **K** | K |
| **Assets** | | | | |
| Cash and due from other banks | **10,193,880** | 3,747,743 | **10,193,880** | 3,747,743 |
| Treasury bills | **35,366,864** | 24,516,521 | **35,366,864** | 24,516,521 |
| Loans and advances to customers | **11,405,668** | 11,435,954 | **11,405,668** | 11,435,954 |
| Income tax receivable | **141,717** | 69,478 | **141,717** | 69,478 |
| Deferred tax assets | **359,124** | 198,535 | **359,124** | 198,535 |
| Due from parent company | **117,338** | 180,995 | **117,338** | 180,995 |
| Due from related companies | **387,526** | 149,824 | **387,526** | 149,824 |
| Investment securities | **636,990** | 1,044,968 | **730,676** | 1,162,726 |
| Property and equipment | **780,446** | 824,484 | **780,446** | 824,484 |
| Other assets | **773,320** | 262,360 | **773,320** | 262,360 |
| | **60,162,873** | 42,430,862 | **60,256,559** | 42,548,620 |
| **Liabilities** | | | | |
| Due to customers | **55,436,801** | 38,886,326 | **55,436,801** | 38,886,326 |
| Employee provisions | **158,919** | 157,978 | **158,919** | 157,978 |
| Other liabilities | **1,040,769** | 555,807 | **1,040,769** | 555,807 |
| | **56,636,489** | 39,600,111 | **56,636,489** | 39,600,111 |

**Cash and due from other banks**

Cash and due from other banks includes inter-bank placements.

**Loans and advances to customers**

Loan and advances are net of specific and general provisions for impairment.

**Investment securities**

In 2003, investment securities include only assets available-for-sale and are now measured at fair value.

**Deposits and borrowings**

The estimated fair value of deposits with stated maturity, which includes interest deposits, is the amount repayable on demand.

# Corporate Directory

## REGISTERED OFFICE

**Kina Finance Limited**

Level 2 Deloitte Tower Douglas Street

PO Box 1141 Port Moresby NCD Papua New Guinea

Telephone (675) 308 3838 Facsimile (675) 308 3839

Email finance@kina.com.pg Website www.kina.com.pg

## SENIOR MANAGEMENT

Syd Yates MBE - CEO & Executive Director

Alvin Guillermo - Manager of Finance & Administration

Geua Willie - Team Leader Operations

Maxwell Kababa - Team Leader Esi Loans

## SOLICITORS

**Blake Dawson Waldron**

Level 4 Mogoru Moto Building Champion Parade

PO Box 850 Port Moresby NCD

Papua New Guinea

**Allens Arthur Robinson**

Level 5 Pacific Place Musgrave Street

PO BOX 1178 Port Moresby NCD

Papua New Guinea

## AUDITOR'S

**PriceWaterhouseCoopers**

Level 6 Credit House Cuthbertson Street

PO Box 484 Port Moresby NCD

Papua New Guinea

www.kina.com.pg